



Office of Energy  
Government of Western Australia

**Proposed Amendments to the  
*Electricity Networks Access Code 2004*  
Background Document**

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- Appendix 2: Western Power’s discussion paper on amending thresholds for the Regulatory Test

## INTRODUCTION

This document provides background information on the proposed *Electricity Networks Access Code Amendments (No. 2) 2008* (the **proposed amendments**) which were provided for consultation on the website of the Office of Energy (the **Office**) in the Annotated Code dated 11 July 2008. This document, while not forming part of the proposal, provides further context, expands on the reasoning behind the proposed changes and sets out policy considerations for the benefit of interested parties.

## PROPOSED AMENDMENTS

The Annotated Code proposes amendments to the *Electricity Networks Access Code 2004* (the **Code**) that deal with the following issues:

1. Confidentiality obligations;
2. Contract for services;
3. ETAC transfer;
4. Headworks;
5. Identification of covered network;
6. Mid-term amendment;
7. Miscellaneous;
8. Networks terminology;
9. (No 2) 2007 consequential;
10. Non-capital contribution;
11. Technical rules; and
12. Thresholds for regulatory test.

These issues align with the issue categories identified in the introductory note to, and by footnotes in, the Annotated Code.

Each issue is listed and further explained below. The text for each issue includes the general description of the issue (in *italics*, as extracted from the introductory note to the Annotated Code) plus further information, where relevant.

## 1 Confidentiality obligations

*This proposed amendment ensures that the Minister is not subject to the confidential information provisions of Chapter 14. It is not appropriate for the Code to impose confidentiality requirements upon the Minister for Energy. Service providers and the Authority remain subject to the provisions.*

See:

- *definition of “recipient”.*<sup>1</sup>

No further background information is provided in relation to this amendment.

## 2 Contract for services

*The defined term “access contract” does not include contracts for access entered into prior to the commencement of the Code, including under the Electricity Transmission Regulations 1996 (ETR) and Electricity Distribution Regulations 1997 (EDR). This means that pre-Code contracts for access are not captured by important Code provisions.*

*These amendments will introduce the new defined term “contract for services” to capture such pre-Code access contracts where appropriate and to clarify the distinction between “access contract” and “contract for services”.*

*A related issue is the subtle inconsistency between the Act and the Code in their respective definitions of the important term “service”. This inconsistency was not intended, and impacts upon the new defined term “contract for services”. Further amendments will thus harmonise the defined terms “service” in the Code and “services” in the Act.*

See:

- *definitions of “access application”, “contract for services” and “service”; and*
- *other “contract for services” footnotes.*<sup>2</sup>

### 2.1 “ACCESS CONTRACT” VERSUS “CONTRACT FOR SERVICES”

*“Access contract” is defined in the Code as “an agreement under the Code between a network service provider and another person (a “network user”) for that person to have access to services”. The effect of the words “under*

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<sup>1</sup> From the introductory note to the Annotated Code.

<sup>2</sup> From the introductory note to the Annotated Code.

the Code” is that a contract for access to services which is not entered into under the Code is arguably not an “access contract” in the Code.

Most current contracts on the South West Interconnected System (**SWIS**), including contracts entered into under the ETR and EDR, predate the Code coming into operation, and therefore are not easily defined as contracts “under the Code”. The Code uses the expression “contract for services” as a broader concept, not limited by the requirement that it be “under the Code”. But the term “contract for services” is not currently defined.

The Office proposes including a definition of “contract for services” that encompasses both “access contracts” under the Code and contracts under the old regime. The proposed definition thus mirrors the definition of “access contract” with the exclusion of the words “under the Code”.

This has resulted in a number of consequential amendments throughout the Code, normally involving the deletion of the words “access contract” and the insertion of “contract for services”, to ensure that, where appropriate, contracts under the previous regime are dealt with by the Code. In other places, the appropriate term is “access contract” because the provision relates only to a contract under the Code.

## 2.2 “SERVICE” IN THE CODE VERSUS “SERVICES” IN THE ACT

The word “service” is defined in the Code by reference to the parallel definitions of “covered service” and “non-covered service”, each of which was expressed to be a service “in relation to the transportation of electricity”. This differs from the *Electricity Industry Act 2004* (the **Act**) definition of the expression “services”. It is not intended that the Act and the Code have different meanings for this important expression.

Thus, it is proposed that the definition of “service” be deleted and the definition “services” be inserted, which will be given its meaning under the Act. This will ensure that the Code and the Act are aligned.

## 3 ETAC Transfer

*These proposed amendments are intended to address the concern that users who merely transfer from an earlier access contract (including a contract under the ETR or EDR) to an Electricity Transfer Access Contract (ETAC) under the Code may be subject to the queuing rules. Some users perceive a risk that upon such transfer their access might be overtaken by an earlier applicant in the queue. Although this risk is largely theoretical, the Office has been informed that in some instances it has been enough to deter users from applying to update their contracts.*

*These amendments will clarify that such transferring users need not be “competing applications” as against other users in the queue.*

See:

- *definition of “competing applications”; and*

- *section 5.9A.*<sup>3</sup>

No further background information is provided in relation to these amendments.

## 4 Headworks

*These proposed amendments provide for the charging of “headworks” contributions. In addition to the amendments implemented in the ENAC Amendments (No 2) 2007, they are required to ensure that Western Power’s Distribution Headworks Charge Scheme, which was endorsed by Cabinet on 29 August 2007, is adequately regulated.*

*The Headworks amendments will do so by allowing a service provider to set up a “headworks scheme” under its contributions policy. The headworks scheme will allow the service provider to levy a charge on users of a certain class or classes to recover the cost of any “headworks” – that is, the cost of distribution network reinforcement. A number of proposed sections stipulate the manner in which the headworks charge must be calculated, and an aggregate limit to the amount that may be recovered by headworks charges is provided.*

See:

- *definitions of “contributing user”, “contribution”, “headworks”, “headworks charge” and “headworks scheme”;*
- *sections 2.11 and 2.12;*
- *sections 5.17C and 5.17D;*
- *section 6.51A; and*
- *other “headworks” footnotes.*<sup>4</sup>

This consultation is on the amendments to the Code to facilitate the operation of a headworks charge scheme. Extensive consultation has previously occurred on the design and implementation of Western Power’s Distribution Headworks Charge Scheme, and it is not intended to consult further on the Western Power scheme in this consultation process.

### 4.1 BACKGROUND

Western Power’s headworks charge scheme provides a means by which the cost of capacity expansion at the extremities of the distribution network (such as at Jurien, Ravensthorpe and Walpole), can be spread across certain future applicants for regional capacity. The headworks charge scheme is not

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<sup>3</sup> From the introductory note to the Annotated Code.

<sup>4</sup> From the introductory note to the Annotated Code.

to apply to the cost of extension of the network or to dedicated connection costs, which are typically paid for by the applicant.

Under Western Power's approved Capital Contributions Policy as it was originally applied, the unfortunate applicant who triggered the need for a network expansion was asked to pay a contribution for the entire un-economic cost of that expansion. Expansions at the fringes of the grid, where population density is low, would often result in a user being charged an expensive contribution. In many cases, these expansions would not proceed because users could not or would not pay. This situation presented a barrier to development in these regions.

