



Level 3, 32 Walker St
North Sydney NSW 2062

9 December 2005

Mr Warwick Anderson
A/g General Manager – Access Branch
Australian Energy Regulator
PO BOX 1199
Dickson ACT 2604

Dear Mr Anderson

Metgasco is writing in response to the AER's draft determination on the Directlink Joint Venture Application for Conversion and Revenue cap.

Metgasco is currently developing and commercialising gas resources in Northern NSW. Our initial project has recently been increased in scale from 12MW to 28 MW. This project will be in operation by December 2006 and is located at Casino in NSW. We would be pleased to provide further detail on the design and status of this project to the AER.

Metgasco's comments on the AER's draft determination largely relate to the establishment of the regulated asset value of Directlink and the term of regulation. Our specific comments are as follows:

Comment on Conversion Decision

Metgasco has no objection to the conversion of Directlink to a prescribed service.

Comment on Application of Regulatory Test and Establishment of Asset Value

Metgasco has no comment on the interregional transfer benefits identified by the AER. However, we would query the allocation of identified network augmentation deferral benefits to Directlink.

1. A reasonable evaluation of Metgasco's project is required in order to satisfy the regulatory test

Metgasco's project is capable of providing support to the network in northern NSW. However, in our view this project has not been sufficiently evaluated by the AER for the purpose of the regulatory test for Directlink. Metgasco appreciates that a detailed analysis of alternative options has been undertaken by consultants to the AER and that these consultants were not aware of Metgasco's planned project at the time. However, this does not obviate the need to consider this project now prior to finalising a regulatory decision. The alternative projects proposed by consultants to the AER are all hypothetical alternative projects, while the Metgasco project is a real, viable project which offers a competitive alternative to provide network support.

2. Regulation should promote competition and prefer market based outcomes

The AER has an obligation under the code to "promote competition in upstream and downstream markets and *the promotion of competition in the provision of network services where economically feasible*" (Metgasco emphasis). The automatic allocation of network augmentation deferral benefits to Directlink without allowing Transgrid to follow the normal process of calling for competitive bids is circumventing the pro-competitive mechanisms contained within the code.

Metgasco notes that Transgrid has recently called for expressions of interest for reliability augmentations on the 966 Armidale-Koolkhan 132kV line which specifically exclude Directlink from providing this service. In our view, Metgasco and Directlink should have the opportunity to submit competitive bids to Transgrid for network augmentation deferral benefits.

3. Proposed Length of the Regulatory Control Period is too long

Metgasco disagrees with the AER's findings for a ten year regulatory control period for Directlink. This is an unusually long regulatory period in the context of the national market as TNSPs normally have a five year regulatory control period. A longer regulatory period is not required to encourage private sector investment and attract new entrants to the NEM. If this were the case then there would be no private sector investment in systems where there are five year regulatory periods, and this is clearly not the case.

The five year regulatory term was determined for sound economic reasons at the time of the establishment of the national market. The argument that an entity should receive uncontested regulated revenue over a ten year period because it will save the cost of going through a regulatory reset process in five years time has no merit and could result in perverse outcomes in a market subject to significant change over the regulatory period. The north coast of NSW is one of the fastest growing electricity markets in Australia and will certainly be subject to significant change over the next five years as a result of load growth. In addition, Metgasco is in the process of commercialising a gas resource of over 4.8 Trillion cubic feet in a market which has never had access to pipeline gas. The

availability of this energy source may well result in changes in energy usage patterns over the next five years.

The Directlink assets were established for a merchant purpose and there is no certainty that they will be able to fulfil the service obligations required of a regulated TNSP. A five year regulatory control period would allow an opportunity for the AER to review the performance of Directlink as a TNSP while providing a reasonable opportunity for Directlink to demonstrate its operating capabilities.

Finally, Metgasco would like to clarify comments by the AER relating to Metgasco's project. (p63). Firstly, Metgasco's project is in the normal stage of development for a project expected to meet the planned commissioning date as described above. Secondly, Metgasco is not currently in negotiations with Transgrid or Country Energy with respect to network support agreements for the far north NSW region. Metgasco has been advised by both organisations that that they are unable to enter into such arrangements without following an open competitive bidding process and that such processes may or may not arise in the future.

Thank you for the opportunity to respond to the Draft Decision.

Yours Sincerely

A handwritten signature in black ink, appearing to read 'D. Johnson', written in a cursive style.

David Johnson
Managing Director