



THIRTY-EIGHTH PARLIAMENT

REPORT 41

**STANDING COMMITTEE ON ESTIMATES AND
FINANCIAL OPERATIONS**

**INQUIRY INTO WESTERN POWER'S EVIDENCE:
AN INFORMED DEBATE?**

Presented by Hon Giz Watson MLC (Chair)

November 2012

STANDING COMMITTEE ON ESTIMATES AND FINANCIAL OPERATIONS

Date first appointed:

30 June 2005

Terms of Reference:

The following is an extract from Schedule 1 of the Legislative Council Standing Orders:

“2. Standing Committee on Estimates and Financial Operations

2.1 *An Estimates and Financial Operations Committee* is established.

2.2 The Committee consists of 5 Members, 3 of whom shall be non-government Members.

2.3 The functions of the Committee are to consider and report on –

- (a) the estimates of expenditure laid before the Council each year;
- (b) any matter relating to the financial administration of the State;
- (c) any bill or other matter relating to the foregoing functions referred by the House;
- (d) to consult regularly with the Auditor General and any person holding an office of a like character.”

Members as at the time of this inquiry:

Hon Giz Watson MLC (Chair)

Hon Philip Gardiner MLC (Deputy Chair)

Hon Brian Ellis MLC (substitute for Hon Liz Behjat MLC)

Hon Ljiljanna Ravlich MLC

Hon Ken Travers MLC

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EXECUTIVE SUMMARY, FINDINGS AND RECOMMENDATIONS

EXECUTIVE SUMMARY

- 1 The state of Western Power's wooden power pole network is a material public safety issue. The risk to the State arising from potential bushfires ignited by electrical faults was known in 2009. This risk remains present and is likely to continue over the AA3 period. There will be large social and economic consequences if the risk materialises.
- 2 The Standing Committee of Public Administration's Report "*Unassisted Failure*" dealt mainly with how the wooden power pole risk was managed by Western Power. This inquiry focussed on whether:
 - the Committee was misled regarding the financial aspects of managing this risk; and
 - Parliament understands Western Power's financial risks to the State.

Did the Minister mislead the Committee?

- 3 The Committee is of the view that the Minister for Energy's failure to advise the Committee of the proposed expenditure on wooden power poles was misleading.
- 4 A minority (Hon Brian Ellis, Hon Philip Gardiner) of the Committee accepts the Minister for Energy's subsequent acknowledgement that, in retrospect, it may have been appropriate to reveal more fully the level of risk and potential mitigation.
- 5 A majority of the Committee (Hon Giz Watson, Hon Ken Travers and Hon Ljiljanna Ravlich) believes that the Minister misled the Committee unknowingly because at the time he failed to understand the significance of the issues being raised.
- 6 Given a matter must be of sufficient seriousness to substantially obstruct the Committee in the performance of its functions, the Committee is of the view that this threshold has not been reached. Therefore, the Committee will not be taking any further action.
- 7 The Committee reminds the House that it expects that all Ministers, Parliamentary Secretaries, and Ministers representing other Ministers appearing before it to have been briefed on:
 - the Government's policy positions;
 - recent Questions that have been asked in Parliament regarding the portfolio;

- current issues of public interest; and
- current legislative and policy reforms under consideration by the Government.

Did Western Power mislead the Committee?

- 8 Western Power gave evidence to the Committee in Estimates Hearings during 2011. The accuracy of the evidence given was directly challenged on two occasions in *Unassisted Failure*.
- 9 The Committee sought an explanation from the relevant Western Power witness regarding the challenged evidence and it became apparent that the Estimates evidence given was misleading. However, the Committee is of the view that there was no intention to mislead the Committee by the witness and concluded it was not done knowingly.

Western Power's financial risks to the State

- 10 The disturbing aspect of this Inquiry was the extent to which the financial dimensions of mitigating Western Power's wooden power pole risk were known to the Government but not disclosed in the 2011/12 Budget Papers.
- 11 The Committee is of the view that:
- the public safety risks associated with Western Power's wooden power pole risk were understood by all key agencies prior to 20 April 2011;
 - the large costs associated with mitigating the wooden power pole risk had been estimated by Western Power with a degree of reliability before 20 April 2011; and
 - it was feasible to include in the 2011/12 budget papers spending risk disclosure details of the amounts proposed to be spent by Western Power for capital expenditure in its AA3 submission, with suitable qualifications as to any concerns about their accuracy.
- 12 Knowledge of these financial dimensions would have informed public debate not only of the need to rectify the condition of the network but also of a matter material to the 2011/12 budget papers regarding the out years level of the level of State debt.
- 13 When Treasury's position was challenged by the Committee, Treasury adopted an attitude dismissive of the Committee's concerns, indicating that in similar circumstances it would not change anything it had done. The Committee notes that ultimately what is included in the budget is a decision of Government.

- 14 The Committee is of the view that in failing to disclose relevant and material information in the 2011/12 Budget Papers it was misled.
- 15 The Committee views the current process for informing Parliament of infrastructure investment is unsatisfactory. The Committee notes the approach taken by the New South Wales Treasury which merits consideration.

Treasury Oversight of Western Power

- 16 Western Power is a company created under the *Electricity Corporations Act 2005*. It is not an agent of the State and it does not have the status, immunities and privileges of the State.
- 17 The Board of Western Power is its governing body and is to perform the functions, determine the policies and control the affairs of the corporation.
- 18 The Board of Directors have obligations imposed on them under the *Electricity Corporations Act 2005*. The Committee notes that Treasury and its officers are not subject to the *Corporations Act*.
- 19 Western Power's reliance upon Treasury for funding and its inability to control the prices, terms and conditions for the services it provides through the Access Agreement process indicates to the Committee that its Board is constrained in managing the business.
- 20 The Committee is of the view that given Treasury's involvement in the management of Western Power's business, it should arrange for a Treasury officer to be formally appointed as a Board member and accept the same responsibilities and liabilities as current Western Power directors.

CHAPTER ONE

BACKGROUND

- 1.1 This Inquiry was commenced as a result of the findings of the Standing Committee on Public Administration's *Unassisted Failure*¹ Report. The implications of the findings in *Unassisted Failure* that:

*Western Power may have either intentionally, or inadvertently, provided misleading testimony in the course of the 2011 Legislative Council Estimates hearings by failing to advise that Committee of relevant detail that was known to Western Power and which, if known, would have materially altered the Committee's understanding of the relevant appropriations.*²

and later that:

*Western Power's Budget Papers do not disclose, either in a manner equivalent to the related disclosures of Horizon Power or in a manner commensurate with the state of knowledge held by Western Power itself, the full extent of the serviceability and safety challenges faced by Western Power with respect to its network wooden power poles.*³

- 1.2 The Committee made preliminary enquiries with Western Power to determine the veracity of the claims made in *Unassisted Failure*.
- 1.3 After considering additional material provided, the Committee resolved on XX September 2012 that:

further to the findings made by the Standing Committee on Public Administration's Report Number 14, Unassisted Failure, tabled on 20 January 2012, it will inquire into and report to the Legislative Council on whether it was misled during the 2011/12 Budget Estimates hearing with Western Power with the following terms of reference –

- *whether the Committee was misled by the Minister for Energy or any other witness during the 2011/12 Budget Estimates hearings with Western Power on 27 June 2011;*

¹ Western Australia, Legislative Council, Standing Committee on Public Administration, Report 14, *Unassisted Failure*, January 2012 referred to hereafter as *Unassisted Failure*

² *Ibid*, para 7.60 p139.

³ *Ibid*, para 7.59 p139.

- *whether the 2011/12 Budget Papers sufficiently disclosed risks associated with Western Power's capital expenditure; and*
- *any other relevant matter.*

1.4 The Committee took evidence from the following parties:

- Mr Timothy Marney, Under Treasurer, Department of Treasury;
- Mr Anthony Kannis, Executive Director, Infrastructure and Finance, Department of Treasury;
- Mr Douglas Aberle, former Managing Director of Western Power; and
- Hon Peter Collier MLC, Minister for Energy.

Access Agreements and the Economic Regulation Authority

1.5 Western Power is licensed under the *Electricity Industry Act 2004* to operate the South West Interconnected Network (SWIN).

1.6 The *Electricity Networks Access Code* ("Access Code") is established under the *Electricity Industry Act 2004*. The Access Code details the framework for the regulation of electricity networks in Western Australia by the Economic Regulation Authority ("ERA"). The Access Code's regulatory mechanism is an Access Arrangement, which is described as

... the main agreement negotiated between the Economic Regulation Authority (ERA) and Western Power. It describes the terms and conditions for obtaining access to the Western Power Network. Generally, it is electricity retailers and generators such as Synergy and Verve Energy (see electricity industry players) who apply to gain access to the network, so that they can transport electricity to customers.⁴

1.7 Access Arrangement 3 ("AA3") is the agreement that runs from the five year period between 1 July 2012 and 30 June 2017. AA3 outlines the services to be provided to the public, the standards they are to be provided to and the revenue to be generated for those services. These revenue decisions directly affect how much profit Western Power can make from providing electricity distribution services. The level of profit that Western Power earns directly affects the State budget through the dividends and tax equivalent payments that Western Power makes to the Government.

⁴ <http://www.westernpower.com.au/aboutus/accessArrangement/accessArrangement.html> viewed on 12 October 2012.

- 1.8 In order to make decisions regarding Western Power's revenue, the ERA assesses whether Western Power's expenditure is economically efficient. This requires it to assess operational expenditures but more importantly, capital expenditures. This means that Western Power is required to outline in the Access Arrangement authorization process its proposals for capital expenditure over the access period.

Key Western Power Funding risk

- 1.9 Western Power has two main routes for funding its capital investment program; retained profits and debt. Each of these is a policy decision of the Government of the day. Revenue which contributes to retained profits is derived from the electricity charges which the Government decides can be made as a result of the costs incurred by Verve (the power generator), Western Power (the power network operator) and Synergy (the power retailer and purchaser of power across the breadth of generators).
- 1.10 The level of debt required is similarly determined by the Government of the day. Historically, debt has been the main mechanism used to fund Western Power's capital investment program.⁵ As at 30 June 2012, Western Power's borrowings were \$5.47 billion and its leverage (borrowings to total assets) was 74.7%. This compares to the benchmark set out in the ERA's final report of 60%.
- 1.11 Western Power's ability to continue to use debt as a source of finance for its capital investment needs is constrained by the State's willingness to borrow.

⁵ This approach is commented upon in Budget Paper No. 3 2011/12 Budget, p 51

CHAPTER 2

EVIDENCE RECEIVED DURING THE 2011/12 ESTIMATES HEARINGS

- 2.1 In its report *Unassisted Failure*, the Standing Committee on Public Administration (SCPA), found that:

*Western Power may have either intentionally, or inadvertently, provided misleading testimony in the course of the 2011 Legislative Council Estimates hearings by failing to advise that Committee of relevant detail that was known to Western Power and which, if known, would have materially altered the Committee's understanding of the relevant appropriations.*⁶

- 2.2 In their report the SCPA highlighted two pieces of evidence that indicated this Committee may have been misled. This Committee then raised these matters directly with Western Power's former Managing Director and the Minister for Energy.
- 2.3 For the Committee to refer a matter to the Procedure and Privileges Committee it is required to establish two elements:
- 2.3.1 The evidence provided was misleading; and
- 2.3.2 The person providing the evidence did so knowingly.

Reference to the Privileges and Procedures Committee

- 2.4 In assessing whether a matter should be referred to the Standing Committee on Procedures and Privilege the Committee is obliged to assess:
- *whether the matter tended substantially to obstruct the Committee in the performance of their functions;*
 - *whether there was any other remedy available;*
 - *whether the act was committed knowingly; or*
 - *whether there was any reasonable excuse for the commission of the act.*⁷

⁶ *Ibid*, para 7.60 p139.

⁷ Legislative Council of Western Australia, *The Standing Orders of the Legislative Council*, Standing Order 93 and Schedule 4: Contempts of the Council

- 2.5 There is no definition of knowingly in the Legislative Council Standing Orders. The definition stated in the Macquarie dictionary includes “conscious; intentional; deliberate.”⁸

MINISTER FOR ENERGY’S EVIDENCE

- 2.6 The Estimates hearing evidence the Committee considered was given on 27 July 2011 as follows.

Hon LIZ BEHJAT: *In relation to the Toodyay disaster with the fire and poles, there was the 2008 audit which was referred to in Commerce at page 460 of the budget papers, but it is also referred to elsewhere. Can you give us an update on what is happening to the audit and the works that are being done so that we can be confident—as much as you can ever be confident when you have wood poles—that we are not likely to see another disaster like Toodyay happen?*

Hon PETER COLLIER: *When you have got wood poles, you are always going to have difficulty. They have well in excess of about 630 000 poles with Western Power, which is wood poles, which itself presents enormous challenges for the corporation. In June 2008 they had a pole maintenance backlog of around 73 000. That is now nil. They have done extremely well from that perspective. For the 2010–11 financial year to date, they have inspected over 120 000 poles. We will provide around \$177 million over the two-year period from 2010–11 to 2011–12 on pole replacement and reinforcement. Of that amount of \$177 million, \$79.5 million is additional funding. We have certainly made the investment. Western Power has brought down the pole maintenance inspection, which is very, very good in terms of the inspection backlog. That has now been reduced to nil, which is a positive step forward. As I said, when you have one of the largest above-ground networks in the world, it brings with it special challenges and special problems. It is an ageing network. It is a network that has been, I have to say, neglected by successive governments over decades, but the fact that we have really injected so much money over the last couple of years, and the inspection backlog has been reduced to zero, is testament to Western Power.*

⁸ http://www.macquariedictionary.com.au/203.26.91.80@929FFC14495444/-/p/thes/article_display.html?type=title&first=1&mid=3&last=3¤t=1&result=1&DatabaseList=dictbigmac&fzy=1&query=knowingly&searchType=findrank (viewed on 21 November 2012.)

Background

- 2.7 The material provided to the Committee by Western Power provided some relevant history as to the Minister for Energy's awareness of the issues surrounding Western Power's wooden power pole issues.

Letter from the Minister of Commerce arising out of Unassisted Failure Hearings

- 2.8 In a letter dated 19 January 2011, the Minister for Commerce (the Minister who has oversight of EnergySafety) wrote to the Minister for Energy stating:

As you may be aware, in October 2010 EnergySafety appeared before the Standing Committee on Public Administration inquiry into Electricity Transmission and Distribution Management by Western Power and Horizon Power.

Questions raised by the committee canvassed EnergySafety's audit of 2005/06 and specifically referred to the progress of work towards the improvement of the wood pole network.⁹

- 2.9 The letter concluded by stating:

I believe it is necessary and timely that Western Power produce a realistic plan to address this issue, and I would be grateful if you could advise as to what progress has been made in development of such a plan.¹⁰

Minister of Energy's Response

- 2.10 The Minister for Energy responded by a letter dated February 2011 to the Minister for Commerce's letter stating that:

... Western Power is currently preparing its expenditure forecast for the next regulatory period (2012/13-2016/17) and I am advised it will seek sufficient funds to continue to mitigate the significant remaining community risk posed by the generally poor condition of the wood pole population.¹¹

- 2.11 The Minister for Energy agreed that his description of the "significant remaining community risk" in his letter was consistent with the ERA's description of the wooden power pole risk which states that:

⁹ Letter from Minister for Commerce, 19 January 2011.

¹⁰ *Ibid.*

¹¹ Letter from Minister for Energy, 25 February 2011, p2.

*The poor condition of its wood pole population poses a high risk for Western Power because of the risk to public safety from unassisted wood pole failures and the potential for such failures to start bush fires that cause extensive property damage.*¹²

2.12 The Minister for Energy also stated in his letter to the Minister for Commerce that:

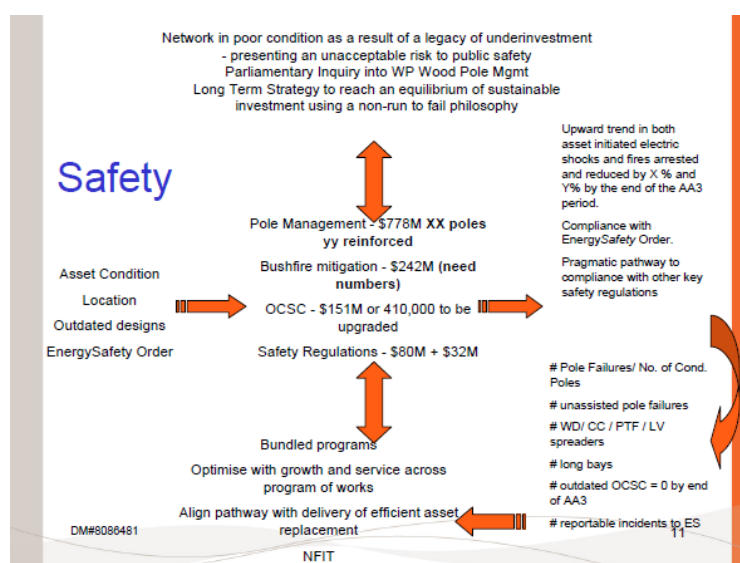
*...you would be aware that over 30% of the current wood pole population is over 40 years old. Immediately replacing this large number of poles would require the Government to inject a large increase in additional funding on top of that which I have outlined to you [in this letter].*¹³

Western Power's Presentation

2.13 A slide from a presentation was discussed with the Minister during the hearing of 17 September 2012. That slide is provided below:

Figure 1

Western Power Presentation AA3 Senior Executive Review 20 April 2011¹⁴



2.14 The Committee sought confirmation that this presentation was received by the Minister and was advised that:

¹² Economic Regulation Authority of WA, *Final Decision on Proposed Revisions to the Access Arrangement for the Western Power Network*, WA, 29 March 2012, p8.

¹³ Letter from Hon Peter Collier MLC, Minister for Energy, 25 Feb 2011, p3.

¹⁴ Western Power, *AA3 Senior Executive Review*, Safety slide dated 20 April 2011. The pdf document computer file was named *2011.3.29 AA3 Briefing for Minister (DM#8086481)*. The briefing was a PowerPoint presentation titled *AA3 Senior Executive Review 2011 dated 20 April 2011*.

The CHAIR: ... Did you receive this briefing on 20 April 2011?

Hon PETER COLLIER: It does look familiar. I cannot say that I received it on 20 April, but I can go back and have a look in my diary, if you like, and confirm that.

*[Supplementary Information No B10.]*¹⁵

2.15 The Minister for Energy responded:

Did the Minister receive this briefing (copy provided during the meeting) on 20 April 2011 from Western Power?

