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George Maltabarow
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RE: Regulatory Impact Statement on the Separation of Generation & Transmission

Dear Sir / Madam,

I refer to the Regulatory Impact Statement (RIS) on the separation of generation and transmission which was released by the Ministerial Council on Energy (MCE) on 15 October 2007 for consultation. We welcome the opportunity to provide our views on this matter and direct you to the attached submission.

As you would be aware, the RIS acknowledges that EnergyAustralia's distribution business has a small amount of its network assets classified as transmission. This is largely as a result of a technical distinction embedded within the National Electricity Rules (NER). The RIS also acknowledges that it was not the intention that transmission assets of this type be covered by the proposed separation arrangements. As such, it is necessary that some provision, preferably an outright exclusion, is needed to accommodate companies such as EnergyAustralia who have assets classified as such.

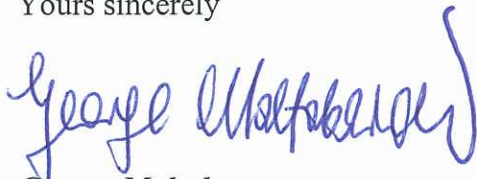
Without assets of this type being specifically excluded from the proposed provisions, EnergyAustralia's retail business will potentially be placed at a significant disadvantage in the energy market if it is effectively prevented from pursuing any strategy that includes acquisition of generation capacity. Our retail business competes against a significant number of retailers within the national electricity market that have no transmission or distribution interests. These retailers, in numerous instances, have acquired significant competitive advantage in their retailing and wholesale operations through the acquisition of generation capacity. With tight retail margins, this capability makes it increasingly difficult for those without generation to remain competitive. It is becoming increasingly apparent that the strategy of combining retail and generation interests will be a common feature of the future market structure.

While no physical separation of EnergyAustralia's retail and distribution businesses has occurred, significant internal ring fencing already exists as a result of internal reporting structures and the requirements contained within EnergyAustralia's distribution licence. Further, it should be emphasised that the businesses operate under two completely different regulatory regimes. In this regard, EnergyAustralia's retail business exercises no level of control over the operations of the network business.

More specifically, the assets owned by EnergyAustralia's distribution business and classified as transmission cannot, under any test, affect the operation of the wholesale electricity market – either via an impact on the price at which generators are dispatched or otherwise. As such, any suggestion that the proposed provisions would capture these assets is not relevant or appropriate.

This issue is of considerable future importance for the competitiveness of EnergyAustralia's retail business and we ask that the MCE give consideration to the issues raised in the attached submission. Should you have any questions, or wish to explore alternative options that may be available to exclude retailers in a similar position to EnergyAustralia from the proposed provisions, please contact Nicholas Convery A/Manager Retail Regulation on (02) 9269 2485.

Yours sincerely



George Maltabarow
Managing Director

Attachment A

EnergyAustralia submission on MCE Regulatory Impact Statement on the separation of Generation and Transmission

About EnergyAustralia

EnergyAustralia, a NSW Statutory State Owned Corporation, owns and operates Australia's largest electricity distribution network and is one of the largest retailers of electricity and gas in the NEM with around 1.4m customers. EnergyAustralia's distribution network covers approximately 22,275 square kilometres across the Sydney Metropolitan, Gosford and Hunter regions. The customer base within the distribution area includes some of the most densely populated, fastest growing and high profile areas of NSW. In addition, EnergyAustralia's retail business sells electricity and gas to more than 1.4 million customers in NSW, the ACT and Queensland. The business has also previously sold electricity and gas to customers in Victoria and South Australia both independently and as part of a successful retail partnership.

Segregation of the Retail & Network businesses

While EnergyAustralia's retail and network businesses co-exist under the one statutory structure, Ministerially imposed licence conditions that apply to EnergyAustralia's distribution business require that:

"The distribution system operation affairs of the Licence Holder must be kept separate from the other affairs of the Licence Holder, including its affairs in relation to the supply of electricity....."

While no physical separation of EnergyAustralia's retail and distribution businesses has occurred, the two businesses effectively operate on an independent basis – although there is some sharing of common resources and a single Executive Management Team and Board of Directors. Similarly, as is required by the distribution businesses licence, separate accounting and business records are undertaken by the businesses. Further to this, the General Manager Wholesale Energy acts independently of the network business and has formalised reporting responsibilities to an internal risk management panel as well as the EnergyAustralia Board Sub-committee for Retail Performance and Risk Management.

