



COPY

19 July, 2006

Mr Mike Buckley
General Manager
Network Regulation North Branch
Australian Energy Regulator
PO Box 1199
DICKSON ACT 2602

Dear Mike,

**SUBMISSION FOR COST PASSTHROUGH TO REVENUE CAP FOR 2006/07
– GRID SUPPORT COSTS**

In accordance with the Australian Competition and Consumer Commission's Decision on the Queensland Transmission Network Revenue Cap 2002-2006/07 (November 2001), Powerlink seeks approval for passthrough in the 2006/07 maximum allowable revenue (MAR) of \$7.685 million in costs associated with the provision of grid support during the 2004/05 and 2005/06 financial years.

During these regulatory years there has been some variation between the allowed and actual grid support requirements due to forecasting difficulty, abnormally low rainfall and high temperatures experienced in North Queensland, significantly higher fuel costs for the generators supplying the grid support in NQ, a prolonged outage of a hydro generator, and the delay in the conversion to regulated status of Directlink. This application deals specifically with grid support cost variations which have occurred in the last two years. Powerlink believes that the variations are material, efficient and reasonable.

Material

On 18 May 2005, the Commission approved Powerlink's application for passthrough of grid support costs in the amount of \$22.65 million to address, in net terms, the then-forecast under-recovery of costs. This amount was based upon forecasts of grid support for the latter part of 2004/05 and for the 2005/06 and 2006/07 years. Costs associated with grid support from Directlink for 2005/06 summer period were not included in those forecasts as Directlink's application for conversion to regulated status was well advanced and was assumed to be imminent. However, this conversion did not occur until March 2006, and therefore Powerlink was required to pay grid support to the Directlink MNSP over the 2005/06 summer period.

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Actual grid support costs incurred by Powerlink for the last two years are provided below:

Year	Allowance (\$'000)	CPI-Adjusted Allowance (\$'000)	Actual (\$'000)	Variation (\$'000)
2004/05	15,427	15,638	15,342	(296)
2005/06	13,294 ⁽³⁾ .	13,481 ⁽²⁾ .	21,462 ⁽¹⁾ .	7,981

⁽¹⁾ Includes grid support from Directlink.

⁽²⁾ Represents the revised forecast cost submitted to and approved by the ACCC in May 2005.

⁽³⁾ Revised allowance derived from CPI-adjusted allowance.

The figures above show that Powerlink has under-recovered costs associated with the provision of grid support in the amount of \$7,685 million (net). This amount is considered material.

A number of specific factors (all outside Powerlink's control) have also contributed to higher outturn grid support costs for the 2005/06 year, including:

- higher demand – actual demand in North Queensland has turned out to be higher than forecast, necessitating increased requirements for grid support. The 50% PoE temperature corrected peak demand in North Queensland (less industrials) exceeded the 2005 Annual Planning Report forecast by 34 MW;
- prolonged generator outage – during this time, Barron Gorge hydro power station was out of commission for approximately 7 months inclusive of the summer period; and
- higher fuel costs – between September 2005 to April 2006, a 53% increase in generator fuel costs (on a \$/GJ generated basis) occurred under its network support agreement with Enertrade.

Efficient

Powerlink is the largest acquirer of grid support services in the National Electricity Market. Powerlink undertakes an open and transparent consultation process under the National Electricity Rules and Regulatory Test to determine whether a non-network solution such as grid support is appropriate to address an identified limitation.

In particular, the following Regulatory Tests demonstrate the efficiency of grid support as the (or part of the) best-ranked solution:

- in 2001, a Regulatory Test¹ was conducted by Powerlink to address transmission network constraints in the central Queensland to north Queensland and Ross limit areas. The analysis determined that grid support from Enertrade was the best solution. Powerlink and Enertrade entered into a contract for grid support from Enertrade's portfolio of existing generators from 1 January 2002;

¹ Powerlink, Final Recommendation, Addressing Transmission Network Constraints, 21 September 2001.



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- in 2004, a joint Regulatory Test² was conducted by Powerlink and Energex in relation to a proposed new large network asset in the Gold Coast and Tweed Areas. The Regulatory Test determined that the lowest cost solution involved network support for summer 2005/06 via Directlink at an estimated cost of \$2.7 million (followed by a network augmentation). This was a lower cost solution than an immediate network augmentation; and
- in 2005, a Regulatory Test³ was undertaken by Powerlink relating to electricity supply to north and far north Queensland. The analysis determined that continued network support from local generators at an estimated cost of \$13 - 38 million for 2005/06 was the best-ranked solution in the majority of plausible market development scenarios. Again, this was more cost-effective than immediate augmentation of the network.

As in previous years, Powerlink considers that its use of grid support is efficient given that:

- its grid support contracts with Enertrade, Pioneer Mill and Directlink were determined through the Rules process (including the Regulatory test) for assessing network needs;
- the structured utilisation of northern Queensland generators is understood to result in similar or lower costs than those which would have been incurred by the market had NEMMCO 'directed on' generation on an ad-hoc basis during this period; and
- under Powerlink's grid support contracts, Queensland electricity customers, rather than the entire national electricity market, bear the costs associated with the provision of network support in Queensland.

Reasonable

Powerlink's experience to date has shown that grid support costs are very difficult to forecast. This is because grid support requirements in North Queensland are driven primarily by factors beyond Powerlink's control, including:

- demand levels – which, in turn, depend on temperature and rainfall levels;
- hydro generation levels – which depend on spot market prices and rainfall, and generator decisions about plant outages; and
- base level generation from the Collinsville and Townsville power stations – which are dependent upon spot market prices and power purchase agreements between the power station owners and Enertrade.

A significant advantage of Powerlink's grid support contract with Enertrade is that it not only provides the service as and when required, but it is also structured so as to facilitate the use of the lowest overall cost mix of generation from that portfolio.

² Joint Report by Powerlink and Energex Ltd, Final Report, Proposed New Large Network Asset – Gold Coast and Tweed Areas, 6 July 2004.

³ Powerlink Queensland, Final Recommendation to Address Transmission Constraints 2005-2007, North and Far North Queensland, 27 July 2005.

Letter to Mike Buckley
General Manager, Network Regulation North Branch, AER
Submission for Cost Passthrough to Revenue Cap for 2006/07 – Grid Support Costs



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As noted earlier, the cost variation also includes costs associated with grid support from Directlink for 2005/06 summer period which were not included in forecasts as Directlink's application for conversion to regulated status was well advanced at that time, and was assumed to be imminent. However, as this did not occur until March 2006, Powerlink was required to pay grid support to the Directlink MNSP over the 2005/06 summer period.

For these reasons, Powerlink believes that it is reasonable to seek recovery of the variation in grid support costs.

In summary, Powerlink believes this variation clearly meets the necessary criteria of being material, efficient and reasonable.

If you have any queries relating to this matter, please contact Jennifer Harris.

Yours sincerely,

A handwritten signature in cursive script that reads "Gordon Jardine".

Gordon Jardine
CHIEF EXECUTIVE

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