#### **4.2 SCOPE OF HEADWORKS SCHEME**

The headworks charge scheme is designed to resolve this situation by facilitating a forward looking charge upon a class or classes of users that apply for connection or increased capacity at a connection point. The charge goes towards a "pot" of funds that will be drawn down over a period of time for works over a wide geographic area. This means that the triggering user will no longer carry the full burden of an expansion.

A headworks charge is a new type of "contribution" under the Code. Previously the Code only provided for capital contributions for specific "required augmentations" (known as "required work" in the proposed amendments). In addition to headworks, the proposed amendments also introduce "non-capital contributions" (see part 10 below). Like capital contributions, non-capital contributions will be limited to specific "required work" for a given user. In contrast, however, the headworks charge will not always be linked to specific "required work" for a given user. This has made it necessary to change how the Code creates the link between capital and non-capital contributions and "required work" (see the definitions of those terms and new section 5.14(c) in the Annotated Code).

The headworks charge may be charged for works of a capital as well as a non capital nature (such as renting generation for local network support). It is limited to expansions (not extensions) to a distribution system (proposed section 5.17D(a)), reflecting Western Power's proposal. The headworks charge scheme is also proposed to be limited by a firm monetary value (proposed section 5.17D(b)), reflecting Western Power's expectation that annual headworks contributions will be in the order of \$3 million. Further limitations upon the manner in which a headworks charge may be calculated are set out and explained in the Annotated Code (see section 5.17D(d)).

The headworks charge scheme environment could potentially be expanded by future Code amendment. For example, further amendments could allow a headworks charge scheme to include works to a transmission network or to extend a distribution network. However, such amendment would not be undertaken without thorough consultation.

### 4.3 *NEW SECTION 6.51A*

Consequential upon the headworks amendments, the architecture around the New Facilities Investment Test (**NFIT**) at section 6.52 has been amended to provide a higher level statement on the circumstances in which capital contributions can be rolled into the capital base. New section 6.51A draws together the NFIT in section 6.52 and the test in former section 6.56. Hence, section 6.56, which previously provided for the roll in of capital contributions into the capital base in specific circumstances, has been replaced by new section 6.51A(b) which is expressed in more general terms.

New section 6.51A(a) does not change the position with NFIT. As to new section 6.51A(b), Economic Regulation Authority (**Authority**) approval is subject to the investment being the subject of a contribution, being prudent (see section 6.52(a)) and there being no “double recovery”.

The reason for this revised approach is that the drafting required to describe how charges raised under a headworks charge scheme could be rolled into the capital base would have made section 6.56 cumbersome and confusing. It was decided instead to raise the generality of the drafting, which is more appropriate for the general nature of the Code. Rather than providing specifically for the potential implementation of a future headworks charge scheme, the proposed amendments provide for the Authority to determine which capital contributions may be rolled into the capital base.

While it is recognised that section 6.51A provides significant additional discretion to the Authority, it is considered to be more desirable than using complex and specific drafting that would restrict flexibility and could lead to unintended outcomes.

There are precedents in the Code for the Authority having such a degree of discretion. For example, section 6.48 provides the service provider and the Authority the power to determine the opening capital base, only restricted by the guideline that it be consistent with the Code objective (this requirement will also apply to new section 6.51A). Under this provision there is no guarantee that a “roll-forward” method will be used to set the capital base.

Given that the Authority has such unfettered discretion in deciding whether or not to use a roll-forward method at all, it is appropriate for it to have similar discretion about a lower-level matter such as one particular aspect of the roll-forward.

### 4.4 *USE OF TERM “DOUBLE RECOVERY”*

The phrase “double recovery” has been used in relation to headworks and other types of contributions in sections 5.14(d), 5.17D(iv) and 6.51A without definition. It is accepted that leaving the term “double recovery” undefined may create uncertainty. However, because of the difficulty of defining the term, attempting to do so could potentially cause more mischief than leaving it undefined. For example, if the definition contained an inadvertent loophole.

It was considered that the commonly used term “no double recovery” would be understood in this context to include, for example, “preventing charging a contribution in respect of any amount of new facilities investment (NFI) or non-capital costs that are recovered, or are likely to be recovered, through reference tariffs”. However, this statement illustrates the difficulty of defining a more specific statutory test: if these particular words were used without further qualification, they may prohibit the roll in of capital contributions (under what has been called the “Queensland model”) as previously permitted under section 6.56.

On its face, “double recovery” means “recovering twice”. The word “recover” is already established in the Code, for example in section 6.52 itself and in the primary pricing method objective in section 7.3(a). If the combined effect of price control and pricing methods is that NFI or non-capital costs get recovered more than once, there will have been double recovery, in breach of the “no double recovery” objective.

## 5 Identification of covered network

*This proposed amendment will make a technical drafting correction to the definition of the term “covered” to clarify which networks are “covered networks” under the Code.*

See:

- *definition of “covered”.*<sup>5</sup>

After the *Electricity Networks Access Code Amendments (No 2) 2007* were made, an apparent circularity was identified in the definition of “covered network”. It referred to the definition of “covered”, which referred to section 4.1, which referred back to the definition of “covered network”. The proposed new definition of “covered” resolves this problem by setting out in greater detail which networks are covered.

This clarification is important as, among other things, coverage of a network means that the service provider must submit a proposed access arrangement under section 4.1.

## 6 Mid-term amendment

*These proposed amendments enable more flexible amendments to an access arrangement between major resets.*

*Due to the pace of regulatory change in the nascent Code regime, coupled with the significant length of access arrangement periods (see section 5.31), issues are likely to arise between resets. For example, Western Power may need to amend its capital contributions policy under its approved access arrangement to provide for its distribution headworks charge scheme. At present, an access arrangement may only be amended between resets in*

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<sup>5</sup> From the introductory note to the Annotated Code.

*limited circumstances. Greater flexibility of potential amendment is intended to enable service providers and the Authority to efficiently resolve such issues.*

*The proposed changes will allow for a mid-term amendment to an access arrangement upon a relevant Code change; or upon the Authority's approval of a service provider's proposed amendment.*

See:

- *definition of "Code change"; and*
- *sections 4.41 to 4.45.*<sup>6</sup>

Currently an access arrangement may only be amended by the Authority prior to a revisions commencement date (**mid-term amendment**) under the following circumstances:

1. upon the occurrence of a trigger event specified in the access arrangement (section 4.37);
2. if a material error or misleading information provided by the service provider is discovered (section 4.38(a)), in which case price control or pricing methods may be revised;
3. if the approval of an access arrangement contained a material error or was based on deficient information, or significant unforeseen developments occur outside the control of the service provider (section 4.38(b)) , in which case price control or pricing methods may be revised; or
4. if a Code change occurs that materially alters either the model applications and queuing policy, the model standard access contract or the model capital contributions policy (section 4.41).

These circumstances are limited, as are the access arrangement changes that may be made consequential upon their occurrence. Further, in making mid-term amendments under these sections, the Authority is subject to consultation obligations that may be unnecessary in the case of minor amendments.

