

15 December 2010
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Re: Maximum Reserve Capacity Price 2013/14 Draft Price

Dear Troy,

Thank-you for the opportunity to comment on the Maximum Reserve Capacity Price (MRCP) Draft Price to apply to the 2013/14 Reserve Capacity Year.

Tesla understands the importance of the MRCP and its use in setting the Reserve Capacity Price each year. We are also cognisant of the impact the MRCP has on the attractiveness of the market for new entrants, however, we believe that clarity is important to allow market participants understand how the price is constructed. We are having some difficulty understanding the drivers behind the formulation of the draft price for 2013/14.

There are a number of points we seek clarity on:

- 1. Western Power Transmission Connection Costs**
- 2. Easement Costs**
- 3. Land Cost**
- 4. Escalation of Costs**

Western Power Transmission Connection Costs

The IMO Draft Report MRCP 2013/14 states that *“The Transmission Costs have risen sharply as spare capacity in the transmission network has been utilised, such that the connection of a 160 MW facility now requires significant augmentation to the network.”* (page 4).

We note that while the total dedicated connection asset costs have increased to A\$9.2m, shared connection asset costs have decreased from \$46.8m by 22% to A\$36.3m.

The report produced by Western Power to provide input to the IMO for the determination of the MRCP states that *“maximum capacity has been reached for the*

meshed 66kV and 132kV network arrangement” and “Due to the parallel nature of the 330kV and 132kV systems, generation connecting to the SWIS at the 330kV level may necessitate reinforcement of both the 330kV and 132kV networks. The 132kV network reinforcements are necessary to remove the constraints existing on the 132kV system which are currently acting as bottlenecks to power transfers.”

It is difficult to understand the situation which occurs when the IMO report states that transmission costs rise sharply, coupled with Western Power stating the network is becoming saturated and operating at maximum capacity therefore requiring deep augmentation results in the calculated “connection” cost in the MRCP calculation to decrease year on year. It seems that qualitatively, it has become more expensive to connect to the network due to the requirement for augmentation, but at the same time, the quantitative contribution to the MRCP has decreased.

There should be some bridge between the qualitative notes that the network is now at capacity (and therefore implying high costs to connect) to the actual costs (which have decreased) calculated to input into the MRCP calculation.

The draft report states that “For the purpose of estimating capital contributions for new generators in the determination of the MRCP, Western Power has assumed pro-rata costs of the required new augmentations for new generators based on capacity.” We seek clarity on how broadening the scope of augmentation from only the 330kV network to include the mesh effects (and subsequent augmentation requirements) of the 132kV network results in lower connection costs as a whole. We understand that “un-meshing” the network is a significant project with significant costs and long lead times.

It seems the decreased Shared Costs are primarily driven by the change in strategy of connection – it may be cheaper to upgrade the 132kV network (un-mesh) as opposed to upgrading the 330kV as has been the strategy in previous capacity years (to feed into the MRCP).

However, it is unlikely a proponent attempting to connect for the 2013/14 capacity year would be able to take advantage of these theoretical lower costs due to timing. Un-meshing the network is likely to be a 5+ year project. Therefore the 2013/14 MRCP should not assume an “un-meshing” cost of connection as it is not likely to be available to a proponent to allow commissioning by October 2013. If Western Power can confirm the un-meshing can occur by this time and available to proponents for connection by October 2013, then this methodology may be valid.

The documentation is also not explicit as to the comparison of specific items (e.g. PSC, PDAC) from year to year. A comparison table (similar to those provided for the WACC inputs) would be useful to directly compare the Western Power transmission cost estimates.

We also note that the 2012/13 Western Power costing report stated the connection cost at Kemerton Industrial Park (the lowest cost location utilised for the purposes of

the MRCP calculation) assumed no re-energisation of Muja A/B. We now know this is not the case with the Muja A/B project being awarded capacity credits for the 2012/13 capacity year. The presence of Muja A/B would theoretically increase the deep connection costs (not decrease) in 2013/14 as there is less excess capacity available due to Muja A/B coming back onstream.

Easement Costs

The treatment of the cost of obtaining access to easements has changed from 2012/13 to 2013/14. It was previously assumed the 2km transmission line easement would be purchased, but now is assumed to be 50% purchased and 50% “secured rights”. It is likely to secure the “rights” to use the easement, a payment of some sort would be required. It is also likely that the Net Present Value of this “rental” payment would be greater than the actual acquisition cost over a 30 year period to convey some monetary benefit to the land owner.

Using the above assumption, it may prove a lower cost outcome to purchase the land in line with the 2010 methodology.

Changing methodology of calculation year to year also increases the perceived risk of the variability of the MRCP in the future. There is significant value in making the risks clear and apparent – the MRCP working group would be a good forum for this sort of change. Otherwise, there are unquantifiable risks to the MRCP that proponents cannot forecast and understand.

It is our view that the treatment of easement costs should be maintained in a consistent manner and in line with 2010 methodology.

Methodology changes similar to this should be addressed within the MRCP Working Group and probably not arbitrarily by consultants. Changing the methodology of calculation year to year increases the perceived risks and uncertainty of the Electricity Market.

Land Cost

It is noted that the Kemerton Industrial Park Region is the lowest cost connection point used to formulate the MRCP. However, it is also noted in the MRCP Landgate report that the minimum lot size within the Kemerton Industrial Park is 5 hectares. The land cost has been based upon a lot size of 3 hectares.

This is inconsistent with the estimate of transmission line distance. The lot size should be calculated on the basis of 5 hectares if Kemerton is to be used as the reference site as it is not possible (due to planning restrictions) to obtain a site smaller than 5 hectares within a 2km distance of any substation in the Kemerton region. Alternatively the 2km distance should be increased to a meaningful distance that allows a 3 hectare site to be utilised.

The costs should reflect a model plant, but the model plant should be possible to build. It is not possible to build this model plant as planning rules (acknowledged by Landgate) prevent this from occurring.

While we recognise the selection of 3 hectares as a cost base is within the market rules, it is our view the land cost should be based on 5 hectares to reflect reality.

Escalation of Costs

The IMO proposes to use cost escalations of 0.82% for the switchyard and -2.72% for the transmission materials. It is noted that while general base metal costs in AUD have decreased, we have not observed a corresponding decrease in the cost of the actual equipment. Due to the rapid recovery of the world market, switchyard and transmission materials have not decreased in price in line with the base metal cost. We ask the cost escalation values be reviewed prior to acceptance into the final MRCP price.

We look forward to receiving further information on the points mentioned above.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Ben Tan', with a long horizontal flourish extending to the right.

Ben Tan
CEO
Tesla Corporation