Answer: No

*A meeting with Western Power was held on 18 April 2011, at which the AA3 submission was discussed. The presentation provided to the Committee is not included in the official pack of papers for that meeting, however, it may have been provided as a handout. In any case, information provided at that time was not final and it was almost six months before Western Power's A3 submission was due.*¹⁶

2.16 The presentation slide indicates that \$1,283 million is proposed to be spent on safety related matters by Western Power across AA3. The Committee sought the Minister's views regarding this and was advised as follows:

CHAIR: What did you think when you saw this specific presentation, its expenditures and the comments regarding public safety?

Hon PETER COLLIER: I cannot recall what I thought. Again, this is 18 months ago. If I saw that, I would say—I can only speculate on what I might have thought—that is the fact that it is a significant capital spend, there are risk issues, and that will be taken into consideration in terms of government's decision on funding the network.¹⁷

The Minister for Energy's explanation

2.17 The Committee sought an explanation from the Minister for Energy regarding the discrepancy between his level of knowledge regarding wooden power poles and his

¹⁵ Hon Peter Collier MLC, Minister for Energy, *Transcript of Evidence*, 17 September 2012, p10, p10.

¹⁶ Letter from Hon Peter Collier, Minister for Energy, 12 October 2012, Supplementary Information B10.

¹⁷ Hon Peter Collier, Minister for Energy, *Transcript of Evidence*, 17 September 2012, p10-11.

evidence provided to the Committee during an Estimates hearing. That explanation is outlined below.

***The CHAIR:** This, minister, is your response to a question from a committee member regarding what has been done with respect to the wooden poles during a hearing with our committee in June of this year. The evidence presented earlier indicates that you were aware of Western Power's proposals to invest substantial sums of money in rectification of the wooden power pole network through the AA3. Why did you not advise the committee and the public of Western Power's proposal to spend nearly \$700 million in the AA3 on wooden power poles?*

***Hon PETER COLLIER:** This was in June 2011. This goes way back, so at that stage you are still talking about a proposal and the access agreement. That was in the very early stages. We still have a way to go before we get to the point whereby that proposal is in a formal document that goes to the ERA for consideration. So, as I said, at that stage I think it probably would have been inappropriate to provide that sort of information. That is really just a proposal to the regulator. We have still got a long way to go yet before the AA3 is finalised, and so we are still not there even yet, which is getting towards the end of 2012.*

***The CHAIR:** I guess from the committee's perspective I suppose it might feel that it was relevant information that would have enhanced our understanding of the situation and the public understanding of what was being done with regard to the level of risk and the potential mitigation.*

***Hon PETER COLLIER:** Yes, look, I understand that, and I appreciate that, having said that, as I said, certainly the fact that it was so early in the piece as far as the access agreement is concerned and the determination of the access agreement is concerned. I think it was probably a little early in the piece. Having said that, **the estimates committee is the perfect opportunity to provide full transparent disclosure, and in retrospect it may have been appropriate.** [emphasis added]¹⁸*

Did the Minister mislead the Committee?

- 2.18 The Committee is of the view that the Minister for Energy's failure to advise the Committee of the proposed expenditure on wooden power poles was misleading.

¹⁸

Hon Peter Collier, Minister for Energy, *Transcript of Evidence*, 17 September 2012, p13.

- 2.19 A minority (Hon Brian Ellis, Hon Philip Gardiner) of the Committee accepts the Minister for Energy's subsequent acknowledgement that, in retrospect, it may have been appropriate to reveal more fully the level of risk and potential mitigation.
- 2.20 A majority of the Committee (Hon Giz Watson, Hon Ken Travers and Hon Ljiljanna Ravlich) believes that the Minister misled the Committee unknowingly because at the time he failed to understand the significance of the issues being raised.
- 2.21 Given a matter must be of sufficient seriousness to substantially obstruct the Committee in the performance of its functions, the Committee is of the view that this threshold has not been reached. Therefore, the Committee will not be taking any further action.
- 2.22 The Committee reminds the House that it expects that all Ministers, Parliamentary Secretaries, and Ministers representing other Ministers appearing before it have been briefed on:
- the Government's policy positions;
 - recent Questions that have been asked in Parliament regarding the portfolio;
 - current issues of public interest; and
 - current legislative and policy reforms under consideration by the Government.

WESTERN POWER'S EVIDENCE

- 2.23 *Unassisted Failure* indicated that there were two occasions where evidence provided to the Committee may have been misleading. One occasion related to the impact of lost power poles, the other in relation to funding wooden power poles.

Lost Power Poles

- 2.24 The original evidence given during the Estimates hearing is detailed below:

Hon PETER COLLIER: ... As I said, when you have one of the largest above-ground networks in the world, it brings with it special challenges and special problems. It is an ageing network. It is a network that has been, I have to say, neglected by successive governments over decades, but the fact that we have really injected so much money over the last couple of years, and the inspection backlog has been reduced to zero, is testament to Western Power.

Mr Aberle: If I could just for clarity point out that the backlog is down at the functional minimum, which is not zero—there is always between zero and 1 000 waiting to be done because you do not go out

*and do one pole at a time—but sitting at that level is tantamount to nil. For absolute clarity, there is always a small population programmed to be inspected in the immediate weeks.*¹⁹

2.25 Paragraph 7.54 of *Unassisted Failure* states that:

*... if the Managing Director had genuinely sought to provide “absolute clarity” about this matter, he might have included the qualification that was acknowledged in evidence before this Committee on Wednesday, 9 November 2011; namely that 0.7% of the wooden power pole asset base (well over 4,000 poles) had an unknown location...*²⁰

2.26 The Committee sought an explanation from Mr Aberle regarding the failure to mention the lost 4,000 power poles, which follows:

The CHAIR: ... At the time you made this clarification, were you aware of the lost power poles referred to in “Unassisted Failure” report?

Mr Aberle: Technically, they are not lost. What that was referring to is that of the total, 4 000 were not in the database, but they were poles that were clearly in the network and that we would deal with as we came upon them. So, to suggest that they had simply evaporated, or were lost, is not technically correct. And it is a very small percentage of the 600 000, so our view was that as we went through the process of continuing to inspect as we came upon those, they would simply be swept up into the database, and of course they are then inspected as we got there anyway, even if they were not on the database. So, to me, that was really a side issue.

The CHAIR: Would you agree that without clarification, this statement may have been misleading for the committee?

Mr Aberle: Well, it certainly was not intended to be. As I said, the actual—what impelled me to say something was to make clear that it was not actually sitting at zero. To be honest, I did not even think of that issue, because I saw it as quite a minor database-cleansing issue. For context, we had been through a substantial exercise of database and data cleansing and uplift over the past couple years, so to have a relatively small number that had not made it into the database but

¹⁹ Hon Peter Collier MLC, Minister for Energy, *Transcript of Evidence*, 27 June 2011, p7.

²⁰ Western Australia, Legislative Council, Standing Committee on Public Administration, *Unassisted Failure*, Report 14, p136. Para 7.54

*were nevertheless there and of course dealt with as they were come upon, did not, in practical terms, strike me as a major exposure. I know that something was made of that in the previous inquiry, but the practical reality was that it was not as if there was some major haemorrhaging gap. The first answer is: it did not occur to me in the moment as we were going through responding. I did not even think of it. But as you present the opportunity to me now, the reason they did not was that I saw them in that context. They were the last part of a long clean-up and because they would not simply have been ignored. They were generally stay poles as I recall. It has been a little while now. The scenario most likely, as I recall it, would be that people would go out to a pole on the database and find there was a stay pole attached to it that was not recorded. They would naturally look at that as part of that process and, of course, put it up and put it into the database as they went along. In that context, I did not see the 4 000 as a major issue. To come back to what was happening in that moment, no that did not occur to me and my interest was in making sure that the answer about zero was not misleading.*²¹

Committee Comment

- 2.27 Mr Aberle's evidence confirms to the Committee that he misled the Committee during the estimates hearing on 27 June 2011. However, this act does not appear to have been done knowingly.
- 2.28 Therefore, the Committee will not be referring the matter to the Procedures and Privileges Committee.

Wooden Power Pole Replacement Capital Expenditure

- 2.29 The second allegation dealt with another clarification provided by Mr Aberle in response to a question from a Member regarding funding wooden power pole expenditure.
- 2.30 The original exchange during the Estimates hearing is detailed below:

Hon KATE DOUST: *My question relates to the heading "New Works" on page 620. I note that under the line item for wood pole replacement and reinforcement and pole-top replacement, there is no allocation for the replacement of overhead customer connections, targeted reliability work and wood pole replacement and associated*

²¹ Mr Doug Aberle, Former Managing Director, Western Power, *Transcript of Evidence*, 17 September 2012, p2.

works after 2011–12. For each of these items, can you please tell me why there are no additional allocations?

...

Hon KATE DOUST: *No; it refers to new works.*

The DEPUTY CHAIR: *It is in the table about two-thirds of the way down under “New Works”.*

Mr Peacock: *That entire table and this particular section of the budget papers relates just to the budget paper provisions. Our full investment program is contained on pages 618 and 619. What you have looked at is simply a subset of that work. The full extent of the wood pole replacements in that asset category is included on page 619 within the distribution network spend.*

Hon KATE DOUST: *Is that under the heading “Distribution”?*

Mr Peacock: *Yes.*

Hon KATE DOUST: *Under “Customer-Driven”?*

Mr Peacock: *No.*

Hon KATE DOUST: *Sorry; it is the asset replacement.*

Mr Peacock: *That is correct.*

Hon KATE DOUST: *Okay; that is fine.*

Mr Aberle: *There is no provision in the out years. We do not anticipate needing one. We are expecting it to be funded.*²²

2.31 Paragraph 7.58 of *Unassisted Failure* states that:

Western Power has subsequently provided the Committee with confidential documents that demonstrate clearly that, as early as May 2011, Western Power management had settled on hard figures, with respect to its proposed safety related expenditures for the AA3 period, prior to submitting those figures to the Western Power Board. These

²²

Mr Doug Aberle, Managing Director, Western Power, *Transcript of Evidence*, 27 June 2011, p18.

*hard figures do not vary materially from the figures included in the Media Release of 15 September 2011.*²³

- 2.32 Some of the material provided to the Public Administration Committee has also been provided to the Committee. Some of this evidence is discussed later in this report. The Committee sought an explanation from Mr Aberle, which follows:

The CHAIR: *I take you to this next overhead, which is from the same period, and page 18 of the transcript from that hearing. I do not know whether you want a minute to remind yourself of that particular exchange. I refer to the part at the end.*

Mr Aberle: *Yes; this was the confusion around the difference between provisions and line items. Yes, I recall. Mr Peacock went through and attempted to explain. Yes, I do recall that.*

The CHAIR: *Can you explain to the committee what you meant by the statement that is highlighted in red?*

Mr Aberle: *Once again, I threw that in. If you look at the transcript, there was a lot of pressure at that point to get some questions asked before time ran out. It was clear to me that there was some confusion about the difference between what is entered as line items and what are entered as provisions. With a lot more time, if I can take a moment now, provisions are items that are entered into the budget where money will be made available provided certain conditions are met. They are called out separately from the great bulk of the budget allocation. On page, I think 619, or the previous page, there were line items for “Customer Driven” and “Asset Replacement”—I cannot remember the details, but it was the normal breakdown—with quite substantial amounts of money in them. As I recall, the whole next page, which I think is 620, is dedicated to —*

The CHAIR: *Would that help?*

Mr Aberle: *Yes, that is very helpful, thank you. If you can duck back for a moment to 619, you will see there are line items under various headings. For example, under “Works in Progress” there is “New Capacity, Asset Replacement and Public Safety” and a series of line items entered there. That is distribution and under that there is “Transmission” with not dissimilar categories. You can see there that the magnitude of money under distribution, for example, on the fourth*

²³ Western Australia, Legislative Council, Standing Committee on Public Administration, *Unassisted Failure*, Report 14, p138 Para 7.58.

line down, “New Capacity, Asset Replacement and Public Safety”, is \$300 000-plus. That is the bulk of the allocation for all that work. On the next page, if we can jump to that, that was a subset of that work. You will see the figures are very much smaller in magnitude. They were provisional amounts that would be acceded to or agreed to by Treasury, provided certain conditions were met. The one in question here is the one under “Wood Pole Replacement and Reinforcement and Pole Top Replacement”, \$17.4 million, which very small compared with the figures on the other page. It was an additional amount that we had negotiated with Treasury on the basis that we wanted to continue to push and ramp up pole attention. They had said, “Okay, it is within what the regulators allowed under AA2, but we want to see a business case; we want some more convincing.” That meant you have to include it as a provisional on the basis that we could satisfactorily convince them. That is what that item is. You will see some others there around “Customer Access Works”. A really good one is the mid-west energy project. We knew there was a large line. It had taken a couple of years to even get that recognised and we can talk about the budget process versus the regulatory process in a minute if you are willing. Finally, we got to the point where Treasury had enough certainty to say, “Provided certain conditions are met, we will allow that expenditure.” You can see that it goes into not only a small amount in 2011–12 but then a lump in the out years. That is, again, conditional on certain things being met. You get small amounts of money in relative terms that are gathered up. They tend to apply in just the immediate short term, apart from big lines like that. And I did not really have the time to properly explain it, but the previous committee and even to some extent in the interrogation there, I thought there was confusion between what was a provision and what was actually in the out-year allocation. If we can jump back, driver, to page 619 you will see that the out years contain very substantial amounts of money under that heading. So, my comment was we did not have provisions in the out years because we did not expect to have to go through that process of begging more from Treasury. We were expecting large lumps to be included having passed through the regulatory process. So you only get provisions when you are trying to do a little extra thing. I hope I am being clear now, and I threw that in once again in the spirit of not being misleading so that people would get that there was a difference between the small amount for provisions and the already embedded amounts expected.

...

The CHAIR: *That explanation was very useful. I was just thinking that if we had that explanation back then, that would have probably saved us—*

Mr Aberle: *I appreciate you letting me do it because I was sort of bursting to, and I could see that is true. And as I projected myself back to the time of the hearing—*

The CHAIR: *You can understand why we were perhaps confused.*

Mr Aberle: *Yes, I can; I absolutely can. And hence my comment about it may be worth making a recommendation for next time, because once this is over, you will have four years of absolute rock solid—it will line up. But then it will happen again, and I think there are better ways to deal with it than just sort of crank through.*²⁴

Committee Comment

- 2.33 Mr Aberle's evidence confirms to the Committee that he misled the Committee during the estimates hearing on 27 June 2011. However, this act does not appear to have been done knowingly.
- 2.34 Therefore, the Committee will not be referring the matter to the Procedures and Privileges Committee.

²⁴ Mr Doug Aberle, Former Managing Director, Western Power, *Transcript of Evidence*, 17 September 2012, p3-5.

CHAPTER 3

BUDGET PAPER DISCLOSURE

- 3.1 In *Unassisted Failure*, the Public Administration Committee, found:

*that Western Power's Budget Papers do not disclose, either in a manner equivalent to the related disclosures of Horizon Power or in a manner commensurate with the state of knowledge held by Western Power itself, the full extent of the serviceability and safety challenges faced by Western Power with respect to its network wooden power poles.*²⁵

SPENDING RISK DISCLOSURE

- 3.2 The 2011/12 budget paper disclosure that the Committee focussed on is detailed below:

Western Power Capital Expenditure

*Western Power is required to provide its AA3 submission to the Economic Regulation Authority on 1 October 2011. This access arrangement will outline Western Power's capital investment over the period 2012-13 to 2016-17. Additional capital expenditure may be required to meet growth requirements in the network and undertake asset maintenance and replacement to mitigate safety, security and reliability issues.*²⁶

Budget Reporting Obligations

- 3.3 The reporting obligations with respect to budget spending risks can be found in the *Government Financial Responsibility Act 2000 (GFR Act)*. Section 12 of that Act deals with Government Financial Projections Statements.
- 3.4 Section 12(1) requires the Treasurer to release a Government Financial Projections Statement when the appropriate Bills and budget papers for a budget or supplementary budget are tabled in the Legislative Assembly.

²⁵ *Ibid*, para 7.59 p139.

²⁶ Government of Western Australia, *2011-12 Budget Economic and Fiscal Outlook Budget Paper No. 3*, Legislative Assembly of Western Australia, 19 May 2011, p67.

- 3.5 Section 12(2) mandates what is to be included in a Government Financial Projections Statement. Section 12(2) states that a Government Financial Projections Statement is to include, amongst other things:

*A statement of any risks, quantified as far as practicable, that could materially affect the financial projections, including particulars of any contingent liabilities and any government negotiations that have not been finalised.*²⁷

- 3.6 Section 12(2)(3) states that:

When preparing a Government Financial Projections Statement, the Under Treasurer is to take account of the following:

- a. The implications of all relevant decisions that were taken by the Government before the budget planning cut-off date and were known to the Under Treasurer on or before that date.*
- b. Any other information that could have a material effect on the financial projections and that was available to the Under Treasurer on or before the budget planning cut-off date.*

- 3.7 In interpreting Section 12, the Committee noted that under Section 3, nothing in the Act created rights or duties that are enforceable in judicial or other proceedings.

- 3.8 The Committee considers the key phrases in s12(2) relevant to its consideration of this matter to be:

- Quantified as far as practicable; and
- Materially affect the financial projections.

Quantified as far as practicable

- 3.9 Quantified is not defined in the GFR Act. It is not defined in the *Interpretation Act 1984*. This means that it is to be interpreted in accordance with its ordinary meaning. The definition of quantified is derived from the definition of quantify. That definition is:

*to determine the quantity of; measure*²⁸

²⁷ Section 12, *Government Financial Responsibility Act 2000*.

²⁸ http://www.macquariedictionary.com.au/203.26.91.80@929FFC14495444/-/p/thes/article_display.html?type=title&first=1&mid=4&last=4¤t=1&result=1&DatabaseList=dictbigmac&fzy=1&query=quantify&searchType=findrank. (accessed on 21 November 2012)

- 3.10 Practicable is not defined in the GFR Act. It is not defined in the Interpretation Act. This means that it is to be interpreted in accordance with its ordinary meaning. The definition of practicable is:

*capable of being put into practice, done, or effected, especially with the available means or with reason or prudence; feasible.*²⁹

- 3.11 The end result is that the Committee is of the view that the phrase “*quantified as far as practicable*” in s12(2) is to be interpreted to mean placing a dollar figure on a matter to the extent that is feasible to do so.