The proposed amendments to the definition of Code change and to sections 4.41 to 4.45 and 4.52 are to provide for the additional circumstances upon which the Authority may make mid-term amendments. These proposed changes allow:

- the Authority to amend the access arrangement if any relevant Code change occurs (section 4.41(d)); and
- the Authority to approve (or reject) access arrangement revisions proposed by a service provider at any time (section 4.41A).

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<sup>6</sup> From the introductory note to the Annotated Code.

The process for these new mid-term amendment powers is as follows:

- Such mid-term amendments are subject to the test in section 4.42: that the advantages must outweigh the disadvantages.
- In considering mid-term amendments, the Authority is not required to undertake a complete review of the access arrangement (it must, however, consider those aspects of the access arrangement that may be revised) (new section 4.41B). This will improve the efficiency of mid-term amendments.
- The Authority must consult with the public prior to making any mid-term amendment, unless it considers that the change is not material and will not impact upon a reference tariff, a reference service, a standard access contract or the rights of any applicant (amended section 4.43(a)).

In view of the range of potential mid-term amendments that might arise under sections 4.38, 4.41 and 4.41A, the Authority is otherwise granted discretion<sup>7</sup> in the manner in which it deals with such amendments. It is intended that the Authority have the flexibility to deal expeditiously with small or uncontroversial changes.

## 7 Miscellaneous

*These proposed amendments address miscellaneous matters including typographical errors. See the explanatory note at each “Miscellaneous” footnote.<sup>8</sup>*

No further background information is provided in relation to these amendments.

## 8 Networks terminology

*These proposed amendments are consequential upon the ENAC Amendments (No 1) 2007 (of 29 June 2007). They implement terminology that mirrors general industry usage in relation to the networks in the SWIS.*

*The definition of “SWIN” departed from its industry usage by referring only to Western Power’s network and not all the interconnected networks that make up the SWIS. The definition of “SWIN” is replaced by the new defined term “Western Power Network”, which also replaces the phrase “covered network that is covered under section 3.1”.*

See:

- definitions of “SWIN”; “SWIN access arrangement”, “Western Power Network”, “Western Power Network access arrangement”;

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<sup>7</sup> Subject to the Code objective (sections 2.1 and 2.2) and administrative restrictions.

<sup>8</sup> From the introductory note to the Annotated Code.

- *sections 3.1 and 3.2; and*
- *other “networks terminology” footnotes.<sup>9</sup>*

The Office has ascertained that the following terminology is common industry usage:

- the “SWIS” is the whole electricity system in the south-west of the State, as defined in the Act, and includes generation as well as networks;
- the “SWIN” is considered to mean the interconnected networks that make up the networks of the SWIS; which includes Western Power networks and other networks; and
- there is no special name for the networks in the SWIS (or SWIN) that are owned by Western Power (the Electricity Networks Corporation) and which are covered under section 3.1.

As a result, the Code will adopt the term “Western Power Network” to describe the subset of the SWIN owned by Western Power. Thus, references to “SWIN” are to be replaced with “Western Power Network”. Sections 3.1 and 3.2 are amended to be consistent with the above hierarchy and hence clarify which networks are being referred to by the coverage sections.

## **9 (No 2) 2007 consequential**

*This proposed amendment is consequential upon the insertion of section 2.4A by the ENAC Amendments (No 2) 2007 (of 29 August 2007). The subject matter of subsections 2.5(d) and (e) are now dealt with by section 2.4A, so they are proposed to be deleted.*

See:

- *Section 2.5(d) and (e).<sup>10</sup>*

There is no further relevant background information in relation to these amendments.

## **10 Non-capital contribution**

*These proposed amendments are intended to allow the “capital contributions policy” to deal also with contributions charged for non-capital costs. While some capital costs may be recovered from users through contributions, there is no similar provision for non-capital costs. The effect of this is that users who trigger work may not be provided with price signals as to the non-capital cost of that work, because this cost may be recovered through tariffs. It is*

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<sup>9</sup> From the introductory note to the Annotated Code.

<sup>10</sup> From the introductory note to the Annotated Code.

*considered appropriate to regulate the recovery of non-capital costs in the Code.*

*It is proposed that non-capital contributions (as well as capital contributions and headworks) be charged under the new, higher level concept of a “contributions policy”. Other concepts have been introduced or clarified to enable the charging of non-capital contributions under a contributions policy:*

- (a) a new concept of “work”, which replaces “augmentation” as the trigger for a contribution. The concept of “augmentation” remains and refers to increases in network capacity;*
- (b) “contribution” now comprises either or all of “capital contribution” (payable in respect of new facilities investment); “non-capital contribution” (payable in respect of non-capital costs) and headworks charges; and*
- (c) “required augmentation” has been replaced by the broader concept of “required work”.*

*See:*

- definitions of “approved total costs”, “augmentation”, “capital contribution”, “contribution”, “contributions policy”, “non-capital contribution”, “non-capital costs”, “required work” and “work”;*
- sections 2.9 to 2.12;*
- sections 5.12 to 5.17A;*
- section 6.41;*
- sections 6.50 to 6.52, 6.56 and 6.71;*
- appendices 2, 3, 4 and 8; and*
- other “non-capital contribution” footnotes.<sup>11</sup>*

In gas and electricity regulation in Western Australia, non-capital costs have traditionally been rolled into target revenue and recovered through tariffs, provided they are “prudent”. By contrast, capital costs are subjected to thorough regulatory scrutiny and cannot be rolled into the capital base for recovery through tariffs unless they pass one or more tests, such as the NFIT. The capital contributions mechanism is one of the ways the service provider could recover capital expenditure which failed the test for rolling into the capital base. Because all prudent non-capital expenditure could be rolled into tariffs the gas and electricity regimes did not need to provide an equivalent mechanism for “non-capital costs”.

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<sup>11</sup> From the introductory note to the Annotated Code.

This can be contrasted with Western Power's historic practice, which was to charge certain users "contributions" for both capital and non-capital costs, typically where the costs were incurred at the specific request of the user and would not generate additional revenue.

As well as recovering capital expenditure which would not otherwise be recoverable, capital contributions provide a price signal to the user that is asked to pay. Non-capital contributions of the form historically charged by Western Power do likewise. Accordingly, the Office considers that the Code should be amended to allow for non-capital contributions.

Currently, the Code deals with non-capital costs differently from the way it deals with capital costs, because capital contributions relate only to capital costs and not non-capital costs. The Code requires a number of substantive changes or new provisions, plus a large number of consequential changes to facilitate the charging of non-capital contributions under a contributions policy. See the sections of the Annotated Code set out in the introductory note extract above, especially the new limits upon non-capital contributions in proposed sections 5.14(b) to (d). See also part 4.3 above for a discussion of new section 6.51A (which impacts upon non-capital contributions) and part 4.4 for a discussion of the use of the term "no double recovery" (the term is used in sections 5.14(d) and 6.51A in relation to the non-capital contribution amendments).

