9 February 2007

QUEENSLAND
resources
COUNCIL

Mr Mike Buckley
General Manager, Network Regulation North
Australian Energy Regulator
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via powerlinkreset@aer.gov.au

Dear Mr Buckley

The Queensland Resources Council (QRC) is the peak representative body for the minerals and energy resources sector in Queensland. QRC's focus is on securing an environment conducive to the long term sustainability of the resources sector in Queensland.

QRC members are engaged in the export of record volumes of minerals and mineral products from Queensland, and are presently undertaking major expansions of capacity to meet continuing strong export demand. The Australian Bureau of Agricultural and Resource Economics (ABARE) has estimated that there is more than $6 billion direct capital investment underway in the Queensland mining and minerals sector, with substantial supporting investments in major capacity upgrades in rail and ports.

One of QRC's major goals is to secure these key business resources to sustain and grow the sector through competitively priced rail, port, energy and water services. As a result, QRC has been watching with interest the AER's first decision over Powerlink's electricity transmission.

It is unfortunate that this inaugural decision has been complicated by the need to operate under special transitional rules as a result of the Australian Energy Market Commission's review of the national rules (SRP) occurring at the same time as Powerlink finalising their revenue proposal. The process is also complicated by Powerlink's decision to make a late supplementary submission just five days before AER released a draft decision.

The QRC does not profess to be an expert in complex regulatory or technical transmission matters as this is not the Council's role; however QRC is concerned by the headline level issues which have emerged from the hundreds of pages of analysis and independent expert advice. At a time when the AER is being seen by many as a test case for the future of consistent national regulation, there is a risk that the AER's draft decision could be unhelpfully characterised as over-emphasising regulatory precision in favour of workable regulatory decisions that seek to test the "reasonableness" of a regulated entity's claims.

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If this consultation process was a simple matter of industry stakeholders weighing up Powerlink's original proposal against the analysis in the AER's draft decision, QRC would be inclined to take great comfort from the rigour with which AER have dissected Powerlink's claim and be confident that there was little or no element of monopoly rent. While the composition of the different elements of Powerlink's original revenue proposal vary from the AER's draft decision, the fact that the totals are comparable would suggest that Powerlink's proposal is broadly within the bounds of 'reasonableness' as provided in the COAG regulatory principles of 10 February 2006. Under these circumstances, and given Powerlink's past capex performance, QRC would be inclined to support Powerlink's original proposal.

However, COAG's 'reasonableness' test is not as useful a guide for considering Powerlink's supplementary submission, as AER's analysis of this additional submission is not available to QRC members. QRC requests that the AER treat the additional submission in the same manner as they have the original, by winnowing out inefficiencies in determining if the submission is reasonable. AER could usefully consider if it is possible to accommodate some consultation process on the regulator's analysis of Powerlink's supplementary submission without extending regulatory deadlines.

The AER's draft decision notes that transmission electricity charges represent around 8 per cent of the final cost of electricity to the end user (page viii). As you would expect, the Powerlink submissions emphasise their small contribution to the final cost of a unit of electricity.

AER Executive Michelle Groves noted in a speech in July 2006 that over the past decade the Queensland energy market has been one of the most dynamic in the country. She went on to say that:

> "...present indicators are that the next decade will be just as dynamic.
>
> ...We understand that Powerlink is operating in a high demand growth environment. Understanding this is one thing. Being satisfied that allocated funding will be spent soundly is something else."

The Energy Users Association of Australia (EUAA), which noted that users may be able to "accept some degree of overinvestment as long as there is an offsetting customer benefit", raise an important issue of the asymmetric risks for investments in transmissions infrastructure. The resource industry, both upstream and downstream of Powerlink, place great importance on the security and reliability of energy supply. It could be argued that this security does provide a tangible customer benefit and as a result could be explicitly recognised in setting Powerlink's revenue cap.