Materiality Defined

- 3.12 The Committee interpreted the materiality requirement in s12(2) as the reporting hurdle. That is, unless a matter is material, it does not need to be reported in the Statement of Financial Projections spending risks section.

- 3.13 The *Interpretation Act 1984* does not define materiality. However, Section 18 provides that:

In the interpretation of a provision of a written law, a construction that would promote the purpose or object underlying the written law (whether that purpose or object is expressly stated in the written law or not) shall be preferred to a construction that would not promote that purpose or object.

- 3.14 Section 19 of the *Interpretation Act 1984* permits the use of extrinsic material in interpreting the meaning of a provision of a law.

- 3.15 Section 3 states that one of the purposes of the GFR Act is to facilitate public scrutiny of government financial policy and performance. In this regard, section 8(1) of the GFR Act provides that:

Financial projections or financial reports released under this Act are to include projections or reports of the matters usually addressed in a general purpose financial report within the meaning of Australian Accounting Standard Board AASB 1049 Whole of Government and General Government Sector Financial Reporting.

- 3.16 Paragraph 5 of AASB 1049 Whole of Government and General Government Sector Financial Reporting states that:

²⁹ http://www.macquariedictionary.com.au/203.26.91.80@929FFC14495444/-/p/thes/article_display.html?type=title&first=1&mid=4&last=4¤t=1&result=1&DatabaseList=dictbigmac&fzy=1&query=practicable&searchType=findrank accessed on 21 November 2012.

*The requirements specified in this Standard apply where information resulting from their application is material in accordance with AASB 1031 Materiality.*³⁰

3.17 As a result, the Committee is of the view that it is reasonable to interpret the phrase in s12(2) “materially affect the financial projections” in a manner consistent with AASB 1031 Materiality.

3.18 Materiality is defined under AASB1031 as:

*Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.*³¹

3.19 The standard includes guidance on the quantitative and qualitative characteristics of material information. In general terms:

- (a) *an amount which is equal to or greater than 10 per cent of the appropriate base amount may be presumed to be material unless there is evidence or convincing argument to the contrary; and*
- (b) *an amount which is equal to or less than 5 per cent of the appropriate base amount may be presumed not to be material unless there is evidence, or convincing argument, to the contrary.*³²

3.20 In interpreting the clause, the Committee adopted the accounting definition in assessing whether a risk would materially affect the financial projections.

MATERIALITY ASSESSMENT

3.21 The first issue for the Committee’s deliberation was whether the impact of Western Power’s proposed capital expenditure was material compared to the state’s finances. This materiality assessment requires consideration from two perspectives:

- The public safety risk to the State arising from the wooden power pole network; and

³⁰ Australian Accounting Standards Board, AASB 1049 *Whole of Government and General Government Sector Financial Reporting*, December 2011, p11.

³¹ Australian Accounting Standards Board, AASB 1031 *Materiality*, December 2009, Appendix 1.

³² *Ibid*, p10, para 15.

- The risk to the State's finances arising from Western Power's capital investment requirements.

The Public Safety Risk

Black Saturday Bushfires

- 3.22 In January and February 2009 there was a series of bushfires in Victoria. The culmination of these fires came on 7 February 2009 when a series of catastrophic bushfires engulfed a number of areas resulting in a large number of deaths.
- 3.23 The Royal Commission comments on the risks associated with an aging network are provided below:

*Victoria's electricity assets are ageing, and the age of the assets contributed to three of the electricity-caused fires on 7 February 2009—the Kilmore East, Coleraine and Horsham fires. As components of the distribution network age and approach the end of their engineering life, there will probably be an increase in the number of fires resulting from asset failures unless urgent preventive steps are taken.*³³

Balingup Bushfire

- 3.24 On 14 February 2009, a bush fire occurred near Balingup. The Department of Environment and Conservation (DEC) advised EnergySafety the next day that the bush fire appeared to have originated where a Western Power wooden power pole had fallen to the ground.
- 3.25 EnergySafety investigated the matter. EnergySafety concluded the power pole falling over was the cause of the fire.³⁴

Unassisted Failure Inquiry

- 3.26 On 15 September 2009, the Standing Committee on Public Administration commenced an inquiry into Electricity Transmission and Distribution Management by Western Power and Horizon Power.

Electricity Safety Regulator Remedial Order

- 3.27 Western Power has obligations under the *Electricity Act 1945* and *Electricity (Supply Standards and System Safety) Regulations 2001*. These obligations are overseen by

³³ http://www.royalcommission.vic.gov.au/Finaldocuments/summary/PF/VBRC_summary_PF.pdf, p12. accessed on 21 November 2012)

³⁴ EnergySafety, *Electrical Incident Report Power Pole Failure and Bushfire Balingup Western Australia, 14 February 2009*, April 2009.

EnergySafety which “*is responsible for the technical and safety regulation of all the electrical industry and most of the gas industry in Western Australia. This regulation includes the safety and energy efficiency of appliances and certain types of equipment.*”³⁵

- 3.28 EnergySafety undertook a regulatory compliance investigation in 2006 of Western Power’s wood pole management systems and found a substantial number of issues requiring attention. A follow up investigation was undertaken in 2008 with the report being finalised in May 2009.
- 3.29 EnergySafety’s concerns were such that it issued an Order dated 29 September 2009³⁶ requiring Western Power to undertake substantial remedial actions with respect to its wood power pole network.

Toodyay Bushfire

- 3.30 On 29 December 2009, there was a significant bushfire at Toodyay. EnergySafety’s final report was issued on 10 August 2010 and concluded that a power pole falling was the cause of the fire.³⁷

The Final Word – Wooden Power Pole Safety Risk

- 3.31 The Committee summarised the time frames of actions in a PowerPoint slide and sought comment from the Minister for Energy. The slide is included below.

Figure 2

Wooden Power Poles – Safety Risk

³⁵ EnergySafety, Department of Commerce, <<http://www.commerce.wa.gov.au/EnergySafety/>> accessed on 12 April 2012.

³⁶ EnergySafety Order 01-2009 issued under s18B of the *Energy Coordination Act 2009* addressed to Western Power dated 29 September 2009 <http://www.commerce.wa.gov.au/EnergySafety/PDF/Misc/WesternPower_order.pdf> viewed on 5 October 2012

³⁷ EnergySafety, *Final Electrical Incident Report Bushfire Near River and Folewood Roads Toodyay Western Australia 29 December 2009*, 10 August 2010.

Wooden Power Poles – Safety Risk

Date	Event
November 2006	EnergySafety Western Power Compliance Audit Report Released
2008	EnergySafety Distribution Wood Pole Review commenced
7 February 2009	Victorian 'Black Saturday' Bushfires
14 February 2009	Balingup Bushfire
April 2009	EnergySafety Electrical Incident Report Power Pole Failure and Bush Fire Balingup Western Australia 14 February 2009
May 2009	EnergySafety Distribution Wood Pole Review Report released
29 September 2009	EnergySafety issue Western Power with an Order
29 December 2009	Toodyay Bush Fire
July 2010	Victorian 'Black Saturday' Bushfires Royal Commission Report released
10 August 2010	EnergySafety Final Electrical Incident Report Bushfire Near River and Folewood Roads Toodyay Western Australia 29 December 2009

13

3.32 The evidence given by the Minister follows:

***The CHAIR:** Okay. This summarises the history of the EnergySafety's reviews of the wooden power poles, the bushfires that are attributable to wooden power poles and also the Victorian Black Saturday bushfire. Do you agree that the timeframes and the ministerial correspondence and the Horizon investment decision indicated that prior to 20 April 2011 the government and all its key agencies, such as Treasury, could reasonably be expected to be aware of the substantial public safety risk arising from the state of Western Australia's wooden power pole network?*

***Hon PETER COLLIER:** There is certainly sufficient information that has been provided by EnergySafety to identify deficiencies within the network. I have said that consistently.*

***The CHAIR:** Prior to April 2011?*

***Hon PETER COLLIER:** Yes.*

***Hon LJILJANNA RAVLICH:** Minister, can you just outline what some of those deficiencies are?*

*Hon PETER COLLIER: As I said, certainly as far as the network is concerned in the SWIS it is an ageing network. A number of these polls are decades old. It keeps on saying about 630 [sic 630,000] distribution poles. That in itself presents an enormous problem for government and an enormous problem for Western Power and the network as a whole.*³⁸

Committee Comment

- 3.33 The weight of publicly available evidence leads the Committee to conclude that it is not credible for any other Government agency to claim that it was unaware of the risks associated with the age of Western Power's wooden power poles prior to 20 April 2011.
- 3.34 Omission of any reference regarding that expenditure to mitigate the risk could reasonably be expected to influence the Committee's view of a need to expend public monies on rectification of the wooden power pole network.
- 3.35 In the view of the Committee, information regarding proposed expenditure on Western Power's wooden power poles was material to consideration of the 2011/12 budget estimates.

Risk to the State's Finances

Significance of borrowings to utilities

- 3.36 2011/12 Budget Paper Three states with respect to the State's debt levels that:

*Total public sector net debt is forecast to rise from an estimated \$13.4 billion at 30 June 2011 to \$22.4 billion by 30 June 2015. Rising net debt reflects significant infrastructure spending which is only partially funded by operating surpluses (with the balance largely funded by new borrowings).*³⁹

- 3.37 Net debt is explained as

*... the difference between liquid financial assets (including cash and cash equivalents, loans made by government instrumentalities and other liquid investments) and financial liabilities that attract a debt servicing cost.*⁴⁰

³⁸ Hon Peter Collier MLC, Minister for Energy, *Transcript of Evidence*, 17 September 2012, p10.

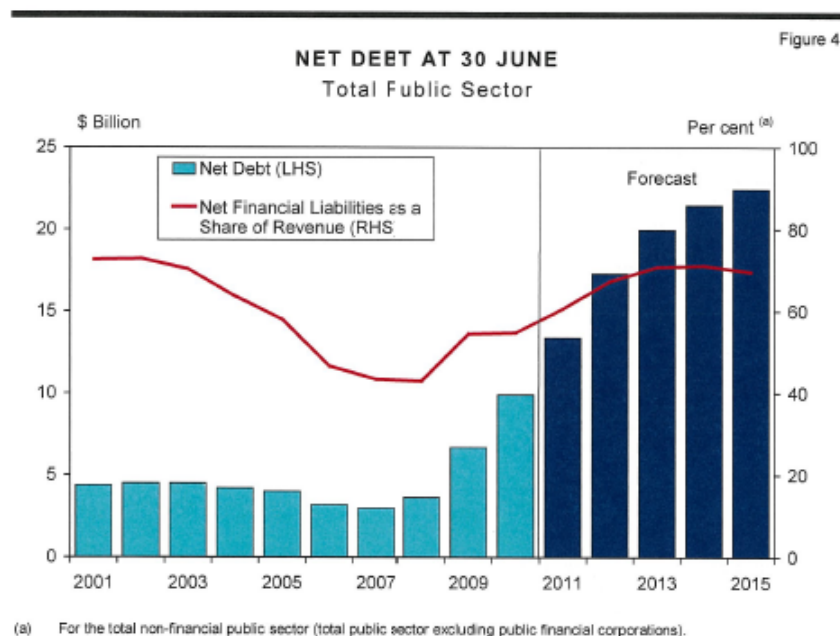
³⁹ Government of Western Australia, *2011-12 Budget Economic and Fiscal Outlook Budget Paper No. 3*, Legislative Assembly of Western Australia, 19 May 2011, p51.

⁴⁰ Government of Western Australia, *2011-12 Budget Economic and Fiscal Outlook Budget Paper No. 3*, Legislative Assembly of Western Australia, 19 May 2011, p51.

3.38 The budget papers include the following graph of net debt at 30 June.

Figure 3

Total Public Sector Net Debt as at 30 June



41

3.39 As can be seen over the period of the forward estimates, net debt is projected to rise substantially.

Treasury comments regarding debt levels

3.40 Debt levels were discussed with Treasury during a hearing relating to the inquiry as follows.

Hon LJILJANNA RAVLICH: *Were you at any time concerned about Western Power's impact on state net debt?*

Mr Marney: *I am not sure that there is ever a time that I am not concerned about that, because it is a large entity, and by virtue of its operations it is capital intensive, and it does have major impacts on the state's net debt position.*

Hon LJILJANNA RAVLICH: *Were you more concerned about Western Power than other agencies?*

Mr Marney: *Due to the materiality and the process around AA3 through 2011, yes, that was probably one of our top four, maybe, pressure points that was worrying us about net debt, so much so that*

*we flagged that, as you put in your presentation, on page 67 of the economic and financial overview as a risk issue for the state. But it was not one that we were able to quantify, so all we could do is qualitatively highlight that that was a risk and a concern.*⁴²

Western Power's Evidence regarding debt levels

- 3.41 The Committee sought the view of Western Power's managing director at the time the AA3 proposal was being considered by Treasury and was advised as follows:

The CHAIR: *So, did you discuss with Treasury the impact of the AA3 proposed investment on the state's finances?*

Mr Aberle: *Well, yes. We talked to them about taking what we were about to submit to the regulator to the EERC. It was a recognition that if the regulator were to sign off, the implication would be—the impact on the state finances—would be substantial. We would see an uplift in debt, effectively. From memory, it was about \$2 billion-odd more than the current projection.* [emphasis added] *I might be wrong, but it was material. And so we did acknowledge that and said, “Well, okay, but we can’t back away from our ever-sharpening analysis of what we think we need to do to minimise risk, and to cope with the growth that is still coming.” I get it that it is uncomfortable, but it has got to be called out. That is why we were having those kinds of conversations and why we wanted to go through that process.*⁴³

- 3.42 Western Power's Board met on 7 April 2011. A Board Paper titled *AA3 status update, key issues and items to be settled* was presented to the Board. The paper stated that:

The key financials at the end of AA3 (2016/17) include debt at \$10 billion, gearing at 83% and a total EBT of \$3.1 billion over the five-year period.

Importantly, under the current position there is a negative net impact to Government of \$2.4 billion (Western Power's debt requirement for AA3 of \$4.4 billion less Net Accruals to Government of \$2 billion).[emphasis added] *Comparatively under*

⁴² Mr Tim Marney, Under Treasurer, The Treasury, *Transcript of Evidence*, 10 September 2012, p5.

⁴³ Mr Doug Aberle, Former Managing Director, Western Power, *Transcript of Evidence*, 17 September 2012, p10.

the current approved SDP⁴⁴ forecast, Western Power's debt requirement is approximately equal to Net Accruals to Government.⁴⁵

Materiality assessment

- 3.43 The table below indicates that as at 20 April 2011 across all the years of the forward estimates, the net impact to government as stated by Western Power is material with respect to net debt of the total public sector.

Table 1

Comparison of forecast Total Public Sector Net Debt against Western Power's April 2011 assessment of AA3's Net Impact to the State

	2011 \$m	2012 \$m	2013 \$m	2014 \$m	2015 \$m
Net debt of the total public sector at 30 June	13,387	17,291	19,959	21,451	22,441
Net Impact to the State at the end of AA3 (30 June 2017)	2,400	2,400	2,400	2,400	2,400
Net Impact as a portion of Net Debt	17.9%	13.9%	12.02%	11.2%	10.7%

FEASIBILITY OF ASSIGNING A NUMBER

- 3.44 The key issue facing the Committee was whether it was possible for Treasury to provide a figure in the budget paper spending risks for Western Power's proposed level of capital expenditure as at 20 April 2011.
- 3.45 The 20 April 2011 date is significant as it is the budget cut-off date.

Western Power's November 2010 Preliminary Expenditure Forecasts

- 3.46 The documentation given to the Committee by Western Power indicates that the first signs of a projected capital expenditure forecast for the AA3 period can be found in a Board Submission dated 12 October 2010. This was considered by Western Power's Board on 2 November 2010. The relevant Board submission states that:

Forecasts are for information only and represent the information as at 15 October 2010. Note the forecasts are subject to ongoing assessments to ensure consistency and discipline in applying the MSCC [Must Should Could Contingent] framework. Therefore, they

⁴⁴ Strategic Development Plan

⁴⁵ Western Power Board Paper No.11.B05.045 (Meeting date 7 April 2011), AA3 status update, key issues and items to be settled, 24 March 2011, p6.

are presented as total forecasts highlighting the expenditure that is currently identified as contingent.

Figure 1 shows that the total preliminary forecast capital expenditure is about \$6.95b over the AA3 period.⁴⁶

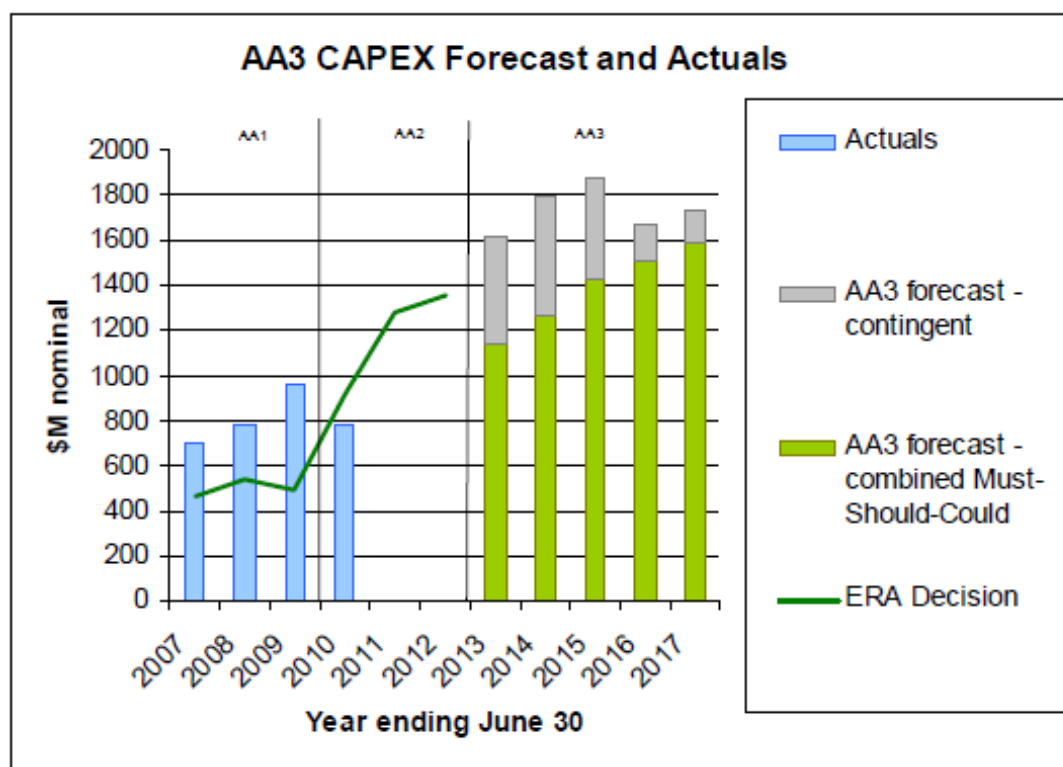


Figure 1: Western Power's total combined preliminary forecast and actual capital expenditure

Western Power Shares its Preliminary Estimate with Government

3.47 On 15 February 2011, Western Power's AA3 proposed expenditure forecasts were shared with Treasury, the Office of Energy and the Department of Premier and Cabinet. The presentation given by Western Power at this meeting is included in Annex One to this report. The Assistant Director, Energy Team Infrastructure, from the Department of Treasury and Finance attended this presentation.⁴⁷

3.48 The presentation included the following slide regarding safety related expenditure.

Figure 4

⁴⁶ Western Power Board Paper No.10.B17.196(ii) (Meeting date 2 November 2010), *AA3 Preliminary Expenditure Forecast*, 12 October 2010, p6.

