



PUBLICATION

New Facilities Investment Test Application for the Mid West Energy Project (Southern Section)

FINAL DETERMINATION

The Economic Regulation Authority has released its [final determination](#) on Western Power's application for a new facilities investment test for the Mid West Energy Project (Southern Section).

This final determination gives the Authority's pre-approval to include \$377.8 million (real dollars as at 30 June 2010) of the \$383.4 million sought by Western Power as capital expenditure for their capital base. The amount not approved does not meet the 'efficiency' test.

The approvals commence at the point in time when the Mid West Energy Project (Southern Section) is commissioned at 330 kV and component network assets are purchased from Karara Mining Limited.

For the new facilities investment test to be satisfied, the proposed investment must not exceed the amount that would be invested by a service provider efficiently minimising costs (the 'efficiency' test) and must satisfy at least one or more of the following conditions:

- the investment generates enough revenue to cover the investment costs (the 'incremental revenue' test); or
- the investment provides a net benefit to justify higher network tariffs (the 'net benefits' test); or
- the investment is necessary to maintain the safety or reliability of the network or its ability to provide network services (the 'safety and reliability' test).

Through these conditions, *the new facilities investment test seeks to ensure that participants in the electricity market – whether they are generators, network operators, or customers – realise a benefit that is at least sufficient to offset the cost of the new facility.* The test ensures that consumers will be better off in the longer term with the investment.

The Authority released a draft determination on Western Power's proposal on 14 November 2011. In the draft determination, the Authority set out that:

- the proposed expenditure of \$383.4 million was consistent with the efficiency test, with the exception of \$16.7 million (4.4 per cent of the total proposed expenditure), which the Authority considered to be potentially inefficient;
- it could not give pre-approval for the total proposed expenditure to be rolled into the regulated capital base as, based on the information provided at that point by Western Power, there was a possibility that existing customers may be exposed to an unacceptable risk of increased transmission charges with no offsetting benefits; and
- Western Power needed to provide more information to support the case for the pre-approval, and in particular should reconsider the approach to support its estimates for the incremental revenue test.

Western Power provided a submission responding to the Authority's draft determination. The Authority also received submissions from eighteen other stakeholders.

With regard to the efficiency test, the Authority accepts a number of Western Power's explanations providing support for proposed expenditures which had previously been questioned. However, the Authority does not accept all of Western Power's responses. On this basis, the Authority has determined that the efficient costs for the Mid West Energy Project (Southern Section) are \$377.8 million (real dollars at 30 June 2010).

With regard to the incremental revenue test, the Authority has developed a robust, conservative estimate of the allowable capital under the incremental revenue test – of \$181 million (real dollars at 30 June 2010).

With regard to the net benefits test, the Authority's determination is that a total of \$233 million (real dollars at 30 June 2010) is approved for the net benefits test, comprising (all net present values):

- generation net benefits of \$188 million;
- a network deferral benefit of \$36 million;
- a reduction in transmission losses of \$9 million.

The majority of these net benefits are expected to flow to consumers.

The Authority therefore is satisfied that the overall net present value of the benefits of the MWEP will be at least \$414 million (real dollars at 30 June 2010), comprising the sum of \$181 million of incremental revenue and \$233 million of net benefits. The estimated net present value of the benefits of \$414 million exceeds the efficient cost for the MWEP of \$377.8 million (real dollars at 30 June 2010), allowing the efficient costs to be approved for the new facilities investment test.

The application was submitted under section 6.71 of the *Electricity Networks Access Code 2004*.

For further information contact:

General Enquiries

Elizabeth Walters
Assistant Director Access
Ph: 61 8 9213 1900
Fax: 61 8 9213 1999

Media Enquiries

Richard Taylor
Riley Mathewson Public Relations
Ph: 61 8 9381 2144
Fax: 61 8 9381 3877

LYNDON ROWE
CHAIRMAN

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