## 11 Technical rules

*These proposed amendments clarify which non-covered networks require technical rules, and how model technical rules may be developed and adopted.*

*The Code provides that a non-covered network requires technical rules if it is part of an interconnected system that contains one or more covered networks. This requirement potentially captures networks that it is inappropriate to require to have technical rules, such as caravan parks and shopping centres. Thus, amendments are proposed that link the requirement for technical rules to the Act's licensing regime – so that a licensee will be required to have technical rules while a service provider exempt from having a licence will not.*

*Those non-covered networks captured by the requirement for technical rules are currently faced with the option of drafting proposed technical rules or adopting Western Power's technical rules. The former option is onerous and it is unclear how the latter would work in practice. To resolve this situation, amendments are proposed to require the Authority to develop model technical rules for the SWIS (and empower it to develop model technical rules otherwise) that may be readily adopted by networks with minor amendment. The Authority may draw from the expertise of the technical rules committee in this process and may base the model rules on previously approved technical rules.*

*The model technical rules will exist as a standard against which the Authority must have regard to proposed technical rules, and to the extent that any proposed rules reproduce published model rules, they must be approved.*

See:

- *definitions of “model technical rules”, “technical rules”;*
- *sections 12.6 to 12.9A;*
- *sections 12.13A to 12.14;*
- *sections 12.23 and 12.28; and*
- *sections 12.61 to 12.68.*<sup>12</sup>

### **11.1 NETWORKS TO BE COVERED**

The proposed amendments clarify which non-covered networks are required to have Technical Rules (expanded section 12.6(b)). Networks are captured that:

- are part of an interconnected system that contains one or more covered networks; and
- hold a transmission, distribution or integrated regional licence under the Act.

This approach links the licensing regime under the Act to the requirement for technical rules.

The amendments are drafted to apply if another network becomes covered in the future. If, for example, Horizon Power’s networks in the Pilbara became covered, the interconnected networks of BHP Billiton and Pilbara Iron, which have licence exemptions, would not be required to have Technical Rules under section 12.6(c).

If the Office considered that this approach produced an unjust outcome, it may consider amending the Code to remedy this situation. Potentially, a Code amendment could “exempt out” certain licensees from the requirement to have technical rules; or, conversely, “opt in” certain exemptees to require that they have technical rules. At this stage, no such provisions are being considered and thorough consultation would be conducted prior to such a change.

### **11.2 TIMING FOR SUBMISSION OF TECHNICAL RULES**

Sections 12.6A to 12.8 determine when a network is required to submit technical rules to the Authority for approval. Appendix 1 provides a flow diagram (see item 2) of the logic used to determine the timing.

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<sup>12</sup> From the introductory note to the Annotated Code.

The fundamental position for a new non-covered network that is required to have technical rules is that it not be commissioned before it has technical rules in place (section 12.6A). This reflects the policy position that all new networks that are required to have technical rules should have them in place upon commissioning.

Section 12.7 sets out the times by which non-covered networks must submit technical rules. It provides that:

- For new networks commissioned after the date of these amendments, the submission date is whenever the service provider chooses (because the network may not be commissioned without technical rules in place, the date that proposed technical rules are submitted is immaterial).
- For non-covered networks already connected to the SWIS, the submission date is four months after the publication of the SWIS model technical rules (see part 11.3 below regarding model technical rules).
- For non-covered networks already connected to a covered network other than the SWIS, the submission date is the later of:
  - 6 months after the network is first required to have technical rules under section 12.6; or
  - if before that 6 months expires, the Authority commences developing model technical rules that will apply to the network – 4 months after the model technical rules are first published.

The totality of the proposed amendments make the previous interim section 12.8A redundant, so it is proposed to be repealed. These proposed amendments now provide further time in which to address the requirement for non-covered networks on the SWIS to have technical rules.

The Authority has discretion to extend the deadlines for service providers of non-covered networks to submit technical rules (section 12.8). This is subject to the Authority issuing a notice advising of the extension and the reasons for the extension.

There is one class of networks which may face a timing issue under the above provisions, namely, networks that are to be commissioned in the SWIS after the date of these amendments, but prior to the publication of model technical rules for the SWIS. Because such a network must not be commissioned without having technical rules in place (section 12.6A), it would be denied the benefit of the model technical rules unless it waited for their publication before being commissioned. This would not, however, prevent the network from developing its own technical rules and having them approved.

Section 12.61 provides that the Authority must develop model technical rules for the SWIS by 1 December 2009, which date may be extended. Therefore,

the time period during which section 12.6A could operate harshly could stretch beyond one year. However, it is assumed that the construction and licensing of a new network will take some time, during which the network may prepare technical rules. Further, the Minister could potentially exempt the new network on a temporary basis via a Code change to allow commissioning without technical rules, on the proviso that technical rules be approved within a specified time. This option would only be considered in exceptional circumstances and with the aid of consultation.

### **11.3 MODEL TECHNICAL RULES**

The Office intends non-covered networks to be able to efficiently adopt technical rules at low cost and with minimum time investment. That is the intention of existing section 12.7(a), but in practice this section could require non-covered networks to go to the trouble and expense of a technical and legal review of Western Power's Technical Rules. Thus, building on the model technical rules concept that already existed in the Code (in section 12.23(a)), the proposed amendments provide for the development of model technical rules and their approval by the Authority (new sections 12.61 to 12.68). Appendix 1 provides a flow diagram (see item 1) of the proposed requirement on the Authority.

The model technical rules provisions have been drafted generally so that model rules may be developed for any interconnected system or class of network. It is anticipated that the model technical rules for an interconnected system will be based on and largely consistent with the approved technical rules of the covered network in the interconnected system (section 12.66). For example, the SWIS model technical rules are anticipated to be based on Western Power's approved Technical Rules.

However, the degree of similarity between the model technical rules for the SWIS and Western Power's Technical Rules is a matter of detail design for the Authority to decide. For example, the Authority may express the model technical rules as a list of exceptions to and modifications of Western Power's Technical Rules (see section 12.66(c)) or could alternatively develop a stand-alone model that differed greatly from Western Power's Technical Rules (as long as the model technical rules were capable of working in an integrated fashion with Western Power's Technical Rules – see section 12.2(a) applying under section 12.65(c)).

It is anticipated that the model technical rules will be compatible with Western Power's Technical Rules to the extent necessary to provide consistency of network and access standards across the SWIS, but will not contain irrelevant material (such as Western Power specific material) or be overly prescriptive.

It is envisaged that the model technical rules will be structured so that a non-covered network will be able to adapt the model technical rules by completing a relatively simple schedule that identified the specific aspects of its own particular network (such as name and ownership details).

Alternatively, if it wished, the non-covered network could customise the model technical rules for its own purposes.

The Authority's approval process for technical rules proposed by a non-covered network, which have been adapted from model technical rules, will be the same as that undertaken when a non-covered network submits proposed technical rules that are not based upon the model. A network will submit adapted model technical rules as normal under section 12.7, and the Authority will consider and approve the proposed rules under sections 12.9 and 12.9A. The only difference will be that the Authority must approve proposed technical rules to the extent that they reproduce the model technical rules (section 12.13B(a)). Conversely, in considering rules that partly or wholly do not reproduce the model technical rules, the Authority must have regard to the model technical rules (section 12.13B(b)).