⁴⁷ Letter from the Treasurer, 5 October 2012, Supplementary Information A1, p2.

Western Power Presentation AA3 Development Group dated 15 February 2011

Improve public safety to an acceptable level where practical over an appropriate time frame

Key programs	Proposed expenditure		
	AA3 (5y)	AA2 (3y)	AA1 (3y)
Wood pole replacement/reinforcement	\$724m	\$225m	\$103m
Bushfire mitigation (incl. Dx carrier replacement)	\$322m	\$126m	\$44m
Overhead service connections	\$151m	\$71m	\$38m
Total	\$1197m	\$422m	\$185m

Measure	Performance		Rationale
	End AA2	End AA3	
Asset initiated fire events	Increasing	Stable	15-20 year program to address root causes but do not expect this to reduce impact during AA3 due to increasing exposure to weather events and fuel – long term trend
No. of condemned poles	Increasing	Increasing	15-20 year program to bring the No. of condemned poles down consistent with replacement rate
Unassisted pole failures	Increasing	Decreasing	Condition based assessment aimed at targeting higher risk poles
Unassisted distribution wires down	Increasing	Decreasing	Completing program to focus on extreme and higher risk zones during AA3 to commence lower risk zones
Electric shocks	Decreasing	Stable	Continuation of targeted programs to address high likelihood events and conditions

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3.49 The table below summarises all the costs indicated in the presentation.

Table 2

Summary of Western Power's Preliminary Expenditure Forecasts - 15 February 2011 Presentation

	\$m
Wood pole replacement reinforcement	724
Bushfire mitigation (Incl. Dx carrier replacement)	322
Overhead service connections	151
Improve public safety to an acceptable level where practical over an appropriate time frame	1,197
Improve compliance with critical aspects of Technical Rules while meeting the challenge of continuing growth	3,857
Maintain compliance with other critical regulations	613
Maintain service levels (on average) with declining asset performance	923
Identifying areas of the network that are performing significantly below average service levels supported by the Government where not commercial	97
Facilitate Government policy initiatives	258 +
Total	6,945

3.50 The Committee took evidence from Mr Doug Aberle, the Managing Director of Western Power at the time. He stated that reason for this presentation was as follows:

The whole point of it was to bring a cluster of people in the government space along, in understanding what was actually being asked for preparatory to taking it to EERC; preparatory to taking it to the regulator.⁴⁸

- 3.51 Western Power's Executive Committee met on 17 February 2011. The Minutes regarding this meeting state that:

The initial engagement with DTF regarding Western Power's forecast AA3 expenditure levels and proposed funding amount took place on 15 February 2011. The feedback from those who attended was positive. There was limited push back on the safety expenditure and the arguments were received positively. The forecast expenditure for capacity expansion will be a challenge and will require careful explanation.⁴⁹

- 3.52 The Committee sought Treasury's comments as to how they responded to this presentation, which are detailed below.

The CHAIR: *I guess my question is particularly in relation to that top line, which is the "Wood pole replacement/reinforcement" line of figures there, which would indicate a pretty rapid increase in client expenditure or requested expenditure. What was the then Department of Treasury and Finance's response to this particular presentation?*

Mr Kannis: *We noted it only at this stage. We were not required at that point to give a response because the response would have been required much later when we were making recommendations when we were informing government of the expenditure levels. But at that point in time we would not have responded. We would have noted, we would have asked, as with all pieces of expenditure within the overall submission, because at this time we were considering working together to identify the investment requirements that would go in the AA3 submission.*

Mr Marney: *So this would have just been noted as information in draft form in preparation of a submission that was due about seven, eight months after that. So I would put it to you that it is an interesting table but not particularly relevant in terms of getting an accurate indication of what a robust business case was at that point in time.*

⁴⁸ Mr Doug Aberle, former Managing Director, Western Power, *Transcript of Evidence*, 17 September 2011, p6.

⁴⁹ Western Power Executive Committee, *Minutes*, 11.X04.62, 17 February 2011, p3.

Hon KEN TRAVERS: *I guess I am interested in whether you would have been then aware after that presentation of the sort of quantum we were talking about and the sorts of risk that are detailed in the second half of that document about what was required to stabilise or to deal with those risks. You were talking about a quantum of over \$700 million; I mean, do you recall those were the sorts of figures and the risks that were being discussed around that time in February of that period?*

Mr Kannis: *I have to admit I do not recall the numbers; I do not recall the exact numbers. We would have been encouraging Western Power at the time in providing its business case to identify risks and other issues that would go with their level of expenditure as proposed.*

Hon LJILJANNA RAVLICH: *Do you remember any of those risks?*

Mr Kannis: *Not off the top of my head, no.*

Mr Marney: *It is a broad time frame of consideration of these investment proposals and decisions. I think it is fair to say that we would have been made aware of the broad nature of risk on a number of occasions, but that would have changed on a number of occasions as well, both in terms of the degree of investment that Western Power was seeking and the associated risks of that degree of investment.⁵⁰*

Western Power Clarifies concerns with Treasury

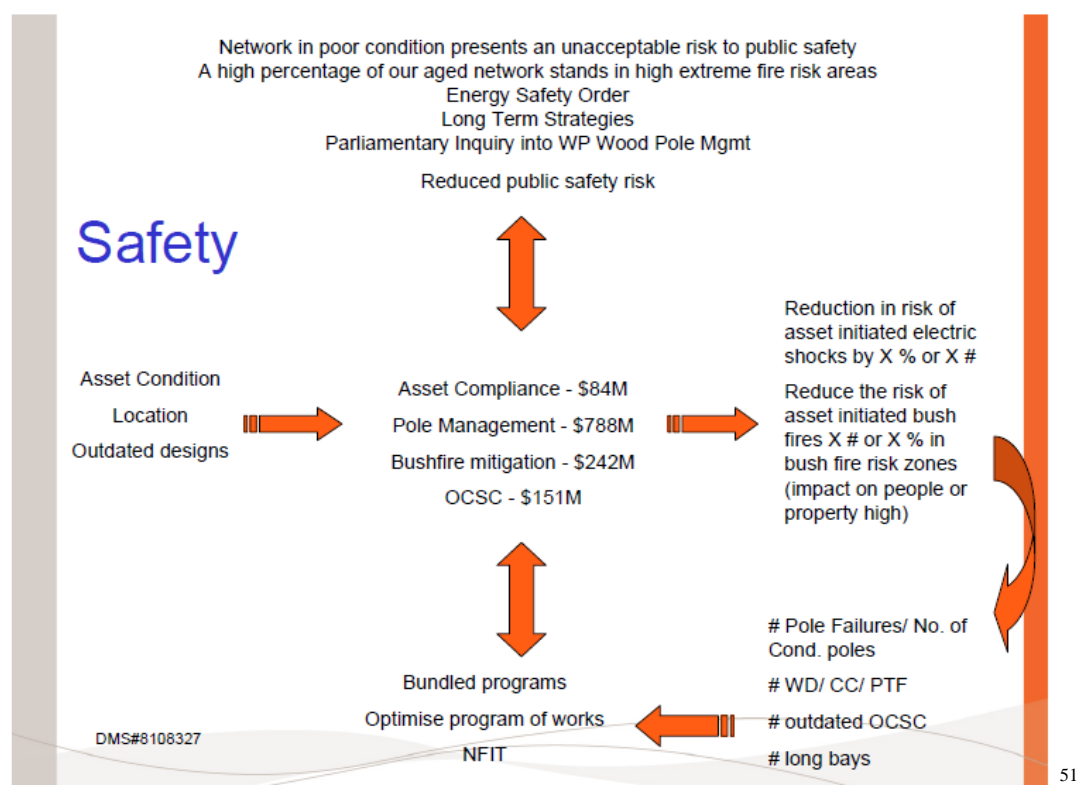
- 3.53 On 5 April 2011, Western Power made another presentation to the Department of Treasury titled *AA3 Proposed measures - Quantifying our targets and outcomes - DTF*.

⁵⁰ Mr Tim Marney, Under Treasurer, Mr Anthony Kannis, Executive Director, Department of Treasury, *Transcript of Evidence*, 10 September 2012, p2-3.

3.54 The presentation included the following slide.

Figure 5

Western Power Presentation AA3 Proposed measures Quantifying our targets and outcomes – DTF Safety slide dated 5 April 2011



3.55 The Department of Treasury confirmed that the Acting Director, Infrastructure, Assistant Director, Energy Team, Infrastructure and Principal Policy Analyst, Energy Team, Infrastructure were in attendance when this presentation was given.

3.56 . This second presentation does not include the costs information to the same detail and extent as the one given on 15 February 2011.

3.57 The following evidence was provided regarding this presentation.

Hon KEN TRAVERS: *You may not be able to answer this today: what would have been going on between that initial briefing on 15 February and this second briefing on 5 April? Maybe you can give it in broad terms and then maybe take it on notice to give more specifically what communications would have been occurring between Western Power and the Department of Treasury to quantify*

⁵¹ Western Power, AA3 Proposed measures Quantifying our targets and outcomes – DTF, Safety slide dated 5 April 2011

these figures. That is what we are talking about—you have to quantify what is the final figure you are going to require. What work would have been occurring between that February briefing and the April briefing?

Mr Marney: *We would have taken away the information from the February briefing, done some analysis internally ourselves, and probably formulated a series of questions to go back to Western Power for them to work on and come back and respond to. This could well be one such response. They would have taken our concerns, our comments, our queries, and continued to work on it, and then briefed us again.*

Mr Kannis: *There would have been a lot of informal toing and froing on this—information being requested et cetera. The purpose about the strong interaction was to get a better outcome at the end. There was strong interaction between Treasury officers and Western Power, which worked pretty well. The point was this was just one small step in a process that ended about August 2011. In terms of where do you get to the point of finalising numbers, the numbers would have been finalised when Western Power advised that they had got to the point where it was closest to their submission to the ERA. That is where they informed government of their final position. I assume there would have been some correspondence with EnergySafety as well; I am sure they had some contact.*

Hon KEN TRAVERS: *Maybe I could ask you to provide us with any written documentation that covers the exchanges that occurred between yourselves and Western Power at those meetings about these issues.*

Mr Marney: *We will take that on notice as supplementary A5, with the condition that we may be unable to provide it if it formed part of the deliberative process of cabinet. There might be some ERC kind of work, because during that period more than likely we would have been flagging some of these issues with ERC.*

*[Supplementary Information No A5.]*⁵²

3.58 The Treasurer responded to the Question Taken on Notice as follows:

⁵² Mr Tim Marney, Under Treasurer, Mr Anthony Kannis, Executive Director, Department of Treasury, *Transcript of Evidence*, 10 September 2012, p9-10.

*Please note that more time would be required to compile such documentation if it was able to be released. However, as the purpose of the documentation and modelling was to inform deliberation by the Economic and Expenditure Reform Committee, which is a sub-committee of Cabinet, I do not have the authority to release this information.*⁵³

- 3.59 The Committee accepts that the communications between Treasury and Western Power requested during the hearing may arguably be covered by Cabinet confidentiality. The Committee is concerned about the breath and ambit of the Government's claim as it would indicate that any public servant writing an e-mail to Western Power could be a cabinet related matter. However, the Committee will not be deterred from striving to access information relevant to the financial operations of the State. On the other hand, if this information was being used to inform Cabinet deliberations then it also follows that the significance of the sums being requested was a matter being considered at Cabinet level. That is, the Committee can reasonably conclude that Cabinet was aware of the magnitude of figures being bandied about for Western Power's proposed AA3 capital investment program during April 2011.

Western Power's Economic Expenditure Reform Committee Meeting

- 3.60 Western Power advised that it appeared before the EERC on 15 August 2011 regarding its AA3 proposal.⁵⁴
- 3.61 Western Power gave the Committee a Network Investment Proposal presentation which outlined its preferred investment option. Western Power's former Managing Director confirmed that the presentation was given to the EERC around mid-August 2011.⁵⁵
- 3.62 The Treasurer advised the Committee that the documentation "*was seen by officers of the Infrastructure and Finance Business Unit within Treasury. However it was not cited by the Under Treasurer.*"⁵⁶
- 3.63 The figure below is a slide from that presentation.

Figure 6

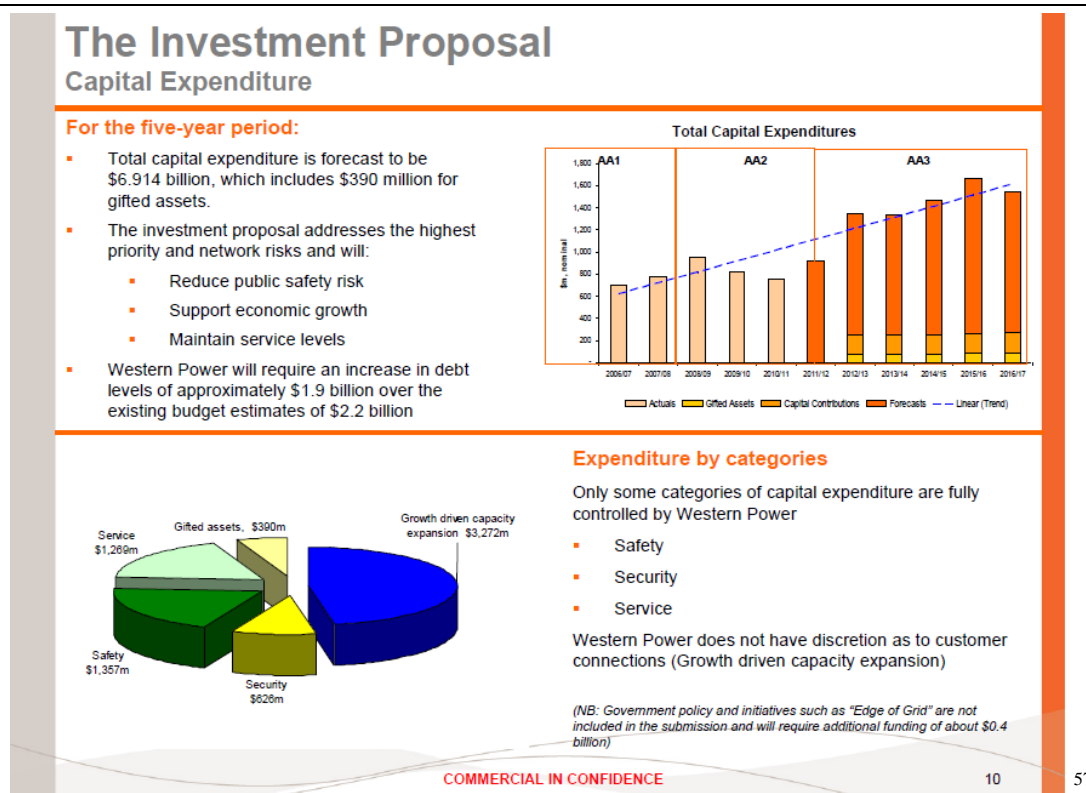
Western Power's Network Investment Proposal EERC Presentation

⁵³ Letter from Treasurer, 5 October 2012, Supplementary Information A5.

⁵⁴ Mr Doug Aberle, Former Managing Director, Western Power, *Transcript of Evidence*, 17 September 2012, p12.

⁵⁵ Mr Doug Aberle, former Managing Director, Western Power, *Transcript of Evidence*, 17 September 2011, p12.

⁵⁶ Letter from the Treasurer, 5 October 2012, Supplementary Information A8



Comparing the estimates

Western Power's November 2010 Preliminary Estimate to August 2011 Cabinet submission

- 3.64 The Committee notes that there is a variation of \$36 million or 0.52% between the initial \$6.95 billion estimate for capital expenditure provided to Western Power's Board in November 2010 and the EERC presentation total of \$6.914 billion (including gifted assets of \$390 million).

Western Power's February 2011 Preliminary Estimate Briefing to August 2011 Cabinet submission

- 3.65 The Committee notes that there was some variation in the proposal to spend for safety purposes. The initial estimate given to Treasury of \$1,197 million on 15 February 2011 has increased to \$1,357 million, a change of \$160 million or 13.4% by the time the Cabinet considered it.
- 3.66 Similarly, there is a variation of \$31 million or 0.45% downwards between the preliminary \$6.945 billion estimate given to Treasury on 15 February 2011 and the final sum provided to the EERC of \$6.914 billion (including gifted assets of \$390 million).

Committee Comment

- 3.67 The table below summarises these claims. As can be seen, the variances between the figures provided to Western Power's Board in 2010 for the total AA3 capital expenditure did not shift significantly between the February 2011 preliminary estimate and the EERC submission.

Table 3**Comparison of total capital expenditure proposals**

	2 Nov 2010 Western Power's Board Preliminary Estimate	15 Feb 2011 Western Power's Presentation Preliminary Estimate	15 August 2011 Western Power's Network Investment Proposal
Western Power's AA3 Total Capital Expenditure	\$6,950 million	\$6,945 million	\$6,914 million

WHY WAS A NUMBER NOT STATED FOR WESTERN POWER'S SPENDING RISKS?

- 3.68 The Committee sought guidance from Treasury as to why it did not include any figures with its disclosure and was advised as follows.

