

Our Ref: DBN-107

Department of
Mines and Energy

Mr John Hall
Chief Executive Officer
Queensland Competition Authority
GPO Box 2257
BRISBANE QLD 4001

Dear Mr Hall *John,*

The Department of Mines and Energy (DME) welcomes the opportunity to provide additional comment on the Queensland Competition Authority's (QCA) *Draft Decision on the Benchmark Retail Cost Index (BRCI) for Electricity: 2008-09* (the Draft Decision). DME is keen to reinforce the views expressed in its previous submission, that in achieving efficient and sustainable energy pricing, it is also important from the consumer's perspective to ensure that only genuine cost increases are reflected in the QCA's Final Decision on the BRCI for 2008-09.

DME was pleased to participate in the QCA's Forum on 27 March 2008 which discussed a range of issues raised in the first round of submissions.

DME anticipates that in making its Final Decision on the BRCI for 2008-09, the QCA will promote competition and efficient energy pricing and appropriately balance the interests of industry stakeholders and consumers by ensuring that only genuine cost increases are reflected in the Decision. Fundamental to this process will be the careful consideration of inputs and assumptions used to calculate the BRCI, given the breadth of views expressed in the consultation process to date.

DME notes that many of the representations at the Forum related to the determination of the cost of energy for the BRCI. This included the tabling of a consultant's report providing some views on Long Run Marginal Cost (LRMC) levels, or movements, in the electricity generation sector. The QCA has since made this report available on its website. The QCA will need to take a view in relation to these matters, having regard to the actual Queensland market situation.

DME makes the following comments in this regard:

Capital costs

Noting the probability of some cost movement to 2008-09, it will be important to consider:

- the need for capital cost estimates to be based on generator unit sizes relevant to Queensland, to capture economies of scale;
- movements in the Australian dollar when applying or quoting overseas prices or escalation;
- the potential for lower costs at brownfield sites; and
- the relatively high availability of Queensland baseload plant over many years.

Fuel costs

The Queensland power station fuel market is not fully integrated with the export coal trade, because of quality and/or locational issues. In addition, DME notes:

- the integrated nature of many mines / power stations, including long-term contracts which will clearly cover 2008-09;
- similar arrangements for some gas-fired power stations; and
- that fuel price assumptions need to be consistent with National Electricity Market bidding behaviour, which does not seem to support significantly higher fuel costs.

Operation and Maintenance

There is a need to ensure that operation and maintenance costs reflect only explicit operational and maintenance costs (labour and materials), not operating costs e.g. fuel preparation, which are considered in heat rates.

Gas Electricity Certificates (GECs)

Despite various arguments about valuation of GECs, DME considers that in competitive markets, generators will bid to run, and will need to recover short run costs from the pool and GECs. While bidding full short run costs could restrict operation and GEC supply, and so raise the GEC price, this is not the observed outcome. Neither would be bidding short run costs less the full tax-adjusted penalty price, which could oversupply the GEC market and lower the GEC price.

Emission Trading Schemes

DME is of the view that it is not appropriate to incorporate into the 2008-09 BRCI any allowance for the costs of future emissions trading or other greenhouse response schemes which have not yet been determined.

Calculation of the Energy Cost Component

There was considerable discussion at the QCA forum on how the QCA calculated the energy cost component of the BRCI. Specifically, Section 92 of the Act sets out the terms on which the QCA must calculate the energy cost component of the BRCI. Relevantly, subsections 92(1) and 92(2) provide that:

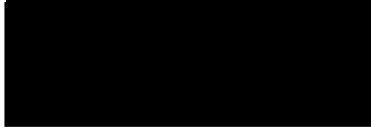
- “(1) The cost of energy must reflect the pricing entity’s view of the likely total of the costs to be incurred during the relevant tariff year to purchase energy to supply all of the NEM load of the State for the relevant tariff year.” [The NEM load being the total loads for the state supplied at each transmission connection point to a distribution network - s91F.]; and
- “(2) The view must be based on the pricing entity’s most recent estimate of the long run marginal cost of energy in the part of the State connected to the national grid...”

It seems clear that these provisions require the QCA to form a view on the cost of energy required to serve the “NEM load”. The view is to be based on the QCA’s estimate of the long run marginal cost in the national grid, taking into account the most efficient combination of generating plant to supply the NEM load (s92(3)). It is a matter for the QCA to determine how best to make that estimate, subject to ss104-107 of the Electricity Regulation 2006.

In conclusion, DME again encourages the QCA to ensure the BRCI for 2008-09 reflects only real cost pressures and to have regard to the actual market situation in Queensland, including its position as a net exporter of electricity, when considering the costs of energy for input into the BRCI, which ultimately impacts on consumers.

I thank you for your consideration of these matters. Should you have any enquiries in the first instance, they should be directed to Ms Michelle Norris, Director, Energy Policy Division, telephone 3225 8256.

Yours sincerely



STUART BOOKER
A/Director-General
Department of Mines and Energy