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Dear Patrick

Draft Report: Maximum Reserve Capacity Price for the 2009/2010 Capacity Year

This submission from Alinta Sales Pty Ltd (**Alinta**) provides comments on the Draft Report issued by the Independent Market Operator (**IMO**) proposing that the Maximum Reserve Capacity Price applicable to the 2009/10 year should be set at \$129,900 per MW.

Alinta has a number of concerns with the IMO's proposed Maximum Reserve Capacity Price.

Specifically, Alinta is concerned that some of the cost estimates used to determine the proposed Maximum Reserve Capacity Price do not accurately reflect actual market costs. Alinta is also concerned with regulatory risk aspects of the IMO's proposal.

Alinta has addressed each of these concerns in the sections below, however, given the limited time frame to respond Alinta has not been able to perform the detailed review that this important issue deserves. Alinta asks that the IMO provide Alinta with an opportunity to discuss its concerns directly with the IMO before the IMO issues a final decision.

Capital Cost - Gas Turbine Price

Alinta suggests that the IMO reviews the requirement to utilise the lowest of the quoted gas turbine prices. Practically, it may not be appropriate to utilise the manufacturer with the lowest quoted price as they may not be able to deliver the project within the required timeframes.

Electricity Transmission Connection Costs – Connecting to the SWIS

Alinta disagrees with the Sinclair Knight Merz (**SKM**) approach to calculating the electricity transmission connection costs.

The Wholesale Electricity Market (**WEM**) rules state that the transmission connection cost *'is the cost of electricity transmission assets required to connect an open cycle gas turbine power station to the SWIS...'*. However, the SKM report appears to have calculated the capital connection cost for connecting a 160MW generator to a generic 330kV transmission line and has not taken into account the actual costs required to meet Western Power's requirements that are unique to the SWIS. For example, the underlying configuration proposed in the SKM report is unlikely to be acceptable to Western Power given the outages required on the 330kV system to construct it.

In order to obtain more accurate cost estimates Alinta suggests that the IMO should:

- arrange for its consultant to liaise more closely with Western Power for current market advice;
- directly obtain the relevant cost estimates from Western Power as suggested in s4.16.4c of the WEM rules; and

- confidentially liaise with Market Generators, who have the most recent/current experience of these costs, for current market advice.

Transmission Connection Costs – Length of Tie Line and Tie Line Cost

Alinta proposes that the length of the tie-line used in the transmission connection cost estimate is typically less than that required by generators connected to the South West Interconnected System (SWIS). Alinta estimates that, on average, tie-lines connecting generators to the SWIS 330kV system are longer than 2km assumed by the IMO and that an amount of 10km to 20km would be more appropriate. Alinta suggests that the IMO assess the location of existing, proposed and under construction generators with a 330kV connection to the SWIS in order to determine an average tie-line length on which to base the cost estimate.

Furthermore, the tie line costs incurred by proponents in the current market are significantly greater than those utilised in the SKM report. Over the last 3 years Alinta has experienced significant cost increases in raw materials and labour associated with the construction of transmission lines that do not appear to be considered in the SKM report.

In order to obtain more accurate cost estimates Alinta suggests that the IMO should:

- arrange for its consultant to liaise more closely with Western Power for current market advice;
- directly obtain the relevant cost estimates from Western Power as suggested in s4.16.4c of the WEM rules; and
- confidentially liaise with Market Generators, who have the most recent/current experience of these costs, for current market advice.

Transmission Connection Costs – Switchyard Costs

Alinta comments that the switchyard costs incurred by proponents to meet Western Power requirements are significantly greater than those assumed in the SKM report. In order to obtain more accurate cost estimates Alinta suggests that the IMO should:

- arrange for its consultant to liaise more closely with Western Power for current market advice;
- directly obtain the relevant cost estimates from Western Power as suggested in s4.16.4c of the WEM rules; and
- confidentially liaise with Market Generators, who have the most recent/current experience of these costs, for current market advice.

Transmission Connection Costs - Removal of SVCs

The SWIS is becoming increasingly constrained, with Western Power imposing additional capital contribution requirements on users to enable Western Power to fund voltage support initiatives and fault level upgrades.

Alinta has significant concerns with the sudden change of methodology to remove costs associated with SVCs.

The draft report (Page 10) states that this change is '*discussed in detail*'. However, Alinta has been unable to locate any detailed discussion that goes toward the justification of this key change in the methodology and the basis on which it needs to diverge from the previous two Maximum Reserve Capacity Price determinations by the IMO.

The draft report states that '*there are other locations in the network where connections will not require an SVC*'. This assertion ignores the vast array of complex considerations and limitations

that a generation proponent faces in the locating and eventual construction of a power station. For example, costs to meet more stringent location specific planning requirements, provision of water supplies, etc. Generally proponents are unable to locate generation in the metropolitan area.

Alinta notes that the conclusion of the draft report refers to a *'transmission costing model'* and *'funding model'* that will be impacted by the removal of the SVCs. There appears to insufficient detail in the report on these two models for Alinta to understand what allowances may have existed in these previously for SVCs and how they will be impacted by removing SVCs from them.

Alinta suggests that the IMO prepare a detailed document on this matter and invite further public comment before releasing a final report.

