



Ergon Energy Corporation Limited

**Submission on Powerlink Queensland
Transmission Network Revenue Cap - Draft
Decision**

**Australian Energy Regulator
9 February 2007**

**Submission on Draft Decision on
Powerlink Queensland transmission network revenue
cap 2007 – 08 to 2011 – 12, 8 December 2006**

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This submission, which is available for publication, is made on behalf of:

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TABLE OF CONTENTS

1	Overview.....	3
2	Summary of Key Issues.....	4
3	Background of Key Issues	5

1 Overview

Ergon Energy Corporation Limited (Ergon Energy) in its capacity as a distribution entity directly connected to the Powerlink transmission network welcomes the opportunity to make this submission with respect to the Australian Energy Regulator (AER) Draft Decision on *"Powerlink Queensland transmission network revenue cap 2007–08 to 2011–12, 8 December 2006"*.

Ergon Energy has reviewed the draft decision and commends both parties on a comprehensive application and decision.

The information contained in both documents was sufficient for Ergon Energy to form an opinion as to the likely impacts on us and our customers when the final decision is handed down.

Ergon Energy has concerns in potential outcomes of this decision as they directly impact on Ergon Energy as a customer of Powerlink and as a distributor of electricity to approximately 600,000 customers in regional Queensland. These concerns are:-

- Reliability of service to customers of Ergon Energy and;
- Availability of service to customers of Ergon Energy

This decision touches areas directly related to maintaining or improving the current reliability of service to our connected customers, the ability of future customers to obtain a service they expect and the future development of the State of Queensland.

2 Summary of Key Issues

Growth and Security, Reliability, Availability

Ergon Energy does not agree with AER's assessment of demand growth and customers willingness to accept a lower level of security should that growth be realised earlier than anticipated.

Particularly, in the Central Queensland area which includes Gladstone. There are a large number of large industrial loads, potential for more large industrial loads and an increasing population driven by the need to provide labour but also by sea/tree change migration.

Ergon Energy does not agree with AER's assessment that DSM and other similar initiatives provide a viable deferral of transmission infrastructure investment. Queensland already has a high level of DSM in place in the form of controlled hot-water. Any potential gains from further load flattening will be at the margins and would not significantly impact the timing of Powerlink's infrastructure projects. DSM cannot deliver capacity on the scale required in areas where major industrial and mining loads are being developed.

Asset Replacement

Ergon Energy does not accept AER's view that asset replacement programs are overstated by Powerlink. Powerlink are recognised leaders in the use of condition based monitoring and asset management. Any replacement programs arising from detailed, objective and quantitative analysis of the condition of the assets should be given due recognition.

Cost Drivers

Ergon Energy agrees with Powerlink's view of recent cost increases in the electricity supply industry. AER needs to consider industry specific indices when forecasting future capital, operational and maintenance costs.

3 Background to Key Issues

Ergon Energy has reviewed the AER draft decision and makes the following comments in relation to that decision and the advice provided by the technical expert Parsons Brinckerhoff Associates (PB). The comments provided by Ergon Energy concern projects within our area of supply that will impact on the reliability and security of supply to our customers.

While Ergon Energy is committed to minimising costs to our customers in the delivery of electricity, we also are subject to price increases from our suppliers and increases in the key input costs of materials and labour. Our ability to absorb these price and cost increases is limited and a balance must be struck between passing these costs on and reducing levels of service. Given Powerlink's crucial role in maintaining and improving the level of service as demanded by our customers then modest increases should be expected.

Opening RAB and past capex

Ergon Energy is generally supportive of the position taken by the AER in this area. We are pleased to note that the AER has accepted Powerlink's updated estimate of expenditure of assets under construction during the present regulatory period. Ergon Energy is also pleased to note that the AER has supported the application of prudent avoidance in relation to EMF.

Forecast capex

Demand driven

Ergon Energy is very supportive of Powerlink's probabilistic planning approach and believes that the scenarios and probabilities of each scenario throughout the region supplied by Ergon Energy are realistic and conform with the load forecasts prepared by us.

We note that in the review of the Strathmore to Ross 275kV project PB indicated that they believed that Powerlink could "negotiate with one of its connected parties for a temporary lesser supply standard..." or "...trip load after a forced transmission outage...". As any reduction in supply standard directly affects our connected customers, Ergon Energy would not be able to agree to such a reduction in supply standard. It is also unlikely that any "small scale demand side responses" would be successful in the near term as Ergon Energy has already implemented a load management scheme in the area of interest. PB did comment that Powerlink had been unsuccessful many times in seeking DSM or grid support solutions to alleviate transmission loading and Ergon Energy agrees that there is little ability to achieve additional demand side response to contingencies in the area. It does appear that PB has dismissed Powerlink's economic studies to use double circuit high capacity lines without any justification. Ergon Energy does not agree with the reductions proposed by PB power for this project due to the adverse impact that any such reductions could have on the security of supply to our customers in the area.

