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Dear Enrico and Greg

**TRANSGRID AND POWERLINK QUEENSLAND
INTERIM REPORT FOR MARKET CONSULTATION ON THE QNI INTERCONNECTOR**

The Energy Users Association of Australia (EUAA) welcomes the opportunity to comment on the *Potential Upgrade of Queensland / New South Wales Interconnector (QNI) – Assessment of Optimal Timing and Net Market Benefits* report recently released by Powerlink and TransGrid. We support the application of rigorous assessments to regulated interconnectors, from an end-users perspective. However, the market benefits limb of the Regulatory Test has proved to be problematic, and the failure of that test to provide support for the construction of a single interconnector (or upgrade) since its inception is a cause of major concern for the EUAA and its members. This is especially in view of the dramatic impact on pool prices that transmission constraints can have – and for which end users end up paying. These interconnector constraints heavily qualify the ‘national’ nature of the NEM.

QNI is one of the most important interconnectors in the NEM, serving major load centres between Sydney and Brisbane. The role that the QNI places in smoothing price separation between these regions cannot be understated. The QNI also plays a crucial role in maintaining system security in the NEM.

On the basis of our own internal assessment which has, necessarily been limited, it appears that the methodology employed in determining the timing and defining the nature of the most suitable QNI upgrade is, for the most part, sound and well reasoned. We note in particular that Option 1 under the ‘high economic growth’ scenario with realistic generator bidding behavior brings forward the optimal timing for the upgrade to 2009/10, and we are not convinced that the growth assumptions underlying that scenario should not be explored further. We do, however, have some general points to make on QNI, the nature of the current Regulatory Test and other factors that we consider should contribute to the assessment of the preferred option.

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The Regulatory Test

The EUAA has made several submissions to reviews of the Regulatory Test in the past. We note that there is currently a further review of the new Regulatory (Investment) Test occurring in the context of the National Transmission Planner (NTP) function being developed by the Australian Energy Markets Commission (AEMC). The EUAA is also contributing to that process. For the record:

- The EUAA considers that the existing Regulatory Test has not, and does not deliver efficient outcomes to end users in the NEM, and the shortcomings of the test have prevented the timely construction of much needed interconnectors and restricted the development of a truly national market.
- Wealth transfers must be considered as part of the application of the Regulatory Test: The *raison d'être* of the NEM is about delivering maximum benefits to end-users. This is embedded in the Market Objective which has as its focus the long term interests of consumers of electricity. Continuing Excessive wealth transfers away from end users to generators (or any other party for that matter) are not consistent with this.
- Concepts of 'competitive neutrality' previously pursued in the application of the Regulatory Test are now less relevant in an environment where investment decisions must be made having due regard to the Market Objective, which, quite rightly, elevates the interests of consumers above those of other stakeholders.
- There are significant efficiency benefits to be gained by creating a more level playing field between investment in generation as against transmission / network development. We note the recent entry of new generation into areas (south-west Queensland) that would otherwise be ripe for transmission investment. This generation has previously delayed the upgrade of QNI, and in the current environment appears to have again done the same. The current Test seems to work in a way that always favours generation over interconnection and therefore ultimately entrenches the market power of generators. We question whether the current Regulatory Test will ever show a result that will justify the building of, or upgrade to an interconnector, while proposed major interconnection upgrades can be undermined by generation investment.

Because of the non-regulated nature of generation and the workings of the Regulatory Test that does not allow the inclusion of wealth transfers from customer to generators to support the construction of interconnector upgrades, the underlying rationale for transmission interconnector upgrades is flawed. The comparatively short lead times that are needed to site and build some types of new generation assets also contribute to generation investment crowding out new transmission investment, which typically requires longer timeframes to implement, particularly in relation to a major upgrade such as the one being contemplated. This can be clearly seen in the re-ranking of the QNI upgrade project in NEMMCO's Statement of Opportunities in recent years.

Policy Challenges

From page 7 of the report, we note that Powerlink and TransGrid consider that the QNI upgrade analysis

'does not take account of any impacts of the Commonwealth Government's proposed emissions trading scheme. Such a scheme can be expected to result in, over time, changes to generator bidding behaviour and new generation investment that are likely to affect the market simulations. These effects are quite uncertain at this point in time, given that the formulation of an emissions trading regime is a body of work in progress.'

It is not clear to us whether this statement relates to the Rudd Government's announced policy positions on both the creation of an emissions trading scheme (ETS) and the implementation of a beefed-up renewable energy target (20% by 2020). The introduction of an ETS carbon cap-and-trade scheme, and the introduction of a renewable energy target that aims to increase Australia's output of energy generated from renewable sources from a current 9,000 GWh to 45,000 GWh by 2020 may well be highly relevant to the assessment of the economics of the QNI interconnector upgrade, particularly in the context of bringing geothermal power to market

TransGrid's Regulatory Reset

We note that TransGrid is due to submit its revenue proposal for 1 July 2009 – 30 June 2014 to the AER in May. We consider that the submission of the regulatory proposal for the next five years from mid-2009 provides an excellent opportunity for TransGrid to include the NSW section of the favored QNI upgrade within that proposal, at least as a contingent project (although as we have mentioned, this is a second-best option and we consider the upgrade should proceed immediately). Including the NSW portion of the project on a contingent project basis is likely to provide TransGrid with maximum flexibility to build the NSW portion of the augmentation as early as possible in the future.

We also note that if the project is included in the next regulatory reset for Powerlink, construction of the project might blow out to 2017 or later, as the Australian Energy Regulator (AER) does not have any coercive powers to ensure that the upgrade is built. There are incentives for both TransGrid and Powerlink to hold off on building the upgrade for as long as possible, should funding be provided for this purpose.

We note that under the study's high economic growth scenario the building of the QNI upgrade (in both NSW and Queensland) becomes the preferred option from 2009/10. If the project is not included on a contingent project basis, then there will be no possibility of meeting this timeframe should the eventuation of a high-growth scenario make viable the early construction of at least a portion of the QNI upgrade. There is a risk that if the QNI upgrade (series compensation) between Armidale-Dumeresq is not constructed in the next six years that further generation development could once again crowd out this investment.

We would like to see some further assessment of the viability of an early QNI upgrade in the light of the new policy focus of the federal government and the other issues that have been raised in this letter. It does not appear to us that the optionality of the development (to deal with uncertainties) has been fully evaluated. For example the report does not address the ability of the upgrade to deal with uncertainties such as changes in hydro yield or changes in plant performance. The report only considers models changes in load growth and bidding behavior. We note that TransGrid and Powerlink have themselves pointed to circumstances in which the bringing forward of the preferred QNI option is likely to meet the market benefits of the current Regulatory Test.

If you have any further questions in relation to this letter, you are welcome to contact me at the EUAA on (03) 9898 3900.

Yours sincerely



Roman Domanski
Executive Director