It is not intended that the model technical rules will disturb a prior approval of technical rules for a covered network (see section 12.68). The effect of section 12.2 (applying under section 12.65(c)) is to require the model technical rules to integrate into the prior approved covered network rules, and not vice versa. However, if the model technical rules process identifies a useful innovation, it may be included in later amendments to the covered network's technical rules.

#### ***11.4 TIMING FOR MODEL TECHNICAL RULES***

The Authority may consider it appropriate to base the model technical rules on the revised Western Power Technical Rules which are expected to commence on 1 July 2009. Therefore, the proposed timing for consultation, approval and publication of the SWIS model technical rules is 1 December 2009 (see section 12.61).

The process of having model technical rules drafted, consulted on, approved and published will be quite challenging. Thus, it is considered appropriate to allow the Authority to extend the deadline in section 12.61, subject to it issuing a notice setting out the reasons why (see section 12.63 and 12.64). This mirrors the approach in the National Gas Law with respect to the regulator's approval of access arrangement proposals.<sup>13</sup>

#### ***11.5 TECHNICAL RULES COMMITTEE***

Under the proposed amendments, the Authority may require the Technical Rules Committee (which it has established under section 12.16) to provide draft model technical rules (see section 12.23(a)) or provide advice in relation to any matter connected with model or proposed technical rules (see section 12.23(c)).

#### ***11.6 MISCELLANEOUS TECHNICAL RULES AMENDMENTS***

The definition of "technical rules" has been amended to enhance clarity. Please see the note at the definition in the Annotated Code.

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<sup>13</sup> See rules 12 to 14 of the *National Gas Rules 2008*.

Section 12.9A is inserted to clarify the technical rules approval process for non-covered networks by setting out an express final decision making power for the Authority in relation to technical rules submitted by non-covered networks.

## 12 Thresholds for regulatory test

*Western Power has proposed that the thresholds for the regulatory test, set out in the definition of “major augmentation”, be doubled or otherwise increased. An increase would reduce the scope of augmentations subject to regulatory test scrutiny under Chapter 9. This would potentially streamline the construction of some augmentations but could also affect the consideration of alternative options. The Office requests comment on this proposal.*

See:

- *definition of “major augmentation”; and*
- *chapter 9 (no proposed changes but amendment to threshold will affect the operation of this chapter).<sup>14</sup>*

### 12.1 BACKGROUND

Western Power is concerned that the thresholds are set too low for when the regulatory test in Chapter 9 of the Code is applied, and is seeking to have these increased. Western Power has suggested a doubling of the current levels in the Code (to \$30 million and \$10 million for transmission and distribution respectively).

The thresholds appear in the definition of “major augmentation” in section 1.3. The thresholds are Consumer Price Index (**CPI**) adjusted and are currently:

	<b>Original</b>	<b>Current (CPI adjusted)</b>	<b>WP Proposal</b>
Transmission	\$15M	\$16.8M	\$30M
Distribution	\$5M	\$5.6M	\$10M

The Code amendment necessary to facilitate Western Power’s request is a simple change to the specified amounts in the definition of “major augmentation” in section 1.3 of the Code.

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<sup>14</sup> From the introductory note to the Annotated Code.

Western Power has supplied a short supporting discussion paper, see Appendix 2.

## **12.2 REASON FOR INCREASING THRESHOLD**

The purpose of the regulatory test is to ensure that network service providers consider alternatives to major network investments, such as demand management or generation solutions; and implement the options that maximize the net benefits to consumers and other electricity market participants.

The original thresholds were set in 2004 as part of the Code development process and had the agreement of Western Power and other stakeholders. It is understood that the intended effect of these thresholds was for those relatively few, large, non-routine network augmentations to be subject to the regulatory test, based on the stated principle in the Code that application of the test should not impose an unreasonable administrative burden or delays on affected parties (see section 9.1(c)).

The electricity industry is experiencing sustained, unprecedented increases in resource costs, to the extent that some competitive tenders are in the order of two times (or more) the previous historical cost. The effect of this is that the costs of some “routine” network extensions and reinforcements are now above the regulatory test thresholds and the overall number of projects subject to the test is increasing rapidly.

Western Power has therefore requested that the level of the thresholds be re-examined. The intent is to increase the threshold so that only the smaller number of projects expected to be subject to the regulatory test are captured. This will then reduce the regulatory time and cost burdens on both Western Power and the Authority.

## **12.3 ISSUES TO CONSIDER**

The overall objective of the regulatory test is to ensure that alternatives to conventional expansion or extension of the network are considered prior to construction. However, this consideration should only take place where there is sufficient scale and scope to justify the attendant administrative burden and project delays that will be incurred. The thresholds are intended to provide a signal as to when it is worthwhile to undertake a thorough regulatory test of a project.

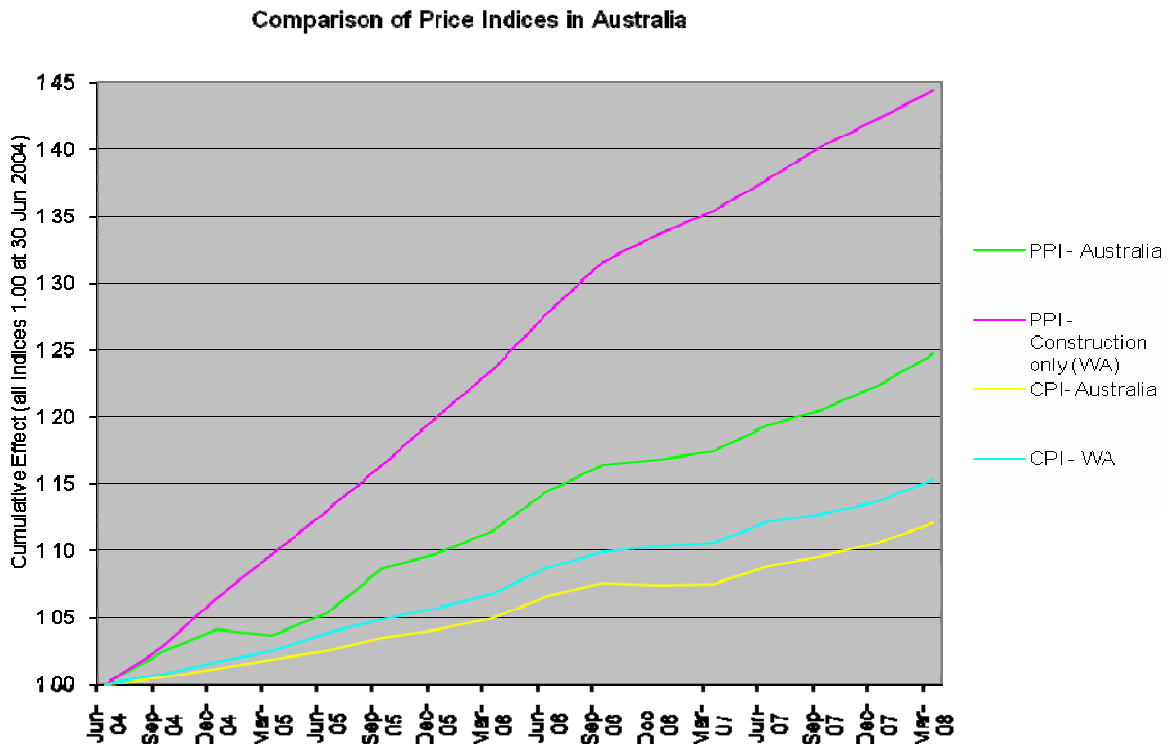
In reviewing the thresholds, there appear to be four considerations:

- 1) Whether monetary value alone is adequate to determine when projects should be assessed. The current thresholds only have regard to two classes of project (distribution and transmission) and specify a monetary threshold for each (and for both in conjunction). It may, however, also be useful to include in the test consideration of other relevant matters such as the impact of demand management or local generation, or whether the enhancement will address safety concerns.