In relation to the Larcom Creek 275kV/132kV substation project PB has stated that "The scope of work for the Larcom Creek substation development was excessive given the early stage of industry development in the area". Ergon Energy supports the strategic initiatives proposed by Powerlink to supply this very important industrial development area and rejects any proposed scaling back of these initiatives. The Gladstone industrial area requires supply security commensurate with the types of industry

operating in that area, and needs to have appropriate capacity available to support new industrial development in challenging time frames and cannot afford sustained lowering of the level of security of supply in order to perform network upgrades. Ergon Energy believes that the Powerlink proposal addresses these requirements.

Ergon Energy considers that in a balanced determination it is necessary to include projects that result from a high load growth scenario as well as all of the other scenarios with an appropriate probabilities assigned to each possible outcome. We see no reason that the projects that make up the CQ No1 132/33kV transformer project section of the submission should be completely excluded because of the low probability that they have been assigned.

Ergon Energy believes that there is no justification for reducing the demand driven capex proposal by an additional 4% based on the review of a subset of the projects in the Powerlink submission. Further reductions should be justified by review of specific projects and not on an estimate obtained from a review of quite separate projects in the submission.

DSM

Queensland already has a high level of DSM in place in the form of controlled hot-water. Any potential gains will be at the margins and would not significantly impact the timing of Powerlink's infrastructure projects – particularly when seen against ongoing cost increases faced by the Electricity Supply Industry. Further, DSM would by and large need to be delivered through Ergon Energy programs as it is highly unlikely Powerlink can source significant quantities of DSM to provide meaningful long term load reductions at the transmission level. Large industrial and commercial operations that are direct customers of Powerlink generally have very high load factors leaving little scope for controlling peak load via DSM initiatives.

Ergon Energy is working with Energex and Powerlink to develop DSM initiatives in Queensland in response to the increased use of air conditioners. The impact of this type of load is a general increase in demand across the daylight hours of the load profile rather than an increase in peak demands. However, there is some potential to improve the summer load profile and these opportunities are being explored.

Replacement Strategies

Ergon Energy agrees with Powerlink that a significant increase in expenditure on the replacement of assets during the next regulatory period is warranted. PB's top down analysis method appears to offer a means to provide an estimate for asset replacement capex. However the value of 20% for augmentation premium and 20% for replacement premium appear to be very much an estimate, with little or no justification being provided as to how these premiums were established. It seems that using this top down approach to provide an estimate has been justified by stating that if it turns out to be incorrect then additional expenditure can be undertaken at the beginning of the following regulatory period.

Ergon Energy would consider that the approach used by Powerlink of completing detailed asset condition assessments and performing prioritisation by means of risk assessments as described in its submission would provide a more justifiable means to determine required replacement expenditure. Unacceptable asset condition can impact adversely on Ergon Energy customers and hence Ergon Energy supports a replacement expenditure program determined by condition assessment of assets with

economically justified augmentation being performed as part of the asset replacement. For this reason we believe that a reduction of \$111 million in the replacement allowance is not warranted.

Ergon Energy does not accept AER's view that asset replacement programs are overstated by Powerlink. Powerlink are recognised leaders in the use of condition based monitoring and asset management. Any replacement programs arising from an analysis of the condition of the assets should be given due recognition. While a top down approach to the level of expenditure is useful as a benchmarking exercise it should not be used to set actual expenditure levels within the comparatively short time frame of the determination period compared to the long term, ongoing program of, renewal over the life of the assets. The transmission network is a complex asset and there are many factors in deciding optimal replacement strategies. Any deferral of asset renewal increases the risk to availability and reliability of supply to Ergon Energy and consequently our customers.

Price and Cost Drivers

Ergon Energy operates in the same environment as Powerlink and contractors are generally similar between both companies. Further the material and labour requirements of both companies are also similar.

Ergon Energy has experienced similar price increases from its contractors as Powerlink has – particularly in the line and substation construction areas.

Ergon Energy has also faced recent cost increases in materials and wages. Materials in the electrical supply industry are largely imported and the suppliers of these materials are operating in a world market where demand is extremely high. At a national level demand for construction contractors is very high. This is compounded in Queensland where a resources boom is being experienced. This competition translates to contractors being able to be selective in choosing their clients and significant competition for skilled people.

Table 1 shows the increases we have experienced this year for contractors. These cost increases are mainly associated with the labour component and aligned expenses. They do not include main items of material. Whilst the EBA increases are generally higher than CPI the contractors in many cases have had to pay above EBA conditions to attract and maintain labour in regional Queensland. There is serious competition from the resource industry for similar skills. This trend is anticipated to continue for some years.

Table 1 Contractor Increases

	2006	
Major impacts	Fuel, EBA, and market demand	
	Existing Dollars Millions	percentage increase
Asset Inspection (incl NAPM)	35	6%
Vegetation Clearing	55	15%
Distribution Lines	50	19%
Substations	70	15%
Transmission lines	30	14%
Other	15	6%
Total	255	14%

The current resources boom in Queensland has made the attraction and retention of skilled labour highly competitive and this has flowed through to increased labour costs for ourselves and our service providers. Additionally, the pool of service providers has been facing increasing demand from the electricity industry across Australia which has allowed them to increase their prices to the industry.

END