

Mr Troy Forward
General Manager, Development
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By email: imo@imowa.com.au

15 December 2010

2013/14 MAXIMUM RESERVE CAPACITY PRICE SUBMISSION

Dear Troy,

Thank you for the opportunity to comment on the Independent Market Operator's (IMO) draft report, "Maximum Reserve Capacity Price Review for the 2013/14 Reserve Capacity Year", issued in November 2010.

Again, we congratulate the IMO on a well presented and considered paper demonstrating ongoing development from experiences of previous years. In general, Infratil is satisfied with the approach taken but offers the following comments.

Cost Escalations

Determining an escalation factor through simple extrapolation of previous year's indices is a weak methodology at the best of times. Using a recent decrease in prices to forecast future ongoing decreases, as SKM has done for transmission line costs, is certainly questionable. As the main input to this is base metal prices then observable forward prices for these commodities could provide a better estimate.

Power Station Capital Costs & Margin

Based on Perth Energy's recent experience in the construction of its Kwinana Power Station, Infratil would concur that the capital costs are reasonable.

Transmission Connection Costs & Optimal (least cost) Approach

It is noted that the IMO is seeking an optimal (least cost) solution in this process, especially when considering location. Coupled with the 15% discount in arriving at the RCP, this "discount on discount" will ultimately result, almost by definition, in RCPs inadequate to support new capacity¹.

Further, once all "low cost" connection options are exhausted, participants will be driven to connect at the least cost location as set out in the prevailing MRCP determination. In doing so, the IMO will risk effectively signalling where new generating plant should be located with the potential to create

¹ Infratil recognises that, in an auction, the 15% discount would not apply but, as previously communicated to the IMO, Infratil does not believe any new entrant/green field capacity would be able to rely on an auction.

network access queues (and likely congestion) at these locations causing issues for Western Power².

Further, the longer term consequence of this approach is the likely sub-economic development of the overall power system resulting in greater system losses and ultimately higher overall energy costs to the consumer. Western Power's report alludes to this on page 4 where it states that its "...response preclude[s] it from representing Western Power's actual network development plan in the future."

Infratil therefore suggests that the IMO uses an average of the assessed locations, not the least cost.

Operations & Maintenance Costs

Based on Perth Energy's, albeit brief, experience with its Kwinana Power Station, Infratil's view is that the O&M costs, though perhaps a little light, would appear reasonable. However, we note that insurance costs have again been omitted; these would be in the order of \$1m per annum.

WACC

We note that not all parameters are required to be reviewed annually. However, we feel it important to reiterate our previous position that generation capacity revenue does not have the same risk profile as regulated revenue earned by network businesses.

Stability of the MRCP

It is important to remember that the RCP is the only visible price for capacity available to investors and financiers. As such, year on year volatility in this price can undermine confidence in the allocation of capital to new capacity in the SWIS. Infratil therefore recommends that the IMO give thought to methods for smoothing the annual price (without blunting price signals). These might include a rolling, say, 3 year price or limiting the move (down) in price by, say, 5% from one year to the next.

² see Western Power report section 3.1, dot point 2.

I trust you find the above comments constructive. Please feel free to contact either myself or Roger Crawford should you wish to discuss the issues raised in this letter further, our contact details are as follows:

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Yours sincerely

for and on behalf of
Infratil Energy Australia Pty Ltd



Darryl S Flukes
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