- 2) Whether the current threshold levels are appropriate, weighing the benefit of the use of alternative options against the cost of applying the regulatory test.
- 3) Whether the CPI escalator correctly reflects the changing cost of such projects.
- 4) That the threshold test should be clear and relatively simple to apply.

The Office is of the view that given the intensive consideration and consultation at the time of the Code development and approval, the threshold mechanism currently embodied in the Code represents a workable compromise for the conflicting considerations represented by items 1, 2 and 4 above

The figure below, using data taken from the Australian Bureau of Statistics, demonstrates how the CPI significantly underestimates the increases in costs of constructing assets, represented by the Producer Price Index (**PPI**).



The figure indicates that even if the proposed doubling of the threshold requested by Western Power is approved, the relevance of this figure will quite likely be whittled away over time if the escalator continues to significantly underestimate (or overestimate) construction costs. The Office therefore considers that the use of an appropriate escalator (item 3 above) has the most potential to improve targeted thresholds. For example, if the

original thresholds of \$5 million and \$15 million were escalated at the PPI (WA) index, they would now be \$7.2 million and \$21.6 million respectively.

#### **12.4 NATIONAL INITIATIVE**

Very similar issues to these are being considered for the National Electricity Market. An application for a rule change was lodged on 21 November 2007, with the Australian Energy Market Commission (the **AEMC**) by the Electricity Transmission Network Owners Forum. This application sought to:

- increase the current regulatory test thresholds:
  - from \$1 million to \$5 million for new small transmission assets; and
  - from \$10 million to \$35 million for new large transmission assets;
- index the monetary thresholds to movements in the PPI; and
- require transmission network service providers to disclose certain information on all proposed replacement network assets in excess of \$5 million in their Annual Planning Reports.

The AEMC has yet to reach a decision on this issue, and has extended its time period to do so twice.<sup>15</sup>

Persons interested in learning more on this investigation are referred to the AEMC website at:

<http://www.aemc.gov.au/electricity.php?r=20071203.143828>

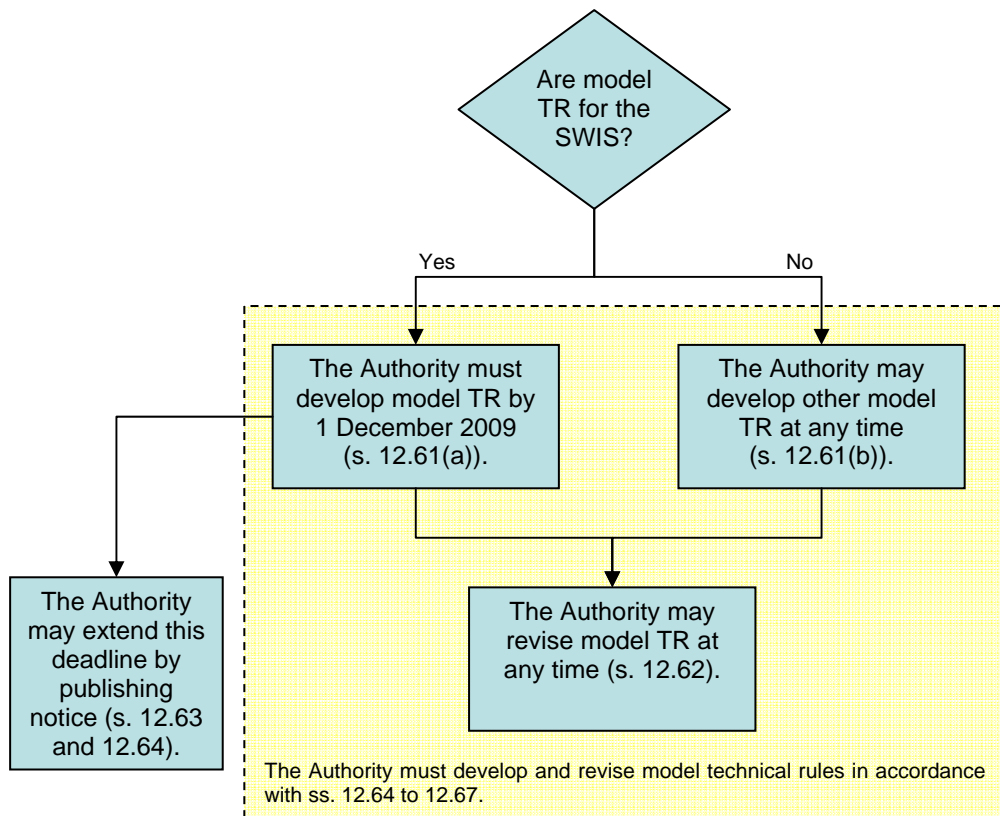
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<sup>15</sup> Currently, a decision is due by 31 July 2008.