Transmission Connection Costs – Shared Network/Deep Connection Costs

The WEM rules state that the transmission costs should include *'an estimate of the cost of augmenting the shared network to facilitate the connection of the open cycle gas turbine power station.'*

The draft report (Page 11) states that a value of \$10.25M was used in the previous review for deep connection and network reinforcement costs. Given that the total proposed transmission connection cost estimate is \$6.098M Alinta can only conclude that deep connection and network reinforcement costs are to be excluded in the current transmission connection cost. If this is the proposal it should be explicitly stated in the report as it is a significant change in methodology.

In a recent submission to the Economic Regulation Authority (ERA) concerning Western Power's proposed network Access Arrangement, Alinta submitted that the majority of Western Power's costs to connect a generator or large load to the SWIS should be added to Western Power's capital base, rather than being paid by users in the form of a capital contribution. If the ERA agrees with Alinta's submission then there would be a drop in the electricity transmission connection costs, which could then be reflected in determination of the Maximum Reserve Capacity Price. However, whilst the status quo is maintained, Alinta contends that electricity transmission connection costs have increased, not decreased. Alinta submits that the IMO should be increasing electricity transmission costs and that deep connection and network reinforcement costs should be included.

Fixed Transmission O&M Costs

Transmission fixed O&M costs were estimated as \$19,000/MW for the 2005 cycle, determined to be \$7,823/MW for the 2006 cycle and proposed to be only \$249/MW for the 2007 cycle. This is a very significant reduction proposed by the IMO in the Draft Report and, because it is an annual cost rather than one that will be capitalised over a number of years, it will have a large impact on the Maximum Reserve Capacity Price. Alinta submits that the IMO has not provided sufficient detail on the derivation of the proposed operating and maintenance cost (including why there has been such a significant change from previous estimates) to enable meaningful comment on the figures. Given the impact of the proposed change, Alinta suggests that the IMO prepare a detailed document on this matter and invite further public comment before releasing a final report.

Fixed Fuel Costs - Lateral Pipeline Installation Cost

Alinta comments that the level of detail on fixed fuel costs on Page 10 is insufficient for Alinta to provide meaningful comment. Alinta notes that bullet (e) in the Introduction states that the IMO is required to assess the appropriateness of *'the capital cost of a gas lateral to allow for dual fuel capability'*. Alinta notes that there is no mention of a gas lateral in the remainder of the report.

Alinta submits that the IMO should be including the cost of a lateral pipeline installation when determining the Maximum Reserve Capacity Price. Clauses 4.16.4(d) and (e) of the Wholesale Electricity Market Rules require that the maximum reserve capacity price will be based on a dual fuel gas turbine in which the cost of fuel tanks and a gas lateral pipeline are included. It appears that the IMO has included the cost of fuel tanks but not the cost of a lateral pipeline.

Insurance

The draft report provides insufficient detail as to how the 0.5% of the capital replacement cost was derived to determine the level of insurance. Alinta suggests that the actual amounts are greater and significantly greater during the construction phases of a project.

Given that the capital replacement cost used to derive the level of insurance is also low the resulting provision for insurance appears too low.

IMO Disclaimer

Alinta submits that the IMO should review and amend the disclaimer attached to the report. The disclaimer states that the document is published 'as an information service'...'*contains only general information*' and '*makes no representations or warranty as to the accuracy, reliability, completeness or suitability for particular purposes of the information in this document*'. These statements appear inconsistent with the importance and intent of the report and question the point of publishing the report at all.

Regulatory Risk Concerns

Alinta notes that the cost estimates utilised to derive the maximum reserve capacity price seem to be at the very low end and at times unrealistically low.

Alinta also notes its ongoing concern that there is significant variability in methodology and outcomes between each capacity year. Changes of such magnitude, and the risk that further similar significant changes may take place in future, will cause instability and uncertainty amongst project proponents and investors. Alinta has significant concerns with the regulatory risks inherent in the IMO's proposals and considers that making such significant changes will be detrimental to the long-term development of the electricity market. The regulatory process needs to provide some long-term certainty to users and prospective users, particularly as there is likely to be an absence of price signals in an energy market where there are very low price caps and probable low volatility such as the proposed Wholesale Energy Market in WA.

Report Structure and Readability

Alinta suggests the report be reworked to improve its readability by:

- including an appendix containing all the inputs and calculation for both the maximum reserve capacity price, including underlying components such as the WACC and k-factor.
- include a chart showing where the increases and decreases are from the previous cycle(s)
- Adjust Table 1 as it currently could misrepresent the proposed transmission connection cost estimates increasing from the 2006 review cycle to the 2007 cycle.

Alinta brings to the IMOs attention the following typographical errors it has found in draft report:

1. The bold GTP[2006] appears to have the wrong units. It shows MW whereas it should be kW (Page 9)
2. The exchange rate contained in the draft report appears to be incorrect. 0.7627 is the number of \$US to an \$A rather than being the number of \$A to a \$US as is required in the formulae (Page 9)

3. Cap cost formulae missing the CAP component (Page 12)
4. Price cap formulae missing brackets around CAP/SDF (Page 15)

Alinta would like to thank the IMO for the opportunity to provide comments on the draft report and would welcome future involvement prior to the release of a final report. Alinta also intends to distribute this submission to the Economic Regulation Authority.

Please contact either myself on (08) 6213 7304 or Mark McKinnon (08) 6213 7316 to discuss the issues raised in this submission.

Yours faithfully

A handwritten signature in black ink that reads "Kristian Myhre". The signature is written in a cursive, slightly slanted style.

Kristian Myhre
Manager, Market Analytics