***The CHAIR:** Can you explain to the committee why you did not include an estimate of Western Power's proposed expenditure in budget paper No 3, risk disclosure?*

***Mr Marney:** Because at that point we did not know what the appropriate figure would have been to incorporate. Hence, we made a qualitative statement that it was a risk. So we disclosed a risk in a qualitative manner. The sum total of the risks associated with Western Power at that point was not known to me with a sufficient degree of validity to warrant publishing in a risk statement. I did not know how much it was with enough certainty to write it in.*

***Hon PHILIP GARDINER:** When did you feel that you were comfortable with the risk range? I do not want the last million dollars. I want to know whether there was a material increase in the risk to a certain range. When did you feel comfortable about that range?*

***Mr Kannis:** Technically, we are not comfortable until the ERA has made its final determination.⁵⁸*

⁵⁸ Mr Tim Marney, Under Treasurer and Mr Anthony Kallis, Executive Director, The Treasury, *Transcript of Evidence*, 10 September 2012, p17.

- 3.69 Western Power advised Treasury of its preliminary capital expenditure estimate on 15 February 2011. The draft AA3 regulatory decision was handed down by the ERA in March 2012, that is, 13 months later. The final decision was handed down by the ERA on 5 September 2012, 19 months later. However, there is still a chance final decision could be varied.
- 3.70 The reason for this approach is explained later as follows:

***Hon PHILIP GARDINER:** I would have thought it could have been also more transparent at your level, but if it is not going to be done at your level, and I can see how you can take it back to the minister has not signed off on it and all that kind of stuff and therefore it should not go in the budget papers—I can kind of understand that—*

***Mr Marney:** It is not that the minister has not signed off, because, as has been pointed out, these requirements are independent of the decision making of government. There have been issues that I have disclosed in risk statements and put a dollar to them that have not been considered by government where I have confidence in that figure. If I do not have confidence in a figure, I am not going to put it anywhere in the budget papers, **because it is going to mislead public debate.** [emphasis added]⁵⁹*

- 3.71 Treasury appears to have misunderstood its legal obligation. It is not Treasury's decision as to whether a figure is accurate that is relevant to complying with s12(2) of the GFR Act. The obligation is to quantify the risk as far as practicable and report it to Parliament.
- 3.72 When this issue was raised with Treasury the Committee was advised as follows:

***Hon KEN TRAVERS:** But you have an obligation to put forward the risk and quantify it as far as practicable. I just think that if you have got all those figures there and you do not give us some idea as a Parliament, that means that you can always get around it by saying, "Well, I couldn't quantify it." But you have fairly substantial information giving you the risk and the quantity of the financial management —*

***Mr Kannis:** I should clarify, substantial information at a very early point in the process—very early. In February we got information. The budget cut off is in early April. We would have had that a few weeks before we needed to actually assess the viability of those numbers.*

⁵⁹Mr Tim Marney, Under Treasurer, The Treasury, *Transcript of Evidence*, 10 September 2012, p21.

Mr Marney: *The bottom line is I did not have sufficient confidence in those numbers to warrant writing the number into the budget papers. That is it. I exercised my judgement in accordance with the act, and I would not do it any differently. The numbers were at such a formative stage that it would have been inappropriate and misleading to incorporate them in the risk statement in 2011.*⁶⁰

Committee Comment

- 3.73 The Committee reconfirms that it is Parliament's role to debate the State's finances and hold the Government of the day to account for its management of the State's finances and spending risks associated with them.
- 3.74 Further, the Committee is of the view that it is not possible for Parliament to determine whether the Government's budget papers reflect the current and future risks to the State's finances when material information is deliberately withheld from it.
- 3.75 In this case, not only was the risk arising from the aged state of the network by Treasury but it would also have known the reliability of the capital expenditure assessment required and its relevance in regard to the network condition. Western Power's figures remained fairly consistent over the review period. The individual components of the total package of expenditure did change by hundreds of millions of dollars but the final total figure was close to the preliminary estimate.
- 3.76 The Committee is of the view that it would have been possible to put an approximate figure on Western Power proposed capital expenditure for AA3 as at 20 April 2011. That figure was \$6.945 billion. That figure could also have been qualified with a statement that it could vary substantially and had not received Treasury or Cabinet consideration.
- 3.77 The Committee acknowledges the \$6.945 billion figure as at 15 February 2011 is an estimate. However, it is also close to the total request placed before the EERC in August 2011 of \$6.914 billion (including \$390 million for gifted assets).
- 3.78 The Committee was repeatedly advised that the figures were just in the formative stage and were estimates.⁶¹ The Committee accepts that this was the case and wishes to make clear that it is not suggesting that formative or estimated information is included in the current year of forward estimates. However, for the purposes of outlining future spending risks, these figures can be provided, with suitable qualification as to risk intended to be covered and their reliability.

⁶⁰ Mr Tim Marney, Under Treasurer, The Treasury, *Transcript of Evidence*, 10 September 2012, p20.

⁶¹ See Mr Tim Marney, Under Treasurer, Executive Director, The Treasury, *Transcript of Evidence*, 10 September 2012, p20 and Hon Peter Collier MLC, Minister for Energy, *Transcript of Evidence*, 17 September 2012, p12

Treasury's view as informing Parliament regarding Western Power's expenditure

- 3.79 The Committee sought to understand how Treasury interpreted its obligation under s12(2) and was advised as follows:

***Hon PHILIP GARDINER:** Are we saying that these words [referring section 12(2) of the GFR Act] do not have any meaning in terms of reporting to the public because that is the sense I am getting from what we are saying here?*

***Mr Marney:** They have significant gravity in terms of reporting to the public the financial position of the state. It relates to financial projections.*

***Mr Kannis:** The submission to the ERA was a public document. These words refer to the potential risk. However, if someone wanted to look at the financial risk potentially with this, they could have gone to Western Power's submission that would have been on the ERA's website.⁶²*

- 3.80 The underlying contention of Treasury's statement is; if Parliament wants to know what is happening regarding Western Power's finances, Parliament should source the information from the regulatory agency that approves the expenditure. If the Committee accepts this contention it would appear that the budget papers should not include as a spending risk:

- a preliminary estimate to spend between \$1.181 billion and \$1.36 billion to mitigate a significant public safety risk until some 13 months after Treasury was initially advised of the matter; and
- Western Power's preliminary estimate to spend approximately \$6,945m over a five year period until a final decision is made, 19 months after Treasury was initially advised of the matter.

- 3.81 The reason for this failure to provide information was Treasury's desire not to mislead public debate.

- 3.82 The Committee disagrees with Treasury's position regarding disclosure of this matter.

Treasury's Attitude

- 3.83 The following exchange between the Committee and Treasury is illuminating.

⁶² Mr Tim Marney, Under Treasurer and Mr Anthony Kallis, Executive Director, The Treasury, *Transcript of Evidence*, 10 September 2012, p18.

Hon PHILIP GARDINER: *No, taking it out of Treasury's hands. That there, in a way, if that was in Western Power's statement of corporate intent or whatever to identify the risk and quantify them, I think you are saying that is where we as the public should be seeing the extent of the risk that is applying to one of the government's agencies. Do I understand you?*

Mr Marney: *That is one mechanism, yes.*

Hon PHILIP GARDINER: *And if they had made representations to seek funds for borrowing, because they can only get funds as we discussed before, and that was not available to them, they should also make that point then in the annual report.*

Mr Marney: *That is up to them and their —*

Hon PHILIP GARDINER: *Yes, sure.*

Mr Marney: *— appetite for transparency and so on. But, ultimately, I did put a statement in the budget papers alerting Parliament that there was a risk in this area. Now, at some point, it becomes Parliament's responsibility to ask further questions around that.*

Hon PHILIP GARDINER: *Fortunately, we had a parliamentary committee to do so, and this is part of the result of that. So that is why a number of us—all of us, I think—are trying to get an improved position than we have had previously so the public can see it more transparently.*

Mr Marney: *So, in that respect, then, my disclosure of the risk has served its purpose—that is, you are debating the issue.*⁶³

Committee Comment

- 3.84 By Treasury failing to disclose full information in the budget papers, the Committee was limited in its ability to ask informed questions of the Minister for Energy and Minister representing the Treasurer during the estimates process.
- 3.85 In the view of the Committee, Treasury's attitude towards disclosure of this figure and the evidence it gave was dismissive of the Committee's concerns.

⁶³ Mr Tim Marney, Under Treasurer and Mr Anthony Kallis, Executive Director, The Treasury, *Transcript of Evidence*, 10 September 2012, p20-21

Other Examples of Budget Paper Disclosure

- 3.86 The Committee requested Treasury provide other examples of its approach to budget paper risk disclosure. One example included the 2012/13 Budget Paper No 3. disclosure regarding Western Power's spending risks, which stated that:

Electricity Utilities

*The Economic Regulation Authority is yet to finalise Western Power's Third Access Arrangement (AA3) and its Inquiry into the efficiency of Synergy's costs and electricity tariffs. As such there remains a significant risk that once these reviews are finalised there will be an additional impact on the State's finances. There is also a significant risk that as a result of these reviews there may a change to the cost-reflective line for electricity tariffs and Western Power's AIP [Asset Investment Program]. Depending on the outcome of these reviews, these risks are both of an upside and downside nature.*⁶⁴

- 3.87 The 2012/13 budget cut off date was 7 May 2012.
- 3.88 On 29 March 2012, the ERA released its Draft Decision on Western Power's Proposed Revised Access Arrangement for the Western Power Network. That decision outlined its comments regarding Western Power's proposed capital expenditure in the AA3 period.
- 3.89 The table below is an extract from the ERA's draft report.

Table 4
Comparison of total capital expenditure proposals

	Western Power Proposal \$m	ERA Draft Decision \$m
Present value of target reference service revenue	\$7,899.1	\$6,133.1
Capital Expenditure (real)	\$5,079.8	\$4,138.6
Operating Expenditure (real)	\$2,713.6	\$2,191.8
Forecast average network tariff increase on 1 July 2012	CPI + 16.4%	CPI - 1.0%

65

⁶⁴ Government of Western Australia, *2012-13 Budget Economic and Fiscal Outlook Budget Paper No. 3*, Legislative Assembly of Western Australia, 17 May 2012, p75

⁶⁵ Economic Regulation Authority, *Draft Decision on Proposed Revisions to the Access Arrangement for the Western Power Network*, Perth, 29 March 2012, p11.

- 3.90 The Committee notes that there was firm information available as at 7 May 2012 regarding the investment proposals that could have been provided to the Parliament through the budget papers. Yet the spending risks disclosure made no mention of the draft decision, or the sums the ERA proposed for capital expenditure and tariff charges. It did say that the outcomes “*could be positive and negative*”.

Budget Paper - Infrastructure Statements

- 3.91 The discussion outlined above indicates there is a fundamental problem with respect to informing Parliament of significant infrastructure investment. Any solution to the problem has to acknowledge the Government’s right to make executive decisions about infrastructure investment in a framework that also facilitates Parliamentary scrutiny.
- 3.92 The present mechanisms have failed. This is a situation that will recur without changing the system for informing Parliament regarding infrastructure expenditure.
- 3.93 In considering a solution, the Committee’s attention was drawn to the New South Wales Government’s budget papers, which includes an *Infrastructure Statement*. Similarly, the Victorian Government provides a budget paper titled *State Capital Program* which appears to do the same thing as the New South Wales Infrastructure Statement. The purpose and scope of New South Wales’s Infrastructure Statement are outlined below for the House’s consideration.

Purpose and Scope

Budget Paper No. 4 Infrastructure Statement provides information on the Government’s infrastructure investment program. The objectives of this Budget paper are to:

- *support transparency and accountability by reporting on planned capital expenditure from the previous Budget*
- *explain how resources have been allocated in the current Budget and the forward estimates for both the general government and public trading enterprise sectors*
- *explain how infrastructure investment supports the Government’s priorities and service delivery, including the underlying policies and strategies*
- *provide details of agency projects within clusters in the general government and public trading enterprise sectors.*

*This Budget Paper includes the infrastructure investment of agencies within the general government and public trading enterprise sectors. Budget Paper No. 2 Budget Statement, includes an overview of agency classifications by sector and a glossary.*⁶⁶

- 3.94 The Committee acknowledges that similar information is contained in the current Budget Papers No. 2 under the Asset Investment Plan. However, the Committee is of the view that explicitly detailing infrastructure related expenditure in a separate document in greater depth will facilitate public debate regarding infrastructure investment, maintenance and funding. This would also enable estimates of proposed future infrastructure expenditure to be detailed in full, along with statements of any concerns as to its accuracy.

⁶⁶ Government of New South Wales, *Budget paper No. 4 Infrastructure Statement 2012/13*, 12 June 2012, pi-ii.

CHAPTER 4

WESTERN POWER'S CAPITAL INVESTMENT NEEDS

- 4.1 Western Power has two significant issues that have become apparent to the Committee over the course of this inquiry. The first relates to borrowings, the second to its governance.

Borrowings

- 4.2 Western Power has two main routes for funding its capital investment program; retained profits and debt. Historically, debt has been the main mechanism used to fund Western Power's capital investment program.⁶⁷
- 4.3 Western Power's ability to continue to use debt as a source of finance for its capital investment needs is constrained by the State's willingness to borrow. This is because the current structures mean that Western Power can access the State's credit rating and borrow in its name. The reason why Western Power would use the State's credit rating is that the costs of borrowing in the State's name through the Western Australian Treasury Corporation (WATC) are substantially below AAA rated companies. Table 5 shows this difference.

Table 5

WA Government borrowing rates vs private sector borrowing rates (at 7 Nov 2011)

Term	WATC	AAA-rated companies	AA-rated companies	A-rated companies	BBB-rated companies
4 years	4.17%	4.81% to 6.86%	5.44% to 5.60%	5.50% to 8.20%	6.06% to 7.20%
9/10 years	4.65%	5.47% to 5.89%	6.57%	6.66%	7.14%

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Loan Guarantee Fee

- 4.4 The 2012/13 budget included an increase in the Loan Guarantee Fee. This is explained in the budget papers as follows:

The Western Australian Treasury Corporation (WATC) collects a Loan Guarantee fee (LGF) from selected agencies in exchange for a Government guarantee on financial liabilities incurred or assumed by

⁶⁷ This approach is commented upon in Budget Paper No. 3 2011/12 Budget, p51

⁶⁸ Western Australia, Legislative Assembly, Public Accounts Committee, Report 16, *Building Foundations for Value An analysis of the processes used to appoint Serco to provide non-clinical services at Fiona Stanley Hospital - Western Australia's largest ever services contract*, 21 June 2012, p127.

the WATC. The LGF is designed to expose GTEs to some of the risk-related cost of debt they would face if they were required to borrow at the market interest rate, and reduce the competitive advantage these agencies can access through a Government guarantee.

From 1 July 2012, the LGF will increase from 20 basis points to 70 basis points for existing and new borrowings of selected agencies.⁶⁹

- 4.5 .The effect of the loan guarantee fee is to increase the cost of borrowings for Government Trading Enterprises that use the State's credit rating to borrow to invest in their business.

Significance of Borrowings to Western Power

- 4.6 Western Power's 2010/11 Annual Report states that:

Western Power's domestic currency loans are all provided by the WATC. The financial liabilities incurred or assumed by the WATC are guaranteed by the Treasurer on behalf of the state.⁷⁰

- 4.7 Table 6 below outlines Western Power's borrowings as at 30 June 2011.

Table 6

Note 15 Western Power Borrowings

	2011 \$'000	2010 \$'000
Domestic currency loans (note (a))	4,967,293	4,630,209
Accrued interest	49,771	50,312
Total	5,017,064	4,680,521

- 4.8 Table 7 below outlines the significance of Domestic currency loans to Western Power by comparing the loans to its total assets. As can be seen Western Power is highly geared and the borrowings through the WATC are significant.

⁶⁹ Government of Western Australia, *2012-13 Budget Economic and Fiscal Outlook Budget Paper No. 3*, Legislative Assembly of Western Australia, 17 May 2012, p314.

⁷⁰ Western Power, *Annual Report 2011*, p108.

Table 7**Western Power Gearing ratios**

	2011 \$'000	2010 \$'000
Borrowings – Domestic Currency Loans	5,017,064	4,680,521
Total Assets	6,610,864	6,165,165
Gearing Ratio = Borrowings / Total Assets ⁷¹	76%	76%

Significance of Western Power's borrowings to the Western Australian Treasury Corporation (WATC)

4.9 The table below highlights that Western Power is a significant borrower from the WATC.

Table 8**Significance of Western Power's Borrowings to the WATC**

Face Value Net Debt Outstanding to WATC at 30 June 2012	2012 \$'000	2011 \$'000
Electricity Networks Corporation	5,426,241	4,957,883
Total Net Debt Outstanding	27,703,854	23,806,880
Western Power's borrowings as a % of Total Net Debt Outstanding	19.6%	20.8%

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Economic Regulation Authority Comments regarding Gearing

4.10 The ERA based its consideration of debt levels on a theoretical model of an economically efficient commercial electricity transmission business. The ERA's final report made some significant comments with respect to gearing where it stated that:

The benchmark gearing ratio for the purpose of calculating a WACC is considered to be the capital structure of a benchmark efficient utility business. The Authority assumes that the regulated business tends towards the benchmark gearing level in the long-run. As the optimal level of gearing is not directly observable, the 60/40 gearing

⁷¹ Gearing ratio is defined in the Final AA3 report as Total Debt/Total Assets in the *Economic Regulation Authority, Final Decision on Proposed Revisions to the Access Arrangement for the Western Power Network, Perth, 29 March 2012*, p 329

⁷² Western Australian Treasury Corporation, *Annual Report 2012*, p77.

level is derived from the average of actual gearing levels from a group of comparable firms. The actual proportion of debt and equity for each business is dynamic and depends on a number of business-specific factors.

...

*The Authority approves Western Power's proposal that the appropriate debt to total assets ratio (gearing level) is 60 per cent and the equity to total assets ratio is 40 per cent.*⁷³

- 4.11 The ERA has stated that the efficient gearing level is 60% (that is, debt/total assets). Western Power's current level of gearing is 76%. The 16% differential between an efficient operator and Western Power's actual level of gearing is approximately \$1.06 billion (16% of \$6,610,864).

Impact of Economic Regulation Authorities Draft Access Arrangement 3 Decision on Western Power

- 4.12 On 29 March 2012, the ERA handed down its draft decision regarding AA3. The table below highlights the significant divergence between what Western Power sought and what was approved.