The possible customer benefits in an expanding market of a *slight* over-investment (certainly as opposed to under-investment), have been contemplated in framing the objective of the National Electricity Market, as stated in the National Electricity Law, which is:

> "To promote efficient investment in, and efficient use of, electricity services for the *long-term interests* of consumers of electricity with respect to price, quality, reliability, and security of supply of electricity and the reliability, safety and security of the national electricity system." (emphasis added)

QRC suggest that this focus on the long-term customer perspective, rather than the medium-term regulatory outlook, would tend to reinforce the importance of avoiding an underinvestment in Queensland's transmission infrastructure.

The other aspect of the balance between under and over investment is the market's growth prospects. In a dynamic and growing economy, too little investment in transmission infrastructure can risk delaying or frustrating new developments, whereas some degree of overinvestment represents more an issue of timing rather than utilization.

In an economy with energy demand growing at the rate at which Queensland is forecast to continue growing, there seems little risk of assets being stranded in the long term but rather an issue of those transmission assets being in place marginally earlier than was necessary. QRC suggests that AER needs to give some credence to the Powerlink's arguments about the need to maintain (if not improve) transmission services in Queensland, given the asymmetric risks presented by these investment decisions.

In QRC's experience, the past behaviour of government owned corporations (GOCs) can be a reliable indicator of their future intentions (at least in the short to medium term). In this context, QRC notes the recognition from the Energy Users Association of Australia (EUAA) presentation to the 20 April 2006 forum in Brisbane that Powerlink is a "*well run and generally efficient*" corporation.

It is also instructive to note that although Powerlink spent some $219 million above their regulated capex allowance in the last regulatory period, the AER's draft decision recognises all of these investments as prudent and includes them in Powerlink's regulated asset base. This recognition is notwithstanding the advice of AER's technical consultants PB that $6.1 million of this be optimised out of the asset base; however PB did acknowledge Powerlink's planning processes were "*systematic, through and of a very high standard*". QRC suggest that this track record of prudent investment should give AER some comfort that Powerlink's planning for future capex investment is also likely to be of a similar quality.

The Energy Users Association of Australia (EUAA) presentation to the 20 April forum in Brisbane warns of the risk of regulatory gaming, that the regulated monopoly may have an incentive to backload the investment profile towards the end of a regulatory period in order to help justify a larger capex allocation in the next period. While QRC regards this as a valid caution, QRC also suggests that the same investment profile could equally be a symptom of prudent investment to meet an upswing in demand towards the end of a regulatory period.

QRC has also raised concerns with transmission infrastructure in the context of the national debate on emissions trading. In two submissions to the National Emissions

Trading Taskforce (November 2005 and December 2006), QRC has made the point that:

> "In modelling the impact of emissions trading, it is easy to neglect real world constraints which substantially limit the economy's capacity to realise the theoretical benefits. For example, transmission constraints currently represent major impediments to promoting efficient investment signals (both locational and timing) and as such, certain transmission links in the National Electricity Market require augmentation in order for major capital investments to efficiently follow any future emissions trading regime."

Currently in Queensland transmission investments can be responsive enough to new demand not to lie on the critical path for the resource industry's new projects. Any change in this situation could mean that delays in investing in transmission infrastructure will cause delays in major resource projects. As noted by QRC above, any such delays could distort all manner of major investment decisions to the detriment of the economy.

The QRC encourages the AER to ensure that any regulatory decisions on Powerlink's revenue cap can consistently deliver the necessary upgrades to the transmission grid to support the capacity expansions in mining, minerals processing, rail and ports within the very tight project timeframes of these export infrastructure chains. In that regard, the present arrangements appear to be working reasonably well, but if these can be streamlined to shorten the development timeframes, this would benefit both QRC members and the Australian economy.

In summary, QRC commends the AER for the thoroughness with which they have reviewed Powerlink's revenue proposal; however QRC suggests that the AER needs to make appropriate allowance for Queensland's specific resource development outlook and construction trends when making a final decision for Powerlink.

Thank you for the opportunity to provide comment on the AER's draft decision. If you would like any further information, please contact Andrew Barger QRC's Director, Industry Policy on 07 3316 2502 or andrewb@qrc.org.au

Yours sincerely

Michael Roche

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