# APPENDIX 1

## Flow Diagrams for Development of Model Technical Rules and Submission of Technical Rules

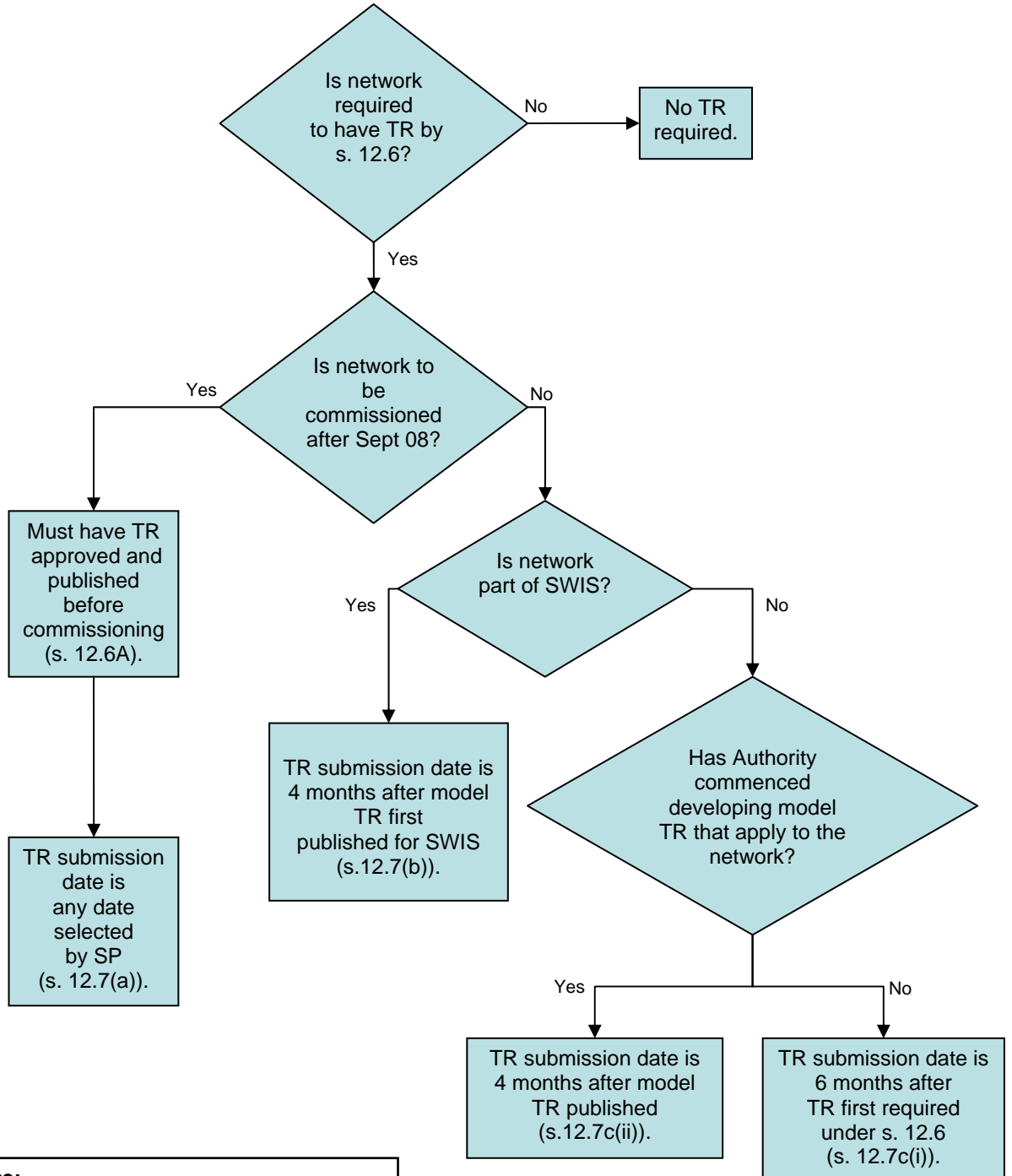
**(1) FLOW DIAGRAM**  
SHOWING  
REQUIREMENT FOR THE AUTHORITY TO DEVELOP MODEL TECHNICAL RULES  
(*ELECTRICITY NETWORK ACCESS CODE AMENDMENTS (No 2) 2008*)



**Note:**  
TR = Technical Rules

## (2) FLOW DIAGRAM

SHOWING  
DEADLINES FOR NON-COVERED NETWORKS TO SUBMIT TECHNICAL RULES  
(ELECTRICITY NETWORK ACCESS CODE AMENDMENTS (No 2) 2008)



**Note:**  
TR = Technical Rules  
SP = Service Provider  
SWIS = South West Interconnected System

## **APPENDIX 2**

### **Western Power Discussion Paper on Amending Thresholds for Regulatory Test**

**ACCESS ARRANGEMENT**  
**DISCUSSION PAPER & RECOMMENDATION**

***Regulatory Test thresholds***

**Background**

Chapter 9 of the *Electricity Networks Access Code 2004* (Code) establishes the requirement for “major augmentations” – those augmentations with a value in excess of \$5 million (distribution augmentations) and \$15 million (transmission augmentations) – to undergo a “regulatory test”.

Chapter 9 of the Code sets out the process to be applied by both the Economic Regulation Authority and Western Power when applying the regulatory test.

The purpose of this paper is to provide an overview of the scope and scale of projects subject to the regulatory test, and to assess whether the threshold at which the regulatory test applies presents a reasonable impost on Western Power. This paper also canvasses a potential varied threshold at which the regulatory test could apply, should the definition of “major augmentation” be amended by the Minister for Energy.

**Code Provisions**

The requirements of chapter 9 of the Code only apply to “major augmentations”, which are defined as:

**“major augmentation”** means an augmentation for which the new facilities investment for the shared assets:

- (a) exceeds \$5 million (CPI adjusted), where the network assets comprising the augmentation are, or are to be, part of a distribution system; and
- (b) exceeds \$15 million (CPI adjusted), where the network assets comprising the augmentation are, or are to be, part of:
  - (i) a transmission system; or
  - (ii) both a distribution system and a transmission system.

Section 9.1 establishes the objectives of the regulatory test provisions as being:

- (a) to ensure that before a *service provider commits* to a proposed *major augmentation* to a *covered network*, the *major augmentation* is properly assessed to determine whether it maximises the *net benefit after considering alternative options*; and
- (b) to provide an incentive to a *service provider*, when considering *augmentation* to a *covered network*, to select the option (which may involve a *major augmentation* or may involve not proceeding with an *augmentation* at all) which maximises the *net benefit after considering alternative options*; and

- (c) to minimise:
  - (i) delay to projects and other developments; and
  - (ii) administrative and regulatory costs; and
  - (iii) any other barriers to the entry of *generators* and *consumers* into the electricity market,arising from the application of the *regulatory test*.

Consequently, the threshold for the application of the regulatory test must be consistent with the three objectives set out above. The third is of most relevance, as it specifies that an objective of the regulatory test should be to minimise delays to projects and to administrative and regulatory costs.

## **Discussion and assessment of options**

### ***2003/04***

It was recognised during Code development that the regulatory test imposed somewhat of a burden upon a network service provider, and that the regulatory test should therefore apply to only a small sub-set of large investment decisions.

When the Code was introduced in 2004, there were already seven transmission projects with a value in excess of \$15 million underway and three new projects with value in excess of \$15 million were subsequently approved. These projects were excluded from the ambit of the regulatory test, on the basis that they were “committed projects”.

The relatively small number of projects subject to the test reflects its intrusive nature and is consistent with the regulatory test objectives; given the burden of consultation and substantiation it was intended to apply to a very small number of projects. Nevertheless, the definition of “major augmentation” has been unchanged since the development of the Code during 2003 and 2004.

### ***Subsequent to 2003/04***

The number of new projects which exceed the major augmentation threshold has increased significantly since 2004 due to sustained unprecedented growth and increasing costs, to the extent that these now include projects whose scope was not intended to be subject to the test. A prominent example of this is zone substations, which could not typically be seen as network investments where the underlying need might be more efficiently addressed through further generation investment.