Table 9

Comparison of Western Power's AA3 Proposal and Draft Decision

	Western Power Proposal	Draft Decision
Present value of target reference service revenue	\$7,899.1 million	\$6,133.1 million
Capital Expenditure previously disallowed as inefficient (real)	\$244 million	\$0
WACC	8.82%	4.73%
Capital Expenditure (real)	\$5,079.8 million	\$4,138.6 million
Operating Expenditure (real)	\$2,713.6 million	\$2,191.8 million
Present value of deferred revenue recovered	\$756.0 million	\$413.8 million
Forecast average network tariff increase on 1 July 2012	CPI + 16.4%	CPI - 1.0%
Forecast average network tariff increase on 1 July 2013	CPI + 11.1%	CPI - 0.7%
Forecast average network tariff increase on 1 July 2014	CPI + 11.2%	CPI - 0.4%
Forecast average network tariff increase on 1 July 2015	CPI + 11.4%	CPI - 0.1%

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⁷³ Economic Regulation Authority, *Final Decision on Proposed Revisions to the Access Arrangement for the Western Power Network*, Perth, 5 September 2012, p330.

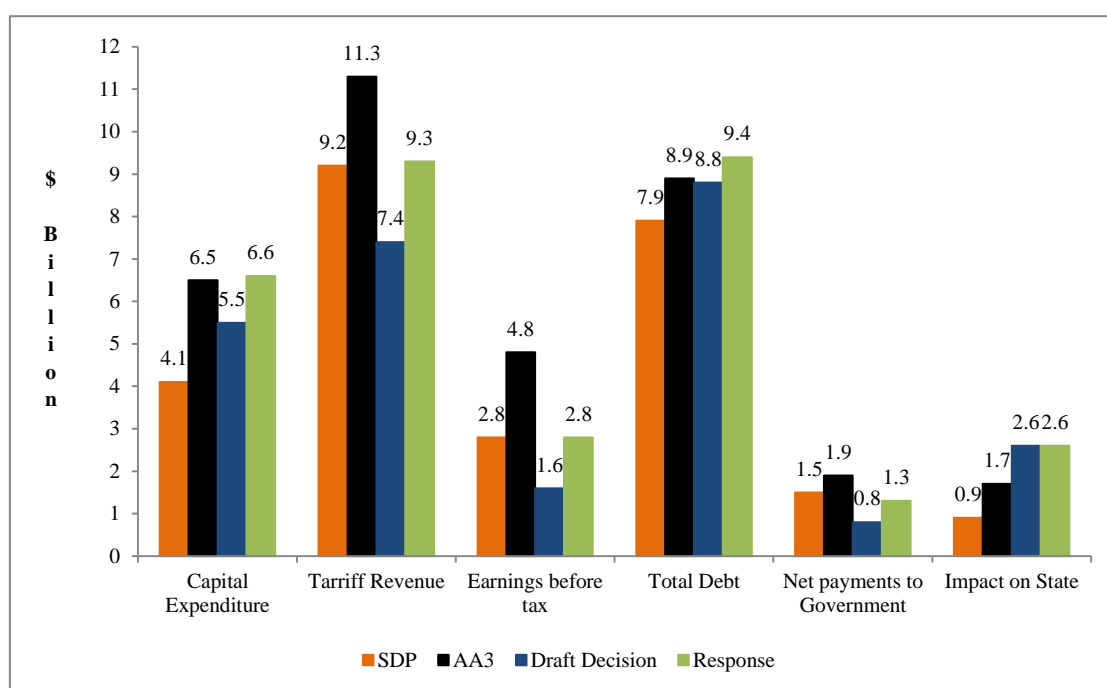
4.13 A Board Paper given to the Committee highlighted the debt issue where it stated:

Financial Implications

The financial implications of the draft decision and the proposed response are provided in the following chart (table 2). The baseline forecasts provided are the F2 forecast for 2011/12 and the draft SDP projections for 2012/13 to 2015/16, which have been approved by government. All values are nominal dollars.

The proposed response would result in an increase in forecast tariff revenue over the AA3 period of approximately \$1.8 billion compared to the draft SDP projections. This would result in a total forecast tariff revenue of approximately \$9.3 billion. Of this amount, approximately \$1.2 billion would flow through to increases in EBT, as reflected in the figure below.

[The graph below was recreated from the document as it would not copy over from the original]



The decline in EBT forecast by the ERA in its draft decision, would be reversed under the proposed response by Western Power, as the recommendations in this paper would result in an increasing price path that would provide sufficient revenue to meet the business's increasing interest costs. The additional cash-flow into the business

would be primarily utilised to fund the increased operating expenditure and the additional tax and dividend payments associated with the increased profitability.

Relative to the ERA's draft decision, the increased level of capital expenditure in the recommended response by Western Power would lead to higher debt levels over the AA3 period (an increase of \$538 million to \$9.4 billion). However, the higher debt levels and increased dividend and tax payments would result in a similar overall financial impact on Western Power's owner as the ERA's draft decision.

Management has conducted preliminary modelling to show the impact of the draft decision on the financial sustainability of Western Power over the next 15 years. The results show the deterioration in key financial ratios projected in the AA3 period continue over the subsequent 10 years. This is primarily attributable to a significant delay between when capital expenditure is incurred and the recovery of this investment through tariff revenue. The effect of this is to significantly reduce Western Power's return on capital employed. **Additional modelling shows that, by 2028, borrowings are projected to rise to over \$20 billion resulting in an annual interest cost of \$1.2 billion, and a gearing ratio averaging 87% over the AA5 period.** [emphasis added] This would expose Western Power to increasing interest rate and liquidity risks.

The increasing significance of Western Power's financial performance on the State budget means Western Power's financial performance also has an increasing affect on the credit rating of the State of Western Australia. Therefore it is imperative that Western Power strongly defends its position in respect of the key elements of AA3 outlined above and continue to educate all stakeholders on the future financial risk to the State.⁷⁵

- 4.14 Western Power's Minutes for the Board meeting held on 9 May 2012 made the following key points:

12.B16.114 Proposed response to ERA's draft decision on AA3

.... During the course of discussion, the following key points were made:

...

⁷⁵ Western Power Board Submission 12.B17.110 (Meeting dated 9 May 2012) *Proposed response to ERA draft decision and indicative outcomes*, 6 May 2012, p5-6.

- *The most significant impacts of the ERA's draft decision relate to WACC and forecast operating expenditure. The overall impact of the ERA's draft decision leaves Western Power in a position of non-compliance with various regulatory obligations, exposed to higher risk, without access to external capital and negative cash flow over the AA3 period.*
- *Management is confident that the proposed response represents an amount that is defensible on the basis that it is genuinely required to maintain safety and reliability standards and to meet expected growth. Management further recognises that there remains significant work to be done, especially from a government and stakeholder perspective.*
- *Management has already briefed the Minister and representatives of the Department of Treasury and the Public Utilities Office. The government intends to lodge a single submission representing the whole of government view on the ERA's draft decision. Representatives of the Department of Treasury views the weighted average cost of capital (WACC) as less of a concern for Western Power as a government trading enterprise (including the resultant 87% gearing ratio), but they accept that it would be a significant concern if Western Power was privately owned. The government also faces a conflict in terms of wanting to contain tariff increases.*
- *The Board noted that whilst ultimately it must accept any decision or direction by government in relation to funding, it is incumbent on Western Power to put forward a submission that seeks an amount that is reasonable and defensible. It was further noted that whilst the government may seek to keep tariff increases to a minimum, the people of Western Australia are entitled to expect, via the government, a reasonable return on investment. The government has other options to address its concerns, for example increasing the express community service obligations.*
- *Feedback from the Minister recognises that the Board needs to make a decision that is in the best interests of the business overall. The Board further confirmed that directors will be available to assist management as required in relation to stakeholder engagement.*

Capital expenditure

- *The proposed response seeks an increase in capital expenditure, a significant proportion of which relates to wood poles. Management is encouraging EnergySafety to publicly support the proposal to increase Western Power's wood pole investment. Management should also consider referencing findings in the Standing Committee's report to support Western Power's response.*
- *Whilst in its draft decision the ERA foreshadowed that Western Power should invest more in wood poles, it proposed that the investment adjustment mechanism (IAM) is used to keep Western Power whole. Management recognises the need to optimise the capital expenditure allowance up front due to the cash flow impact of deferring recovery of investment under the IAM.⁷⁶*

Committee Comment

- 4.15 Western Power's debt levels are substantially higher than those of what the ERA considers appropriate for an economically efficient provider of electricity transmission and distribution services. The future forecast outlined by Western Power is for a substantial expansion in debt funded capital expenditure in AA3. A substantial portion of that capital expenditure is to mitigate safety related issues that are a result of Government neglect over decades.
- 4.16 The most significant aspect of the Board paper is its prognosis for Western Power to have an increasing impact on the state and its debt levels, stating that such debt growth represents a financial risk to the State in the future.
- 4.17 This financial risk is not articulated in the 2011/12 Budget papers. The risk does not appear to be stated in any 2011/12 budget paper document with the same degree of clarity.
- 4.18 The Committee is of the view that these types of risks and forecasts are essential to understanding the current and future financial risks to the State. This information should be disclosed under budget reporting arrangements.

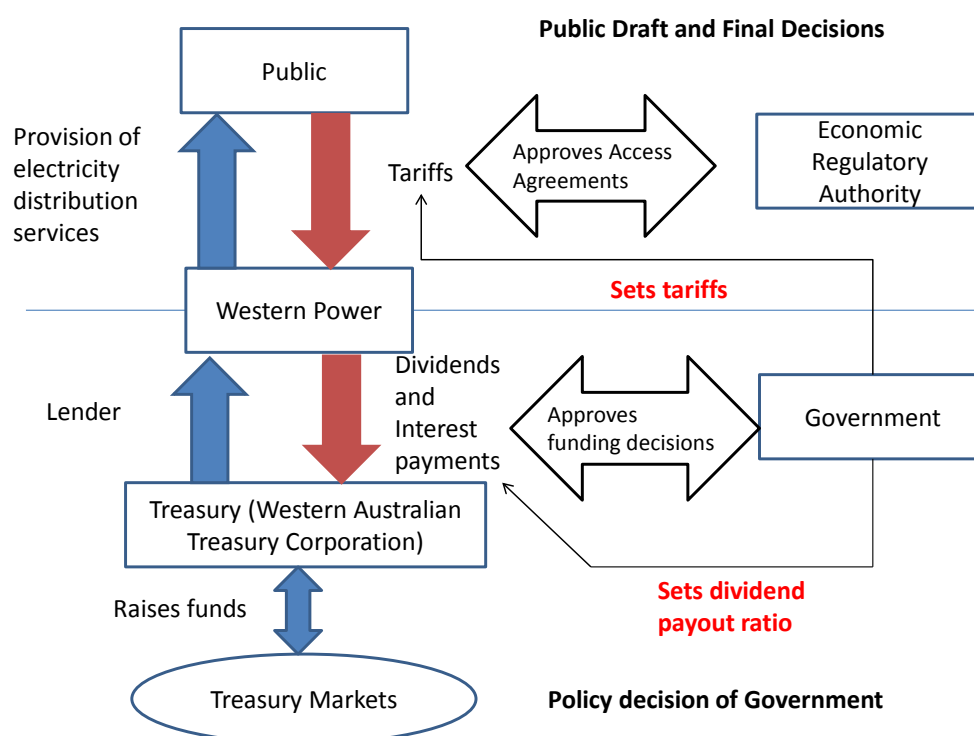
⁷⁶ Western Power Board, *Draft Minutes*, Item 12.B16.14, 9 May 2012, p1.

Western Power's Governance

4.19 The diagram below outlines the Committee's understanding of the roles and levels of decisions that need to be made with respect to considering Western Power's capital investment needs

Figure 7

Summary of key processes relating to Western Power's capital investment funding



Financing Western Power's Capital Investment Program

4.20 The process is in two steps; firstly, the level of capital expenditure needs to be approved; this step falls within the ambit of the Economic Regulation Authority. The second step is the extent to which Western Power's capital expenditure needs will be funded by the Government of the day. This is a policy decision of Government. It is important to note that these steps are independent of each other. That is the process of Access Agreement approval is separate from the process of seeking funding approval. However, the processes are intertwined as the final decision made by the ERA represents the funding commitment that Western Power will seek from the Government.

4.21 The key observation to make is that there is no obligation on the part of the Government to fund Western Power's capital expenditure needs as expressed in its AA3 documents.

Statement of Corporate Intent (SCI)

4.22 The Auditor General described Statements of Corporate Intent as follows:

... a form of annual agreement between government and those agencies which operate at arm's length from government. Agencies are required by their Act or regulations to draft the annual SCI for agreement with their Minister and the Treasurer. Once agreed, the Minister is to table the SCI in Parliament within 14 days. SCIs are therefore an important governance and accountability mechanism.

Tabling requirements vary slightly but generally they must be tabled either before the commencement of the financial year or by mid July, being early in the financial year to which they relate. Where the Minister has not agreed or the Treasurer has not concurred then the latest draft SCI takes effect. However, tabling of the SCI would not take place until full agreement is reached.

The contents of SCIs can vary with agency legislation but generally they include:

- outline of objectives and major planned achievements for the next financial year*
- nature and scope of functions proposed to be performed during that year*
- performance targets and other measures by which performance may be judged*
- outline of capital expenditure, proposed borrowings, pricing arrangements and dividend policy*
- accounting policies that apply to the preparation of financial statements*
- types of information to be given to the Minister, including periodic and annual reporting*
- nature and extent of community service obligations to be performed, costing and funding of these activities and any compensation arrangements*

- *other matters agreed on by the Minister and the board.*⁷⁷

- 4.23 During the 2012/13 Budget Estimates Hearings with Western Power on 3 August 2012, the Committee sought guidance as to why Western Power's 2012/13 Statement of Corporate Intent had not been tabled in Parliament.
- 4.24 The Committee was provided with a number of e-mails arising from that hearing from a Treasury officer. The contents of one of these e-mails contents is detailed below:

Friday, 27 July 2012 1:26 PM

Subject: RE: Response Required: RE: Fw: SCI and covering letter to the Minister

WP [Western Power] wording does not work because utilising the cash would result in an impact on State Finances, and it misses the whole point anyway.

Secondly, as you would be aware we have been struggling over the last few years to ensure that WP delivers its obligation in an efficient and innovative manner. There are two examples I can think of - one is the North Coast Line, where the review by the OOE [Office of Energy] and DTF [Department of Treasury and Finance] showed that WP was not applying innovative thinking to the solution, and secondly Grange whereby we had to twist WP's arm and get external legal advice to show that Grange could be fully funded by a private proponent with WP still having ownership. [emphasis added]

Thirdly, given the current situation with State Finances the Government is keen to ensure that everyone is contributing to ensure that the State is in a sustainable financial position -the efficiency dividend and the capital audit are examples of this. [emphasis added] *This is a key objective of the Government that needs to be understood by the corporations.*

Fourthly, WP hasn't been very consultative with us. As you are aware they have sent the SCI [Statement of Corporate Intent] to the Minister (twice now I think) without first seeking our views on amendments. All I am trying to do is solve the issue so the Min [Minister] could table the SCI, and in this regard I have put in significant effort to try and resolve the issue. I have also told [Western Power Officer] that if they are not happy with the words we can finesse the words further. I'm also happy not to concur.

⁷⁷

Auditor General of Western Australia, Report 10 - Audit Results Report Annual 2010-11 Assurance Audits, November 2010, p23-24.

.... We are not asking the Board in any way to bypass their responsibilities and obligations, we are simply asking them to be aware that the State is constrained financially (mainly due to the GST issue) and therefore they need to put in extra effort to be efficient and innovative. We are in no way saying that they somehow need to cut their works/capex program –just that they be efficient and innovative in delivering it, which will save money.⁷⁸

- 4.25 The significance of Treasury indicating that the Treasurer would not concur with a SCI is that it means that the SCI cannot be tabled in Parliament by the Minister for Energy. That is, Treasury's failure to concur means that Parliament is denied information regarding the operational targets and strategies of Western Power for the relevant financial year.

Committee Comment

- 4.26 Western Power is a company created under the *Electricity Corporations Act 2005*. It is not an agent of the State and it does not have the status, immunities and privileges of the State.⁷⁹
- 4.27 The Board of Western Power is its governing body and is to perform the functions, determine the policies and control the affairs of the corporation.⁸⁰
- 4.28 The principal functions of Western Power under its legislation includes to manage, plan, develop, expand, enhance, improve and reinforce electricity transmission and distribution systems and provide and improve electricity transmission and distribution services.⁸¹
- 4.29 The Board of Directors have obligations imposed on them under the *Electricity Corporations Act 2005* to:
- act honestly⁸²;
 - exercise reasonable care and diligence⁸³;
 - not to make improper use of information⁸⁴; and

⁷⁸ Letter from Hon Peter Collier MLC, Minister for Energy, 14 September 2012, Supplementary Information A9.

⁷⁹ Section 5, *Electricity Corporations Act 2005*

⁸⁰ Section 9, *Electricity Corporations Act 2005*.

⁸¹ Section 41, *Electricity Corporations Act 2005*

⁸² Clause 2, Schedule 2 *Electricity Corporations Act 2005*.

⁸³ Clause 3, Schedule 2 *Electricity Corporations Act 2005*.

⁸⁴ Clause 4, Schedule 2, *Electricity Corporations Act 2005*.

- not to make improper use of position.⁸⁵
- 4.30 As with all company directors, under the Corporations Act, a Director of Western Power has a fiduciary duty to the company.⁸⁶
- 4.31 The Committee notes that Treasury and its officers are not subject to the *Corporations Act*.
- 4.32 Western Power's reliance upon Treasury for funding and its inability to control the prices, terms and conditions for the services it provides through the Access Agreement process indicates to the Committee that its Board is constrained in managing the business. Nothing demonstrates the Board's concerns about these constraints more than the draft Board Minutes stating:
- The overall impact of the ERA's draft decision leaves Western Power in a position of non-compliance with various regulatory obligations, exposed to higher risk, without access to external capital and negative cash flow over the AA3 period.*⁸⁷
- 4.33 The Committee is of the view that given Treasury's involvement in the management of Western Power's business, it should arrange for a Treasury officer to be formally appointed as a Board member and accept the same responsibilities and liabilities as current Western Power directors.
- 4.34 The Committee notes that Western Power's 2012/13 Statement of Corporate Intent was tabled in Parliament on 25 October 2012.

G. Watson

Hon Giz Watson MLC

Chair
30 November 2012

⁸⁵ Clause 5, Schedule 2, *Electricity Corporations Act 2005*.

⁸⁶ Clause 6, Schedule 2, *Electricity Corporations Act 2005*.

⁸⁷ Western Power Board, *Draft Minutes*, Item 12.B16.14, 9 May 2012, p1.

