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Dear Paul,

ENERGY USERS ASSOCIATION OF AUSTRALIA (EUAA) SUBMISSION RE POWERLINK'S REVENUES

1. Cost comparisons

The comparisons made by the EUAA are totally inappropriate for a transportation function like transmission – they ignore transport distance and load density.

The geography of Queensland means that transmission unit prices (expressed in $/MWh) can never match those in more compact geographies or those with much higher load densities.

The EUAA expectation of transport price equivalence is tantamount to expecting that it would cost the same per litre to bulk transport milk between Brisbane and Ipswich (35km) as it does between Brisbane and Cairns (>1700km); or that it would cost the same per litre to deliver 10,000 litres of milk via bulk carrier to a single drop-off point as it does to deliver the same volume in 500ml cartons to 100 drop-off points.

These are the economic fundamentals of a transportation activity, and compact geographies with high load densities (e.g. UK) do have a significant natural relative advantage compared with dispersed geographies with low load densities (e.g. Queensland).

2. Relative risks and WACC

(a) Explicit risks

In relation to 3rd party liability, Powerlink would point out that MSO functions, which are, as EUAA correctly points out, subject to a liability cap, represent less than 2% of Powerlink's activities. By contrast, the mainstream network business is not covered by liability caps.

A long, thin grid is more exposed to outages than a more compact one, and the heavy loading means that the impact of each outage is larger than a grid which is less heavily loaded. For example, over the past 20 years, the annual number of simultaneous outages of both circuits on double circuit lines in Queensland has ranged from 2 to 19, with a median value of 10.

This is much higher than other grids.

In relation to asset stranding risks, Powerlink accepts that when it writes down asset values via optimisation, the Regulator is acting as a proxy for the competitive market. The point Powerlink is making is that there is a much higher risk of that happening to its grid, due, inter alia, to the development of a gas pipeline in parallel with, and for the full length of, the Powerlink grid.

EUAA's suggestion that the resultant gas generators may represent upside for Powerlink is not correct. The major load centre in Queensland is the SE corner, which represents 60% of the State load. There are 2 ways for electricity to be delivered to the SE corner – one delivery system comprises Powerlink's grid and remote power stations; the other comprises a gas pipeline and gas generation close to the load – the latter would bypass, rather than use, Powerlink's grid.

The threat from the pipeline is real – its development is underpinned by the Queensland Energy policy and as recently as this week, newspaper reports have confirmed the plans of Australian Pipeline Trust to build such pipelines in Queensland.

Against this background, Powerlink has to make investment decisions for assets with potential lives of 50 years. Based on EUAA's comments on customers expectations of reliability, Powerlink finds it difficult to believe that customers would want Powerlink to defer investment decisions on reliability augmentations, and in the process expose customers to material risks of loss of supply, in order to wait for more certainty in other developments. It is this "reliability imperative" which means that such decisions cannot be deferred to a more certain investment

environment, and means that Powerlink's investments over the next 5 years have to be made in an environment which is less certain than for other networks.

Powerlink does not agree that the regulatory regime has settled down, and would note that the ACCC regulatory principles are still in draft form, and would also note the many sections of the reports of the ACCC's consultants promote principles which are divergent from the ACCC's draft principles. The regime is still a long way from "bedded down".

There are fundamental problems in using short-term measures for the risk free rate at the heart of the WACC calculation. Powerlink cannot instantly re-finance its $1 billion debt on a daily basis to track interest rate movements. Both the 5-year bond and the 40-day average represent a fundamental mismatch to the real world financing equation for Powerlink.

The EUAA and its members may not appreciate (and we accept that is probably our shortcoming) the cost savings which occur in other elements of the total delivered cost of electricity as a result of transmission augmentations.

One example is the QLD–NSW Interconnector (QNI), which increases TUOS for customers in NSW and QLD by about $0.8M per week. However, upon its commissioning, the costs of ancillary services, which are part of the NEMMCo charges typically passed through to contestable customers, dropped by $2.5M per week and this is a long-term decrease. The net effect for EUAA members is a lower total delivered cost of energy, even though the TUOS component may increase.

Another example is the Cairns reinforcement, which is justified solely on reliability grounds. However, it also delivers a reduction in the MLF of 11% - this far outweighs the increase in TUOS, and again delivers a lower overall total delivered cost of electricity.

There are two pre-conditions for those customer-beneficial outcomes to occur: -

(i) sufficient capex allowance in the revenue cap; and

(ii) a WACC which will enable Powerlink to invest.

In relation to the latter, the WACC proposed by the EUAA comes up short. The investments won't occur and the customer benefits would be foregone. The customers may face lower TUOS, but the total delivered cost of electricity would be higher.

EUAA and its members should not underestimate the impacts on MLF of the long, heavily loaded lines in Queensland. Again, it is typical for retailers to pass the MLF risk through to contestable customers. Transmission losses are proportional to the SQUARE of the current – if the load grows by 4%, the losses increase by 8%. Transmission augmentations (e.g. another circuit) will decrease the current in each line, and hence decrease the losses.

With the high load growths in Queensland (non-smelter load in QLD in 2000/01 is up 7% on last year), and in the absence of transmission augmentations, the MLFs to which contestable customers are exposed will increase significantly each year, adding to the total delivered cost of electricity.

The EUAA and its members may also not fully appreciate the risks to the price of electricity in the coming years due to network constraints.

It is well known that there is an imminent oversupply of generating capacity in Queensland – and, all things being equal, customers are anticipating a reduction in energy costs. However, all things are not equal. Network constraints act to deny customers access to the low priced energy. A recent NEMMCo report identified the Queensland grid as by far the most heavily constrained grid in the NEM.

Again, it is transmission augmentations which alleviate these constraints, and ensure that customers have access to the low priced energy.

In short, the biggest price risk for EUAA members and other customers in Queensland is not an increase in TUOS – after all, TUOS is only 7% of the total delivered cost - the biggest risk is the rising MLFs and network constraints which deny access to the anticipated low cost energy. This risk will arise if there is not enough investment in the NEM's most constrained grid.

At the end of the day, customers need these investments to happen in a timely manner, and the EUAA's proposals on WACC will not deliver that. The EUAA proposed WACC is below Powerlink's cost of funds, and if the ACCC adopts such a low number, it will need, for consistency, to set the forecast capex at zero (and increase the grid support costs by between $30M and $50M per year).

Superficially, this sub-economic rate of return might look attractive to EUAA and its members. In reality, it is a prescription for higher electricity prices for EUAA's members.

3. Opex and capex

In relation to EUAA's calls for more thorough analysis, we would note that the ACCC's consultants did just that, by drilling down to levels of detail which were deeper than Powerlink expected.

4. Service standards

We note that EUAA members are vitally interested in receiving a "world-class level of service". The capex and opex included in Powerlink's submission are based on meeting the reliability criteria in the Code, which are basically a minimum standard for customers-at –large.

The Code provides for customers to negotiate for, and pay for, a higher standard if their particular needs require that. The capex and opex in the Powerlink submission do not include any allowances for higher levels of reliability.

In a long thin grid like Queensland, the delivered level of reliability cannot match that of a compact, highly–meshed grid. In a long thin grid, there are few alternate pathways, and the long distances mean that the addition of new lines /`pathways always involves significant capital.

In short, it is reasonable to expect Powerlink to deliver the same level of reliability as long, thin grids elsewhere. But it is not reasonable to expect the same reliability as a highly meshed grid with multiple pathways, without a much larger capital investment (and cost to customers) than contained in our submission.

Yours sincerely,

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CHIEF EXECUTIVE