Further, it should be emphasised that the businesses operate under two completely different regulatory regimes. In no way does EnergyAustralia's retail business control or affect the operations of the organisations network business.

The statutory structure of EnergyAustralia is not unique and also occurs within other State owned business including Integral Energy and Country Energy in NSW and Ergon Energy in

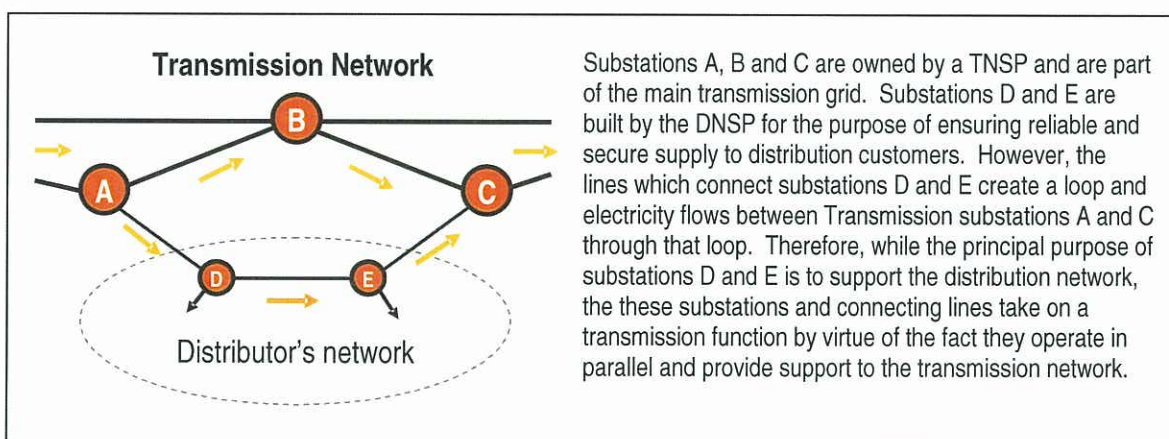
Queensland. With the exception of Ergon Energy, which is a non-competing electricity retailer, the retail businesses of these state owned entities compete with non-state owned retailers across the NEM in acquiring gas and electricity customers.

EnergyAustralia's status as a TNSP

Arising as a result of the National Electricity Rule (NER) definitions of distribution and transmission assets on the basis of their functional characteristics rather than their role in an integrated electricity network, EnergyAustralia's distribution business has a small part of its asset base classified as transmission. As such, while EnergyAustralia is registered as a TNSP with NEMMCO its role in the transmission network is limited to assets which were originally built to meet obligations arising as part of a distribution, but which are deemed to be transmission because of their location to the higher voltage transmission network.

The following section undertakes to explain how some of EnergyAustralia's network assets are classified as being transmission.

The transmission network is meshed and characterised by having "tidal" flows of electricity. That is, a change in either the load or the generation at any location will change the flow in every line in the network. This brings about the potential for overlap in the functional attribute of any one particular asset (as shown diagrammatically below):



This is a simplified illustration of what can be a complex array of loop flows where transmission and distribution network assets meet at the margin. These instances are most common in urban and densely populated areas where the distributor's network is interconnected between higher voltage transmission substations to provide the required levels of security of supply to distribution customers.

From a technical perspective this dual functionality has no impact. In the example above, substations D and E are operated by the DNSP as part of its obligations for the distribution network. The TNSP operates its own network and the flows from A through C acknowledging the loop flows through the distribution network. The planning, operation and maintenance of all of the assets which form the transmission network is closely coordinated between the owners

of the assets and by NEMMCO, to ensure that the overall integrity of the transmission network is maintained.

The classification of distributor's assets as transmission follows the configuration of the network, with assets on normally closed parallel paths being included in the transmission network where there are significant transmission flows through them and they thus perform a support function.

Primarily this is a challenge from an economic regulatory (network) perspective which assumes a clear delineation between transmission services provided by a TNSP and distribution services provided by a DNSP. However, this method of classification has potential, and significant, impacts on retail businesses such as EnergyAustralia considered in view of the present consultation for the separation of generation and transmission. This is acknowledged in the RIS where it states:

"This type of ownership was not intended to be caught by the in-principle COAG decision. For this reason, the design of the options will be important to recognise this type of ownership."

Level playing field

As indicated, the primary function of EnergyAustralia's network business is electricity distribution and its status as a transmission operator comes about by way of a technical distinction provided for in the NER which classifies some of its assets as such. EnergyAustralia's network has electricity distribution as its primary function and therefore its daily operations are no different from other DNSPs.