APPENDIX 1

AA3 WORKING GROUP PRESENTATION OF 15 FEBRUARY 2011

APPENDIX 1

AA3 WORKING GROUP PRESENTATION OF 15 FEBRUARY 2011



AA3 Development Group

February 15 2011



DM#7947823

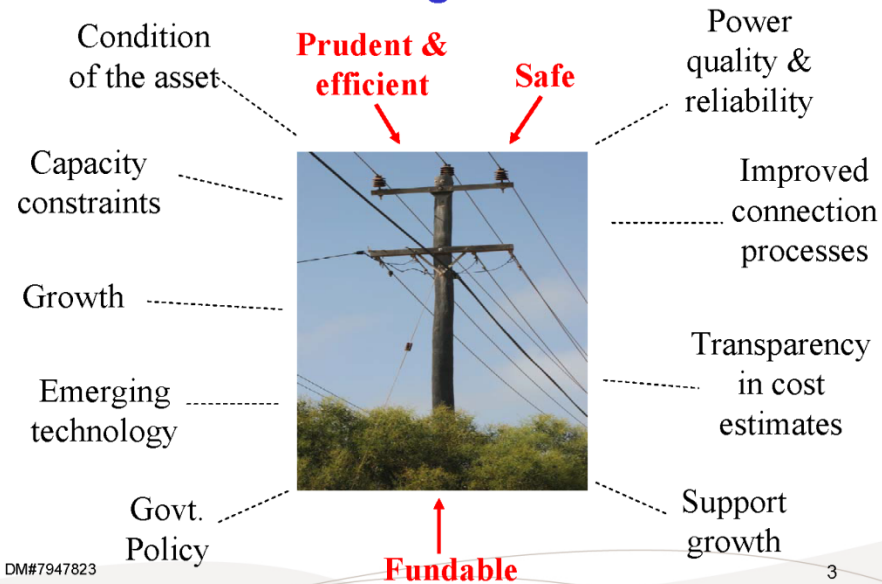
Objectives

1. Present the strategic story for WP for the AA3 period and beyond
2. Provide an overview of the measures of outcomes and performance during the period with a focus on safety
3. Present the expenditure against the categorisation identified for the Cabinet Submission

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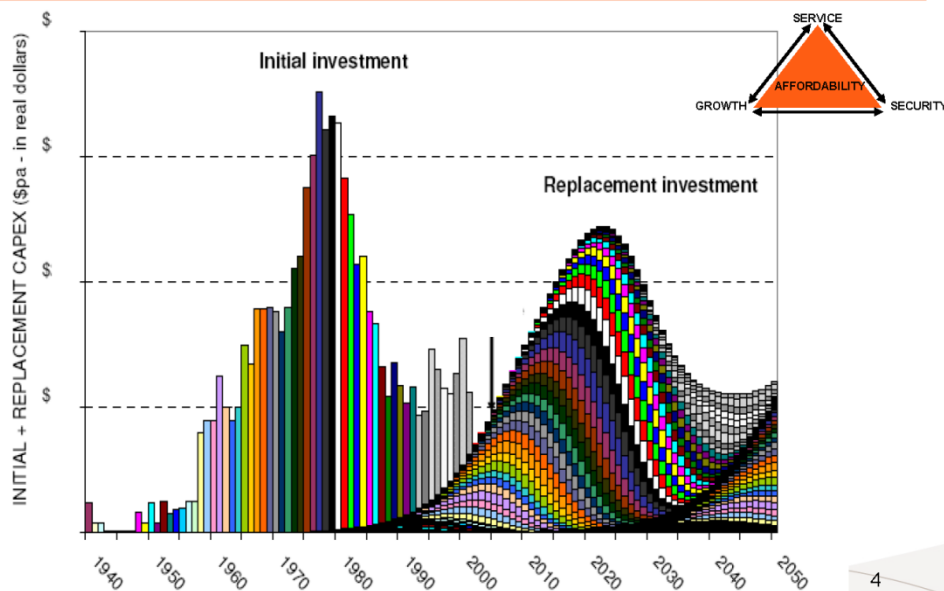
2

What are the key issues that are driving us?



3

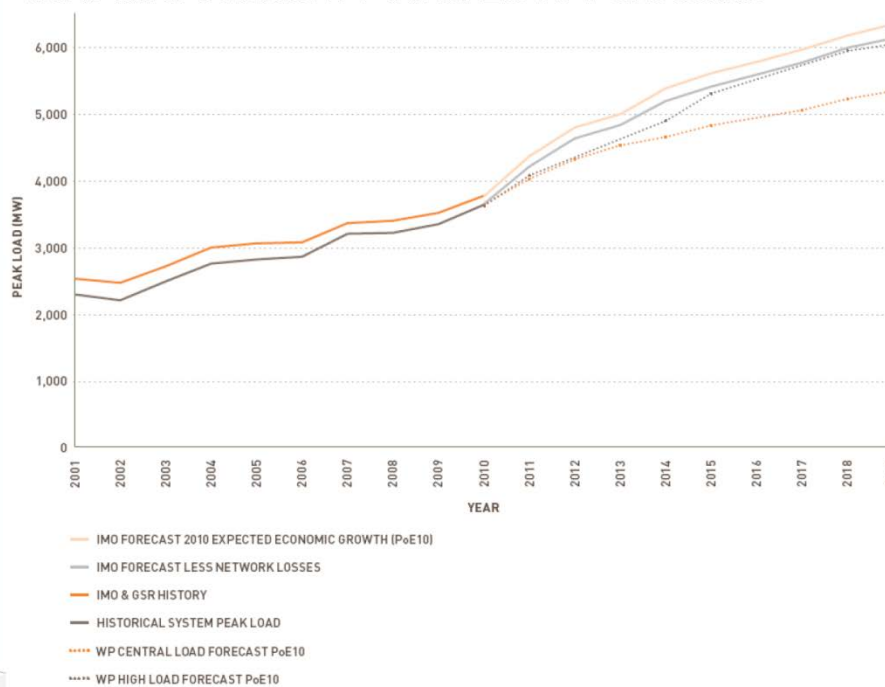
The Bow-Wave of Network Investment



4



IMO and Western Power 2010 Forecasts





Our Network Investment Strategy Vision Building the network that can...

- Satisfy our regulatory obligations
- Meets customer requirements for performance and value
- Enables flexibility and choice
- Facilitate government policy and competition

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8

What does this mean for AA3?

- We have some hard decisions to make
- We need to invest now to address our highest priority risks and set a foundation for service improvements to be achieved in the coming regulatory periods

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9

AA3 Story

- Improve public safety to the extent possible given practical and delivery constraints
- Meet growth challenges whilst improving compliance with critical aspects of Technical rules
- Maintain compliance with other technical rules and critical regulations.
- Maintain service levels (on average) through addressing declining asset performance to support continued improvement in the future
 - Identify areas of the network that are performing significantly below average service levels and seek direct support from Government where it is not commercial to improve.
- Prudent investment in network modernisation to support future generation and customer demands more efficiently
- Facilitate government policy initiatives where required

Need to balance network performance and risk objectives with funding challenges, efficient delivery and price outcomes

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10

Forecasts process and approach

- 1 - Bottom Up Forecast Review – November
- 2 - Top down Forecast Review - December
- 3 - Forecast Development – Activities to be incorporated into January 31 Forecasts
 - Reflect rates agreed between Networks and Operations
 - All fields filled in and missing information identified and explained
 - Consistent with demand forecast
 - Consistent with AA3 period 'story'
 - Consistent with Network Investment Strategy
 - Identification of outcomes and implications
 - Optimised efficient delivery assessment
 - Vulnerabilities assessed
 - NFIT review
 - Treatment of contingent, smart grid, NBN
 - Indirect cost drivers and forecasts clarified, including capitalisation policy
- 4 - Forecast Refinement – Activities to be incorporated into February 28
 - Audit of Activity Templates
 - Trend and relevant predictor analysis
 - Methodology and approach to escalation finalised and consistently applied
 - High level and detailed benchmarking assessment
 - Whole of work program service impact review
 - Delivery Assessments signoff on forecasts
 - Business support and indirect costs consistent with work program forecasts
 - Pathway to compliance identified, justified and where possible supported by external regulator
 - Impact of cross business initiatives identified and appropriately incorporated
 - Optimisation across and within opex and capex
- 5 - Finalise Forecasts – Activities to be incorporated into March 31 Forecasts
 - Consolidation & Final Reconciliation
 - Review of vulnerabilities
 - Delivery Strategy finalised
 - Metrics identified and collated
 - Evidence assembled
 - External Review
 - Forecasts locked down – March 31
- 6 - Final review – April 30
 - NIS, DAMP, TAMP, APR aligned
 - Delivery Strategy paper ready for review
 - External review
 - Strategic review to be completed by Apr 30

We are here

Draft Cabinet
Submission to Group –
12 April

Draft ERA Submission being prepared in
parallel and ready for internal reviews – May 1

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11

Key messages for safety

- Continue longer term plan to address the high number of condemned pole population
 - Reduces public safety incidents and bushfires
 - In line with directions and expectations of Energy Safety
- Ongoing bushfire mitigation program aimed at extreme and high risk bushfire zones is maturing and will keep pace of exposure so that more medium and low risk zones can be addressed
- Continuation of program to replace overhead service connections consistent with obligations and expectations of Energy Safety
 - Expected to be completed during AA4

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12

Improve public safety to an acceptable level where practical over an appropriate time frame

Key programs		Proposed expenditure		
		AA3 (5y)	AA2 (3y)	AA1 (3y)
Wood pole replacement/reinforcement		\$724m	\$225m	\$103m
Bushfire mitigation (incl. Dx carrier replacement)		\$322m	\$126m	\$44m
Overhead service connections		\$151m	\$71m	\$38m
Total		\$1197m	\$422m	\$185m

Measure	Performance		Rationale
	End AA2	End AA3	
Asset initiated fire events	Increasing	Stable	15-20 year program to address root causes but do not expect this to reduce impact during AA3 due to increasing exposure to weather events and fuel – long term trend
No. of condemned poles	Increasing	Increasing	15-20 year program to bring the No. of condemned poles down consistent with replacement rate
Unassisted pole failures	Increasing	Decreasing	Condition based assessment aimed at targeting higher risk poles
Unassisted distribution wires down	Increasing	Decreasing	Completing program to focus on extreme and higher risk zones during AA3 to commence lower risk zones
Electric shocks	Decreasing	Stable	Continuation of targeted programs to address high likelihood events and conditions

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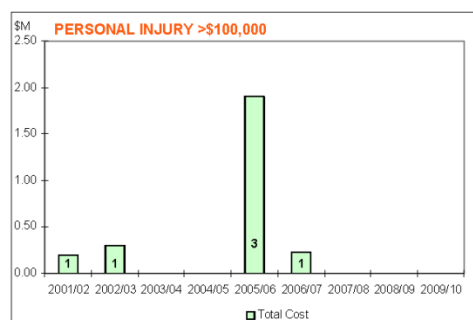
Improve public safety to an acceptable level where practical over an appropriate time frame

Two key public safety risks:

Injury to members of the public from interactions with our network

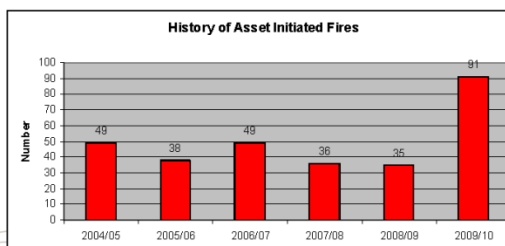
There are a range of situations where members of the public can be injured through interaction with our network.

These include electric shock, electrocution & a range of other injuries.



Bushfires

Western Power asset initiated fires that have the potential to threaten life & property



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Public Safety: Injuries to members of the public

Western Power has a vast electrical network that impacts the general community. Our infrastructure crosses both public and private property, both above and below ground. Western Power has a moral and legal duty to ensure the safety of the public when in the vicinity of our assets.

Electric Shock Incidents

- 2006 / 2007: 1 major electric shock
- 2009 / 2010: 2 major electric shocks
- January 2011: 1 fatality / electric shock

Root Causes

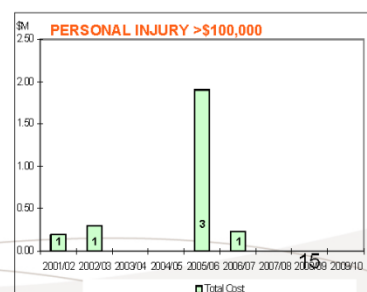
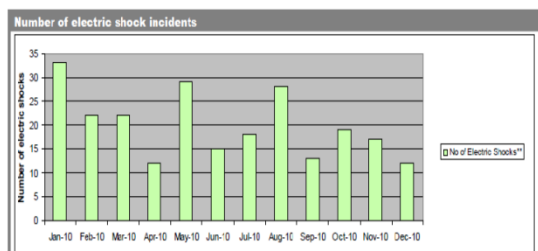
- Loose load neutral on meter
- Live service cable underground
- Loose neutral connection at pillar
- Fallen conductors

Other Personal Injury Incidents

- July 2002: Serious injury to male (loss of legs)
- March 2006: Pole fell onto child

Root Causes

- Illegal entry into substation
- Unassisted pole failure



Public Safety: Bushfire exposure

Western Power has assessed fire conditions of every section of the network, and allocates an appropriate rating based on 4 bushfire risk zones (Low, Moderate, High and Extreme). Bushfire mitigation resources are prioritised and allocated based on fire zone.

Bushfires

- Western power records all asset initiated fire events regardless of damage caused. Recording of minor events has improved significantly from 2009/10.
- The majority of bushfire events are considered "minor" and are readily contained. They generally result in minor grass fires in an open field and/or fence damage.
- The majority of bushfires are attended to by professional and volunteer fire services and controlled and extinguished quickly.

Incidents to date

- The table below illustrates an increase in 2009/10 which has been driven significantly by the improvement in notification / reporting of minor bushfire events
- The table below also provides a breakdown of the causes of the bushfires by year. These include events over which Western Power has limited or no control i.e. Bird / animal
- Western Power has experienced a small number of significant bushfire events since disaggregation

Root Cause	04/05	05/06	06/07	07/08	08/09	09/10
Wires Down	1	2	8	6	5	15
Pole Top fire	19	9	10	8	5	18
Equipment Failure	11	10	12	7	2	14
Clashing Conductor	0	2	7	7	4	11
Drop Out Fuse	0	3	0	0	0	4
Pole Down	1	1	1	0	6	3
Vegetation Encroachment	0	1	2	3	4	7
Tree Down	5	4	2	1	1	5
Operational issue	0	0	0	0	2	3
Wind/ Lightning	4	0	2	0	0	1
Invalidated	3	1	1	1	0	0
Bird/ Animal	5	5	4	3	6	10
Annual Total	49	38	49	36	35	91

Significant Bushfires	Root Causes
February 2007: Toodyay	Clashing conductor caused bushfire
January 2008: Parkerville	Tree growing into conductors
January 2009: Yanchep	Crossarm failure
January 2009: Balingup	Pole failure, wires down

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Managing our public safety exposure

Risk management strategies

Fault Code	Root Causes	Key Risks	KPI's	Strategies
Wires Down	Corrosion Joints Ties	Wires falling to the ground and causing bushfires & potentially endangering the public	Number of wires Down per year	<ul style="list-style-type: none"> - Four year maintenance inspection - Mid cycle aerial inspection of wires in Extreme and High risk areas - Wires Down Mitigation Strategy - Conductor replacement Program
Pole Top Fire	Dust on insulators Moisture and dampness – ie drizzle or very humid conditions Loose hardware Age of insulator	Arcing causing wooden crossarms and pole top catching fire and falling to the ground igniting vegetation	Poles siliconed each year Number of pole top fires	<ul style="list-style-type: none"> - Applying silicone to insulators to prevent the build up of dust and other pollutants - Washing of insulators to prevent the build up of dust and other pollutants - Converting overhead powerlines to underground powerlines - Installing steel crossarms for high voltage - All new constructions use polymeric insulators
Clashing Conductor	Long Bays Short crossarms Hot weather which creates sagging and differential sagging	Conductors clashing cause sparks and hot metal to fall to the ground igniting vegetation	Number of Long Bay solutions each year	<ul style="list-style-type: none"> - Long Bay project – Implementing solutions to HV bays exceeding criteria (bay length, hardware configuration) - LV Spreader Project; Application of spreaders that physically hold conductors apart
Bird	Birds flying into conductors Numerous birds alighting from conductors simultaneously	Flashing over from asset Clashing conductor	Number of bushfires caused by birds each year SAIDI	<ul style="list-style-type: none"> - Reactive proofing works - Undergrounding - Covered conductors
Vegetation Encroachment	Vegetation encroaching into clearance zone and contacting conductors	Sparks and molten metal falling to the ground igniting vegetation	Bushfire Preparedness Index measures inspection and cutting of vegetation in Extreme and High Fire Risk areas by November 30 each year	<ul style="list-style-type: none"> - Extreme and High Fire Risk areas annual clearing - Moderate Fire Risk area on a 2 year cutting cycle - Low Fire Risk area on a three year cycle
Tree Down	Trees falling onto conductors bringing conductors to ground causing bushfires	Live conductors on ground igniting vegetation	Number of bushfires caused by trees down each year	<ul style="list-style-type: none"> - Quantified Tree Risk Assessment - Inspections and cutting based on fire risk cycle
Drop Out Fuse	Expulsion of molten particles	Hot molten particles falling to the ground igniting vegetation	Number of bushfires caused by Drop Out Fuses each year	<ul style="list-style-type: none"> - Pole Base Clearing for fuse poles - Replacement of Drop Out Fuses with Fire Safe Fuses
Pole Down	White ants Rot Wind	Wires falling to the ground causing bushfires & potentially endangering the public	Number of poles down each year	<ul style="list-style-type: none"> - Enhanced 4 year inspection program - Accelerated replacement program - End to End Wood Pole Management System

Key messages on growth and compliance with critical technical rules

- Delayed capacity expansion program during AA2 as a result of improved governance processes, GFC, and funding constraints gives rise to need to 'catch up' WPU3
 - Low system security would continue and deteriorate if AA2 investment level continues, this increases the likelihood of widespread outages and long duration outages
- Recovery post GFC driving increasing number of customer connections and fuelling demand growth
 - Larger Tx Customer driven projects forecast during the period than historically experienced (iron or mines)
 - Economic stimulus driving schools demand during AA2 is being replaced by continuing strong economic and population growth

Improve compliance with critical aspects of Technical Rules whilst meeting the challenge of continuing growth

