17 November 2000

Mr Paul Bilyk
A/ General Manager
Regulatory Affairs - Electricity
ACCC
PO Box 1199
DICKSON ACT 2602

Our Ref: R-00-276

Dear Mr Bilyk

POWERLINK QUEENSLAND– REVENUE CAP DETERMINATION PROCESS

Powerlink Queensland ("Powerlink") are currently preparing to submit their revenue cap determination application to the Australian Competition and Consumer Commission ("ACCC"). In advance of this process, they have sought to highlight a number of issues which they wish the ACCC (as their revenue regulator from 1 January 2002) to consider.

The attached submission provides Ergon Energy's initial thoughts and reactions to the issues raised by Powerlink in two recent papers, and as discussed at the consultation forum held in Brisbane on Thursday 2 November 2000.

Ergon Energy understands that there will be further opportunity to comment in relation to Powerlink's revenue cap determination, following the official submission to the ACCC early next year. We look forward to participating in that process.

If you have any queries in relation to the attached submission, please contact Rebecca Myers on (07) 3228 8134.

Yours sincerely

Darren Barlow
Manager Regulation

ERGON ENERGY

SUBMISSION TO THE ACCC IN RELATION TO POWERLINK QUEENSLAND'S FORTHCOMING REVENUE PRICE CAP DETERMINATION

1.0 INTRODUCTION

From 1 January 2002, the Australian Competition and Consumer Commission ("ACCC") will commence full responsibility for regulating Powerlink's revenue. In advance of this date, the ACCC will be undertaking a process to determine Powerlink's revenue cap, officially commencing early next year with the receipt of Powerlink's application.

In advance of submitting their revenue cap determination application to the ACCC, Powerlink released the following papers in October 2000 as a means of gathering industry and regulatory feedback:

- Forecasting Capital Expenditure for the Queensland Transmission Grid – an approach to deal with a rapidly changing power system; and

- Methodology for Incorporating Regulated Contracted Network Services into the Revenue Cap Determination.

2.0 GENERAL COMMENT

The first paper discusses the lack of certainty which currently exists in Queensland in regard to forecasting where transmission augmentation will be required in the medium and long term. The second paper discusses the need for the ACCC to determine mechanisms which would allow Transmission Network Service Providers (TNSP) to recover costs associated with meeting contracted network service obligations under the National Electricity Code ("Code").

This submission provides responses to the issues raised by Powerlink in both papers, and provides feedback to the ACCC in advance of the actual revenue cap determination application being made by Powerlink. The views expressed are based on the information released at this time, and Ergon Energy may choose to make further submissions to the ACCC during the official consultation phase, which will commence early in 2001.

3.0 DISCUSSION

3.1 CAPEX Forecasting

Ergon Energy agrees that there is current uncertainty in Queensland regarding the likely location and timing of necessary network augmentations, given the uncertainty about future generation capacity construction and any associated 'retirement' of existing plant.

This uncertainty clearly makes annual Capital Expenditure ("CAPEX") forecasting difficult. This promotes the need to utilise a probabilistic style approach to forecasting future expenditure levels, as discussed in the Powerlink papers. Ergon Energy considers that the outcomes of any probabilistic forecasting must be demonstrated as being reasonable by benchmarking against the CAPEX levels of other transmission systems.

3.2 Incentive Mechanisms

Powerlink is proposing that Cost-Plus regulation is more appropriate to its current circumstances and the acknowledged difficulty it will have in forecasting its CAPEX levels. Ergon Energy is supportive of incentive based regulation methodologies as they are most effective way to drive efficiency in regulated monopoly businesses.

It is therefore queried whether the Cost-Plus methodology should be utilised across all elements of the building block approach to the revenue price cap determination, or whether it is only appropriate for the CAPEX elements. If Cost-Plus were applied only to CAPEX elements, we query whether some unique form of Cost-Plus may be required that incentives minimal cost increase.

3.3 Review of CAPEX

Ergon Energy also endorses the setting of a review period in 2005 to ensure the CAPEX forecast remains reasonable in light of actual transmission augmentation requirements. It is understood that this review would be conducted through a 'formularised adjustment' process. It is important however, that this review focuses solely on the CAPEX element of the revenue cap and does not become a full review of the original determination.

3.4 Contracted Network Services

The alternatives to grid augmentation, including grid support contracts and generator constraint contracts, must be considered by TNSPs as part of their obligations under the Code. Where alternate solutions are available and provide a cost effective deferral of grid augmentation, the Code requires that these services should be contracted for. However, as discussed by Powerlink, there is no framework under the Code or the ACCC's Draft Statement Regulatory Principles, for incorporating these costs into a TNSPs regulated revenue cap.

Ergon Energy believes that the ACCC's Statement of Regulatory Principles (for the Regulation of Transmission Revenues) is the most appropriate place to incorporate the cost recovery mechanism for Contract Network Services.

4.0 CONCLUSIONS

In advance of any determination of Powerlink's regulated revenue cap, Ergon Energy believes the ACCC must resolve the issue of how cost recovery for Contracted Network Services will be dealt with, in order to allow TNSPs to deliver their obligations under the Code. It is also believed that the application of Cost-Plus regulation to all aspects of the revenue cap is not appropriate. If a Cost-Plus methodology were applied, it should relate only to the CAPEX elements (and even then be a modified approach to accommodate incentivisation of a least cost regime), with the remaining elements of the revenue requirement subjected to the building block approach as it is, in our view, an appropriate approach to incentive based regulation.