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Mr Sebastian Roberts
A/General Manager
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Dear Mr Roberts

MURRAYLINK CONVERSION APPLICATION

NRG Flinders appreciates the opportunity to offer the following comments and observations on the Murraylink Conversion Application for consideration. While not necessarily opposing the approval of regulated interconnects, NRG Flinders believes that a range of issues need to be addressed before such a proposal could be approved.

Regulatory Test

The approach taken in applying the Regulatory Test to Murraylink is to consider available alternatives, the actual cost of the Murraylink assets and the estimated gross market benefits associated with the proposal. Regulatory asset value (net of O&M costs) is then set at the lowest of these values, which in this case is the level of gross market benefit. Consequently, the expected net market benefit associated with the proposal is zero. As a threshold issue, NRG Flinders would query whether it is appropriate under the Regulatory Test to approve a project with no expected net market benefit.

In terms of the alternative projects assessed, on the analysis provided, none of these options appear to deliver a positive net market benefit and thereby satisfy the Regulatory Test. It is therefore unclear that the net market benefits of available alternatives have been compared in accordance with the Test. In addition, the criteria for selection of these alternatives appear to be relatively narrow. Generation options are dismissed on the basis that these do not provide direct inter-regional transfer capacity, or voltage support (which does not appear to be valued under the Test).

The valuation of the alternative transmission projects considered is influenced heavily by the level of undergrounding assumed. The capital cost of a 275kV Buronga to Monash transmission line is estimated at $246m. In comparison, the total cost of the SNI proposal, involving a longer 275kV transmission line between Buronga and Robertstown (via Monash) and various upstream works, was estimated at $110m in the assessment undertaken by the IRPC.

It is also noted that questions have been raised over the assessed transfer capability of the link and the status and total cost of the upstream works that appear to be necessary to allow the capacity to reach the levels assumed. Clearly these issues need to be addressed before modelling results can be relied upon, and appropriate assumptions need to be adopted and verified. The level of transfer capacity assumed appears to impact heavily on the level of estimated market benefit.

Finally, it is unclear why alternative scenarios (eg SNI) have not been considered, and why alternative timings have not been assessed, as required by the Regulatory Test. These factors could have a material bearing on the outcome of the Test.

Maximum Allowable Revenue

It has been proposed that maximum allowable revenue should be approved for a regulatory period extending to 2012. The ACCC would need to consider whether this is appropriate, given that the regulatory period of the coordinating TNSP(s) that would collect this revenue would only extend a maximum of five years into this period. This approach would also set a precedent for inter-regional assets, by which the risk of optimisation would be borne by consumers for twice the normal period.

The timetable for a final decision on the conversion application also appears to create timing issues. While a final decision is due to be handed down in July, the relevant TNSPs would already have finalised and published their charges for that financial year. The recovery of the first years' revenue stream would either occur through an undesirable pass through event (for which network users would be unable to budget) or would need to be deferred twelve months.

A vanilla WACC of 9.0% has been proposed. This would appear high relative to recent transmission regulatory decisions (eg it is noted that 8.30% was approved for the remaining South Australian transmission assets). It is also unclear that this reflects the reduced optimisation risk inherent in the longer regulatory period proposed. It is assumed that the ACCC will make an appropriate assessment of this issue, given the particular circumstances of Murraylink and level of risk involved.

It is also unclear precisely what uninsured risks Murraylink will be bearing and incurring pass-through insurance costs for, as indicated in the application.

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Service Standards

An incentive scheme has been proposed under which 1% of the annual regulated revenue stream would be linked to measured performance, based on a target reliability factor of 97%.

This reliability factor (equating to an outage duration of 5 hours per week) would appear to be relatively low for underground assets not susceptible to the standard risks of lightning, storm activity etc.

The adequacy of the incentive provided by an exposure level of 1% might also be questioned for assets with the sole purpose of providing inter-regional transfer capacity. This would also appear inconsistent with the directions emerging from the CoAG Energy Market Review, which highlighted the importance of the availability of inter-regional transmission assets, and put forward a model supported by clear and effective financial performance incentives.

It is also noted that the suite of service standards developed by the ACCC is subject to on going development over time. This would need to be borne in mind if any extended regulatory period were approved in this instance. In particular, the desirability of developing and applying appropriate measures of market impact at some point has been recognised.

In the case of Murraylink, a global availability measure alone would be an insufficient performance measure, as it takes no account of the timing or impact of network outages. As recommended by PB Associates, dividing this measure into planned, unplanned peak and unplanned off-peak outages with appropriate weighting should assist to refine the measure by linking it to outage timing. However, the measure ultimately needs to be linked to price impact in order to provide a meaningful measure of market impact (eg inter-regional price separation).

It would also appear that the proposed definition of Force Majeure is unduly broad. FM needs to be limited to events and risks which Murraylink is unable to influence, and which are more appropriately borne by customers. As indicated by PB Associates, it would also be more appropriate to apply a 12-month approach to the measurement of performance, rather than the capped monthly approach proposed in the application.

NRG Flinders appreciates the opportunity to raise these issues. Should you have any queries in relation to this submission please feel free to contact Simon Appleby on (08) 8372 8706.

Yours sincerely

Mark Williamson
General Manager, Marketing and Strategy