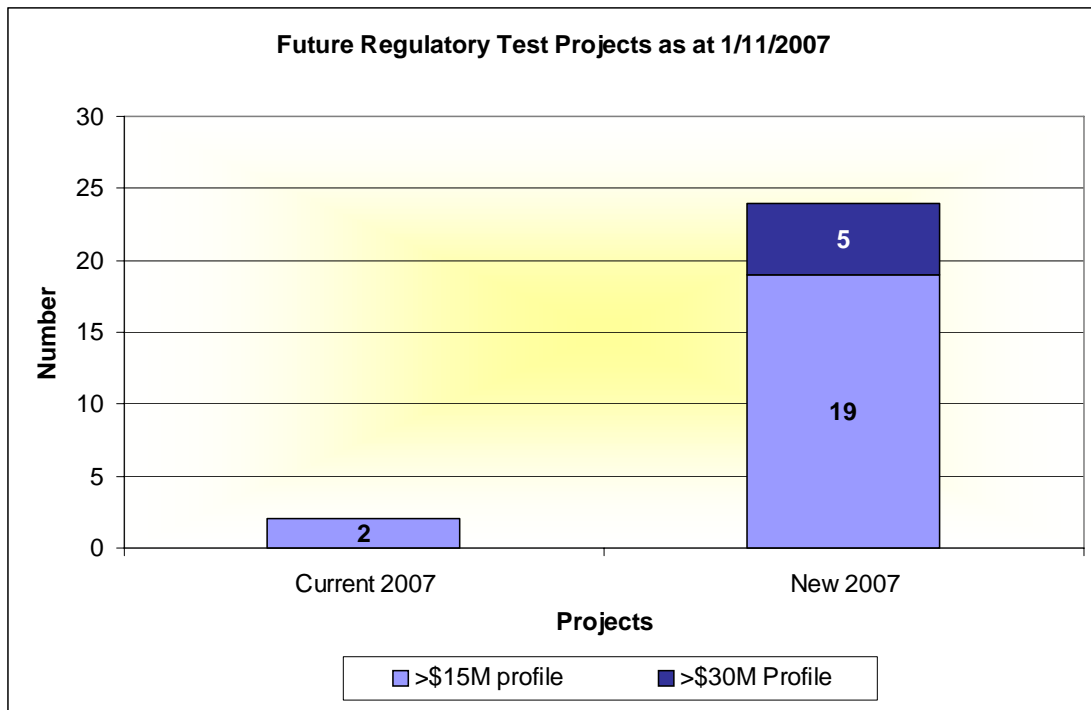
The graph in Appendix 1 to this paper illustrates the new major augmentations which have arisen in 2004 and each subsequent year. The graph shows a significant increase in new projects in excess of the \$15 million threshold with six in 2005 and seven in 2006. There are currently two major augmentations foreshadowed for 2007, with a further six projects in the Business Case approval process. In addition, it is noted that there are nine projects which have been approved and received a budget allocation in previous years, but which have been able to be deferred due to changing circumstances.

### Revising the “major augmentation” threshold

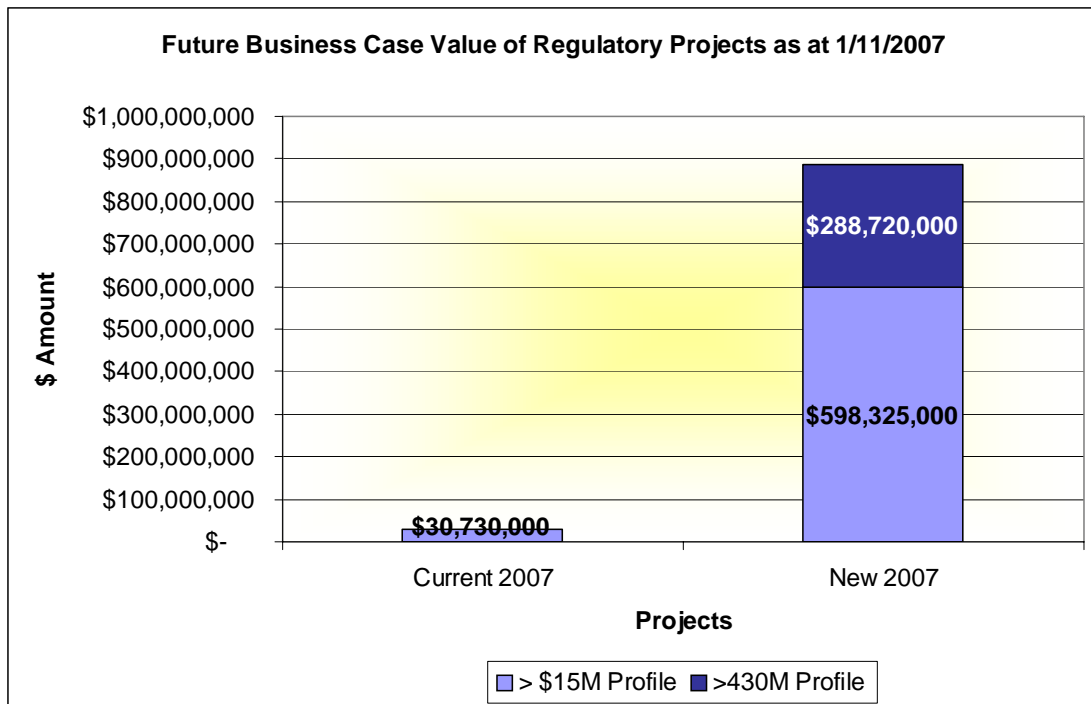
As has been demonstrated, and largely caused by large increase in project costs and the scale of network investment since 2004, the number of projects exceeding the threshold for the application of the regulatory test has increased significantly. Should the threshold not be varied, there would be a further 19 projects (on present projections) which must be subjected to the regulatory test.

It is open to Western Power to make representations to the Office of Energy seeking that the definition of “major augmentation” be amended. It is important that the revised value of the threshold be such that the regulatory test objectives (in section 9.1 of the Code) can be seen to be achieved, without the imposition of too onerous a burden upon Western Power (and the ERA).

If the threshold (for transmission augmentations) is adjusted to \$30 million, the number of projects subject to the regulatory test requirement is significantly reduced (to five). This is graphically depicted below.



In addition, the following graph depicts the value of the projects subject to the regulatory test based on the project numbers depicted in the above table.



### ***Annual Adjustment of Thresholds***

It is further noted that the thresholds specified in the definition of “major augmentation” in the Code are subject to CPI indexation. By virtue of section 4.26 of the Code, the Authority is obliged to “CPI adjust” the threshold amounts on an annual basis, and publish the adjusted amounts.

The Authority published the following new thresholds on 18 December 2007:

- distribution – \$5,400,000; and
- transmission – \$16,200,000.

CPI adjustment of the thresholds does not produce a discernible change in the number of projects currently subject to the regulatory test. However, provided that the proposed step increases are implemented and given that current cost increases will eventually stabilize, it is considered reasonable that this form of annual indexation is retained.

### **Conclusions**

It is concluded that:

1. continuing with a \$15 million threshold for the application of the regulatory test to transmission related augmentations is unsatisfactory, because:
  - the regulatory test was intended to apply to small numbers of projects, however project costs have increased to such an extent that larger numbers of projects, and projects with relatively routine scopes, are now being caught in the ambit of the regulatory test; and

- retention of the existing regulatory test threshold imposes an onerous burden on Western Power and the ERA, contrary to the regulatory test objectives set out in section 9.1 of the Code;
- 2. the Minister for Energy should be requested to amend the definition of “major augmentation” (as it applies to transmission and combined transmission and distribution investments) in the Code; and
- 3. amending the definition of “major augmentation” (as it applies to transmission and combined transmission and distribution investments) to show an amount of \$30 million (CPI adjusted) significantly reduces the number of projects which would be required to undergo the regulatory test, and is otherwise consistent with the regulatory test objectives.

Western Power  
January 2008