Key programs	Proposed expenditure		
	AA3 (5y)	AA2 (3y)	AA1 (3y)
Dx Capacity Expansion	\$451m	\$165m	\$198m
Tx Capacity Expansion	\$1091	\$231m	\$636m
Dx Customer Driven	\$1120m	\$640m	\$616m
Tx Customer Driven	\$637m	\$170m	\$116m
Tx line relocations	\$50m	\$23m	\$16m
MWEP (1 and 2)	\$508m	\$103m	\$10m
Total	\$3857m	\$1332m	\$1592m

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Improve compliance with critical aspects of Technical Rules whilst meeting the challenge of continuing growth

Measure	Performance		Rationale
	End AA2	End AA3	
Amount of new demand served	Increasing	Increasing	Reflects growth impact on the network
No. of additional customers at risk of long duration outages (>5hrs)	Increasing	Decreasing	Provides an indication of the impact of operating an insecure network
No. of customers supplied from constrained country feeders	Increasing	Decreasing	Indicates the constraints from insufficient capacity
Km of under rated conductors in high and extreme fire risk zones	Increasing	Decreasing	Provides an indication of increased risk of asset initiated events
No. of customers at risk of being shed following credible single contingencies due to failure to meet the Planning Standards	Increasing	Decreasing	Provides an indication of an insecure network
Risk of high impact system wide interruptions	Increasing	Decreasing	Provides an indication of an insecure network
No. of locations where fault levels exceed ratings	Increasing	Decreasing	Provides an indication of increasing risk of faults
No. of Transmission driven connections	Increasing	Increasing	Reflects the demand by customers to connect
No. of Distribution connections	Increasing	Increasing	Reflects the demand by customers to connect
Progress of MWEP	Stage 1 commenced	Stage 2 Completed	Project progress

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Key messages on compliance with other critical regulations

- Maintain current levels of compliance with reliability obligations under the NQRS Code
- Increase in targeted initiatives to address power quality non-compliance
 - responding to complaints and increased monitoring equipment
- Maintain current levels of compliance with other regulation – except noise

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Maintain compliance with other critical regulations

Key programs	Proposed expenditure		
	AA3 (5y)	AA2 (3y)	AA1 (3y)
Power Quality	\$28m	\$15m	\$25m
Reliability	\$0m	\$39m	\$68m
Compliance (other – excl noise in AA3)	\$348m	\$79m	\$45m
Metering	\$69m	\$48m	\$37m
Replace non-compliant meters with smart meters	\$168m	\$39m	\$0m
Total	\$613m	\$220m	\$175m

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Maintain compliance with other critical regulations

Measure	Performance		Rationale
	End AA2	End AA3	
No. of incidents where performance measures in NQRS Code not met	Increasing	Increasing	The performance measures in the NQRS cover power quality and reliability. Increased monitoring will result in increasing identified incidence of non-compliance.
No. of customers with more than one 12 hour outage in 10 years	Increasing	Stable	Asset replacement and capacity expansion projects target areas of poor performing network and would therefore expect an improvement with identified program
No. of sites not compliant with noise regulations	Reducing	Increasing	Ongoing discussion regarding compliance with noise regulation. If exemption is not granted then must reduce over the period.
No. of incidences of non-compliance with Metering Code	Stable	Stable	Currently have an exemption for non-compliant three phase meters. Program aims to meet this over AA3. If this is not completed, non-compliance will increase.

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Key messages on maintaining service

- Continuing decline in asset performance will result in deteriorating service performance of the system
 - Expenditure on asset replacement, capacity expansion, compliance, operating and maintenance expenditure is expected to ensure service levels are maintained
 - No targeted reliability driven expenditure
- Financial service incentive scheme will provide financial rewards where service is improved and financial penalties where service deteriorates
 - Strong incentive to deliver work program as forecast and pursue improvement investment where cost is less than financial benefit
 - No revenue for this during AA3, impact will affect AA4 revenue requirement

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Maintaining service levels (on average) with declining asset performance

Key programs	Proposed expenditure		
	AA3 (5y)	AA2 (3y)	AA1 (3y)
Other asset replacement (DX)	\$182m	\$38m	\$18m
Asset replacement (TX)	\$259m	\$64m	\$49m
SCADA	\$119m	\$37m	\$21m
Business Support & IT	\$363m	\$178m	\$154m
Total	\$923m	\$317m	\$242m

Measure	Performance		Rationale
	End AA2	End AA3	
SAIDI and SAIFI	Improving	Stable	Measures average network performance. Limited support for improving average service levels given other competing priorities.
Customer complaints	Improving	Stable	Improving systems and call centre performance to more effectively address customer queries.
No. of asset failures	Increasing	Stable	Increasing investment program, including targeted condition based replacement, to arrest further deterioration and achieve sustainable performance in future periods
Average asset lives DM#7947823	Increasing	Stable	Increasing investment program, including targeted condition based replacement, to arrest further deterioration and achieve sustainable performance in future periods 25

Maintaining service levels (on average) with declining asset performance

Key programs	Proposed expenditure		
	AA3 (5y)	AA2 (3y)	AA1 (3y)
Other asset replacement (DX)	\$182m	\$38m	\$18m
Asset replacement (TX)	\$259m	\$64m	\$49m
SCADA	\$119m	\$37m	\$21m
Business Support & IT	\$363m	\$178m	\$154m
Total	\$923m	\$317m	\$242m

Measure	Performance		Rationale
	End AA2	End AA3	
SAIDI and SAIFI	Improving	Stable	Measures average network performance. Limited support for improving average service levels given other competing priorities.
Customer complaints	Improving	Stable	Improving systems and call centre performance to more effectively address customer queries.
No. of asset failures	Increasing	Stable	Increasing investment program, including targeted condition based replacement, to arrest further deterioration and achieve sustainable performance in future periods
Average asset lives DM#7947823	Increasing	Stable	Increasing investment program, including targeted condition based replacement, to arrest further deterioration and achieve sustainable performance in future periods 25

Key messages: significantly underperforming service areas

- There are a number of individual customers and/or communities that receive significantly worse service than average or service that is less than required
 - Identify programs to improve Edge of Grid performance where commercial (for example where incentive benefit greater than cost) or funded by Government

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Identifying areas of the network that are performing significantly below average service levels supported by Government where not commercial

Key programs	Proposed expenditure		
	AA3 (5y)	AA2 (3y)	AA1 (3y)
Edge of Grid – Reliability improvement	\$25m	\$4m WPU4	\$0m
Edge of Grid – Smart Grid (aimed at peak demand shift)	\$32m	\$0m	\$0m
SSAM incentive benefit investment	\$40m	\$0m	\$0m
Total	\$97m	\$0m	\$0m

Measure	Performance		Rationale
	End AA2	End AA3	
Geographic location SAIDI, SAIFI, improved connection times/capacity	Deteriorating	Improve	In scoping out the programs, clear beneficiaries and outcomes to be identified
Individual customer measures	Deteriorating	improve	In scoping out the programs, clear beneficiaries and outcomes to be identified
SSAM penalties and rewards	Positive	Positive	Targeted programs to improve service where the cost is less than the financial reward or to avoid a financial penalty

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Key messages: facilitate government policy

- State Underground Power Program
 - Continue stage 5
 - Further commitments as directed or assessed to be commercial
- Smart Meter roll-out
 - In response to policy decision to mandate
- NBN
 - Pursue commercial opportunity

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Facilitate Government policy initiatives

Key programs	Proposed expenditure		
	AA3	AA2	AA1
SUPP Round 1-5	\$100m	\$71m	\$66m
Smart Meter roll-out (Phase 3 and 4)	\$158m	\$0m	\$0m
NBN	?	\$0m	\$0m
Total	\$258m+	\$71m	\$66m

Measure	Performance		Rationale
	End AA2	End AA3	
% of Perth Metro customers with underground power	54%	Increasing	Consistent with OOE effectiveness indicator for SUPP progress
SUPP average cost per lot (major project)	\$10,400	Increasing	Consistent with OOE effectiveness indicator for SUPP cost
Smart Meters rolled out	None	Stable	Provides an indication of the activity undertaken
Cost per meter	Stable	Decreasing	Provides an indication of the efficiency of the program

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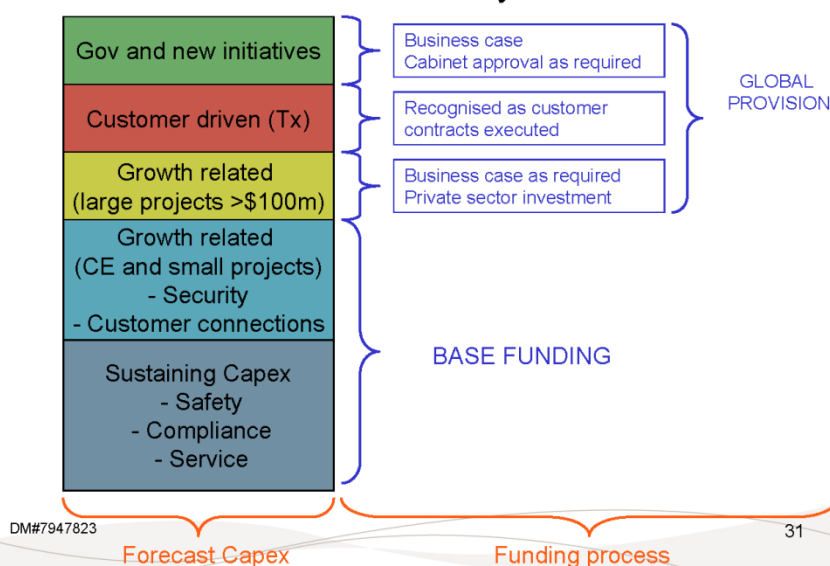
Key messages: Prudent investment for the future

- Ongoing activities include review of prudent and efficient investment to achieve outcomes and objectives
 - Pursue cost saving initiatives
 - Harness benefits of new technology and increased automation
 - Research and Development
 - Defer capital investment including initiatives to address growing peak
 - Plan to ensure good industry practice and move toward best industry practice where appropriate

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Access to funds (proposed): How we categorise capex affects the process and certainty



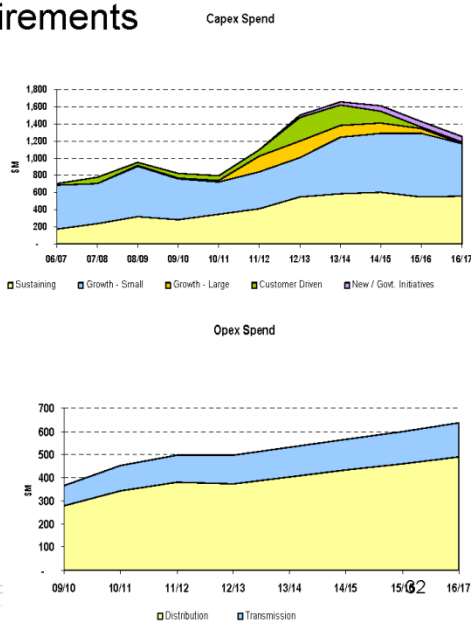
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Expenditure for discussion on funding requirements

- DTF categorisation of capex for funding support
 - Sustaining Capex (\$2.85b, includes \$100m SUPP)
 - Growth – Small projects including capacity expansion (\$2.7b)
 - Growth – Large projects >\$100m (\$508m)
 - Transmission Customer Driven (\$687m)
 - Gov requirements and new Initiatives – not included in revenue requirement but will require funding if go ahead
 - Smart Meters Phase 3&4 (\$158m)
 - NBN (\$?)
 - Reliability improvements (\$40m)
 - Edge of Grid (\$57m)
- Operating expenditure (\$2.8b)
 - Tx (\$0.7b)
 - Dx (\$2.2b)

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Next Steps

- Forecasts will continue to be refined
- Develop next level of detail on measures based on input from group
- Identify what are the immediate areas for more detailed work / explanation
- Consideration of related matters
- Other?

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APPENDIX 2
EXAMPLES OF BUDGET PAPER DISCLOSURE

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EXAMPLES OF BUDGET PAPER DISCLOSURE

LEGISLATIVE COUNCIL – STANDING COMMITTEE ON ESTIMATES AND FINANCIAL OPERATIONS

Date of Hearing: 10 September 2012

Inquiry into Western Power's Evidence

[Supplementary Information No. A9.]

Question: (Hon Philip Gardiner) Could I ask just for some examples of that (risk statements in Budget Papers) because I want to see how this has been applied in the past?

Answer:

A number of examples are provided below:

Budget Paper No. 3 – 2012-13 Budget

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Corrective Measures

The 2012-13 Budget contains a suite of corrective measures focused on containing spending growth, and promoting cost efficient service delivery. The total suite of measures (worth \$4.9 billion in net debt terms over the period to 30 June 2016) assumes that agencies will achieve the targeted savings measures. If agencies are unable to fully achieve these savings, there is a risk that both the spending estimates and projected growth in net debt contained in this budget are understated.

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National Disability Insurance Scheme

Western Australia is prepared to participate in the development of options for a National Disability Insurance Scheme (NDIS) for consideration by the Council of Australian Governments (COAG).

While supportive of the NDIS in principle, the Government does not have clarity from the Commonwealth on the critical issues of eligibility, structure and funding for an NDIS. It therefore remains unclear as to the exact number of people the Commonwealth intends for the policy to apply to, how much the reform will cost or the source of funding for it. Statements from Commonwealth Ministers have varied from 410,000 to 2 million eligible people and the recent Commonwealth Budget did not provide any more detail on how the Commonwealth proposes to fund the potential additional costs of \$8.1 billion per annum for the scheme (noting the States and the Commonwealth collectively spend \$7.0 billion per annum on disability services).

The State Government currently funds 83% of disability services in Western Australia, amounting to \$2.5 billion over the next four years. Recognising the relatively limited financial capacity of States, the Productivity Commission recommended that all of the additional cost of the NDIS be funded by the Commonwealth.

With the funding arrangements for the NDIS yet to be determined, including the extent to which the Commonwealth intends to diverge from the Productivity Commission's recommendations on funding and seek further financial contributions from the States, significant financial risk is associated with the implementation of the policy.

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Electricity Utilities

The Economic Regulation Authority is yet to finalise Western Power's Third Access Arrangement (AA3) and its Inquiry into the efficiency of Synergy's costs and electricity tariffs. As such, there remains a significant risk that once these reviews are finalised there will be an additional impact on the State's finances. There is also a significant risk that as a result of these reviews there may be a change to the cost-reflective line for electricity tariffs and Western Power's AIP. Depending on the outcomes of these reviews, these risks are both of an upside and downside nature.

Budget Paper No. 3 – 2011-12 Budget

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Western Power Capital Expenditure

Western Power is required to provide its AA3 submission to the Economic Regulation Authority on 1 October 2011. This access arrangement will outline Western Power's capital investment over the period 2012-13 to 2016-17. Additional capital expenditure may be required to meet growth requirements in the network and undertake asset maintenance and replacement to mitigate safety, security and reliability issues.

Budget Paper No. 3 – 2010-11 Budget

Page 55

Princess Margaret Hospital (PMH) Replacement – New Children's Hospital

The replacement of PMH to be built on the Queen Elizabeth II medical centre site is one of the Government's 2008 election commitments. Planning continues to progress with appropriate consideration of budget, scope, timing and risk assessment factors (including phasing of works on the site). The current approved budget of \$117 million represents planning and early development for this project, as well as costs associated with maintaining the existing Princess Margaret Hospital. The full costs of the development will be considered by the Government on the presentation of a business case later this year.

Budget Paper No. 3 – 2009-10 Budget

Page 43

Health Sector Expenses

The Government's decision to retain Royal Perth Hospital (RPH) as a tertiary hospital and major trauma facility will result in significant recurrent cost implications for the health system. Prior to this decision, it was intended to close RPH as a tertiary facility and transfer associated expenditures to fund the new Fiona Stanley Hospital. The health system will incur significant operating costs in 2013-14 from operating the 400-bed RPH trauma facility and the commissioning of the new 643-bed Fiona

Stanley Hospital. These costs are yet to be determined or considered by Government.

Electricity Entities

The Economic Regulation Authority (ERA) is currently undertaking a review of Western Power's access arrangement submission. The Western Power submission seeks approval for additional operating and capital expenditure over and above that reflected in this budget, and if the submission were approved and subsequently endorsed by the Government this would also impact upon tariff assumptions.

Page 44

Princess Margaret Hospital Replacement

As part of the Government's 2008 election commitments, a new children's tertiary hospital will be built on the Queen Elizabeth II Medical Centre site to replace the existing Princess Margaret Hospital. Planning and evaluation of the project is underway, in order to establish important parameters such as project scope, cost estimates and timeframes, identify key risks and progress the master planning process. The current allocation in the Department of Health's Asset Investment Program reflects an amount for planning forward works (\$117 million) but does not yet include an estimate of the full cost of the project, which is likely to be substantial.

Budget Paper No. 3 – 2008-09 Budget

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Wages

There are a number of wage agreements applicable to significant occupational groups that have expired or are due to expire in the near future and are yet to be finalised, including the teachers' and TAFE lecturers' EBAs and the Civil Service Association's claim for State public servants.

In addition, other major wage agreements that have recently expired, or are due to do so over 2008, include those for Hospital Salaried Officers, Firefighters, and Public Transport Authority employees.

While the forward estimates include a provision for these EBAs (consistent with existing offers), there is a risk that the actual outcomes may be in excess of this provision, leading to an increase in expenses. As an example, a 1% increase in general government wages in 2008-09 results in an increase in general government salaries and superannuation costs of around \$80 million.

Budget Paper No. 3 – 2007-08 Budget

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Wages

The forward estimates include provision for all Enterprise Bargaining Agreements (EBAs) that have been agreed and finalised, with appropriation-supported agencies required to fund one-third of the cost from annual base allocations (apart from some exceptions related to specialist groups). Where wage outcomes are higher than those provisions, expenses will generally be higher. For example, a 1% increase in general government wages in 2007-08 amounts to an increase in general government salaries

and superannuation costs of around \$71 million.

Budget Paper No. 3 – 2006-07 Budget

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Wages

The forward estimates include provision for all enterprise bargaining agreements that have been agreed and finalised. Beyond these agreements, provisions have also been included for the offers made for significant agreements that are due to expire up to 30 June 2007. Where wage outcomes are higher than expected, expenses will generally be higher. To illustrate the potential impact, a 1% increase in wages in 2006-07 amounts to around \$65 million per annum across the general government sector in both salaries and superannuation costs.