It seems that an unfair burden would be placed on EnergyAustralia's retail businesses if they were to be prohibited from purchasing electricity generation assets, or have significant hurdles placed in front of them by way of their inherent, yet isolated, relationship with a distribution business. This will significantly impact any strategic opportunity it may have in purchasing electricity generation assets. Clearly these are strategies being pursued by other participants within the NEM and it is imperative that any restrictions that may emerge as a result of COAG's decision regarding the separation of generation and transmission allow EnergyAustralia's retail business to pursue similar strategic opportunities – this will ensure that there is sufficient competition in both the retail and generation segments.

EnergyAustralia's transmission assets have no impact on price at which generators are dispatched

EnergyAustralia's network business, in previous submissions to the MCE, AEMC and AER has contended that while it is the owner of transmission assets, that it does not have the same impact as other transmission owners such as TransGrid etc. As indicated earlier, the primary purpose of these assets is to support the distribution network. This is likely to be recognised by the MCE when making Rules regarding the economic regulation of EnergyAustralia's network. Transitional rules are likely to allow EnergyAustralia to treat their transmission assets as distribution for the purpose of economic regulation.

There has been a similar recognition by the AER in their June 2006 decision on the "Indicators of the Market Impact of Transmission Congestion" where they say, at page 13:

"As to EnergyAustralia's concern, the AER notes that the report contains information largely gathered from NEMMCO's information server. Since NEMMCO only models constraints on the transmission networks and EnergyAustralia is not, for these purposes, a TNSP, it has not been included in this analysis. The AER will publish the market impact indicators in its weekly and annual reporting. It will also provide analysis of major events. Energy Australia will not be included in the analysis as NEMMCO does not treat its assets as transmission assets for purposes of modelling transmission constraints."

The AER also states that EnergyAustralia's network transmission assets cannot affect MITC (market impact of transmission congestion) outcomes. See page 8 of the AER's issues paper on this issue (June 2007)

"The AER notes that the revenue reset for Energy Australia's transmission assets is due to coincide with the TransGrid and Transend processes. The AER does not propose applying any MITC incentive to EnergyAustralia as none of EnergyAustralia's assets affect the MITC outcomes. No market generators are connected to EnergyAustralia's transmission assets and its assets do not impact on inter-regional transfers. As it has no ability to influence MITC outcomes, the AER believes that it is inappropriate to develop an incentive regime for EnergyAustralia based on these measures."

On this basis, it would appear that the network business's transmission assets cannot have an impact on the wholesale market for electricity. A further reason supporting this is that the business has no network elements represented in the NEMMCO's dispatch algorithm – meaning that EnergyAustralia has no impact on the price at which generators are dispatched.

It does not appear, under any test, that the transmission assets can be regarded as having the potential to impact on the operation of the wholesale energy market – either via an impact on the price at which generators are dispatched or otherwise.

As such, it is not appropriate that these assets be captured by the proposed provisions.

MCE Proposed Options

Based on the preceding commentary regarding EnergyAustralia's limited role as a transmission operator, brought about primarily by way of technical definition within the NER, and on the basis that it has been shown to have no impact on the wholesale market, there should be no barrier to EnergyAustralia's retail business acquiring generation interests should it so desire.

On this analysis, transmission assets of the type currently held by EnergyAustralia's network business should be specifically, and automatically exempt from the proposed cross ownership provisions. Transmission assets which are of a similar nature and are held by other state owned entities should also be exempt from coverage under this provision.

Without such specific exclusion, EnergyAustralia's retail business will be severely restricted in its ability to pursue any generation opportunities which may enhance its strategic positioning in both the wholesale and retail markets. All non-government retailers enjoy the ability to employ retail and generation combinations and it is unacceptable that organisations such as EnergyAustralia's retail business be prevented from this by reason of technical definitions contained within the NER.

However, we acknowledge that the RIS has indicated that this type of ownership was not intended to be caught up by the in-principle COAG decision and so trust that the legislative drafting on this topic will specifically provide for an exemption of the type we are seeking. Accordingly, we have no comments on the options proposed by the MCE other than to say that should no exemption materialise that all of the options will place significant restrictions and require complex justifications on the part of EnergyAustralia's retail business in the event it chooses to undertake generation in any sizeable capacity.

Should the MCE choose, for whatever reason, not to make provision for a general exemption as is envisaged, then EnergyAustralia requests that it be provided with an opportunity to meet with appropriate MCE representatives to discuss further possible options.

November 2007.