

30 April 2007

Australian Energy Market Commission
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AUSTRALIA SQUARE NSW 1215

submissions@aemc.gov.au

Dear sir or madam;

Rule Change Proposals Relating to the Snowy Region Boundary

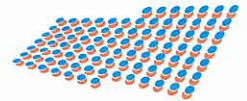
EnergyAustralia welcomes the opportunity to provide comments on the second round consultation on the draft Rule Determination on the Abolition of the Snowy Region proposal (Snowy Hydro proposal), the first round consultation on Macquarie Generation's Split Snowy Region proposal (Split Region proposal) and the Southern Generators' Congestion Pricing and Negative Residue Management Arrangements for the Snowy Region proposal (CSP/CSC proposal).

EnergyAustralia supports the findings in the Australian Energy Market Commission's (AEMC) Draft Rule Determination to abolish the Snowy region and agrees that the proposal will improve dispatch efficiency and competition in the NEM. The AEMC's recent decision to delay the final determination on the Snowy regional boundary until August 2007 is a major concern to EnergyAustralia.

The constraint between Murray and Tumut is enduring and material, and is unlikely to be solved through additional transmission investment (especially given the likely cost, extensive planning and environmental implications of constructing further transmission in the Snowy region). In EnergyAustralia's opinion, the only long term solution is to abolish the Snowy region. The Snowy region is currently giving rise to dispatch and pricing inefficiencies, reduced competition between regions, increased financial risks for market participants, higher prices and the continued need for intervention by NEMMCO in the dispatch process of the National Electricity Market (NEM). EnergyAustralia believes this is also the general consensus in the NEM.

These existing market inefficiencies and the fact that the outcomes of the Ministerial Council on Energy (MCE) Congestion Management Review are at least 18 months away¹ (with no guarantee that the MCE would initiate a rule change to amend the Snowy region) highlight the importance and urgency for the AEMC to proceed with its final determination on the Snowy region without further delay.

¹ As noted by Ms Liza Carver from the AEMC at the AEMC Consultation Forum in Melbourne on 22 February 2007 regarding the abolition of the Snowy region.



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The current uncertainty over the Snowy regional boundary is having an impact on the liquidity, competition and quantity of contracts in the NEM. This reduced liquidity is affecting the ability of retailers to put hedge arrangements in place, particularly given the tightening of the supply and demand balance in the NEM and the need for medium to long term contract commitments for when the NSW ETEF arrangements roll off.

We believe some market participants are resorting to delaying tactics in order to extend the Rule change process and further the uncertainty in the NEM. This self-interest is not only limiting competition in the contract market, but is also having an impact on the spot market.

Snowy Hydro Proposal

EnergyAustralia supports the Snowy Hydro proposal to effectively abolish the Snowy region by altering the NSW and Victorian regional boundaries, relocating Snowy Hydro's Upper and Lower Tumut generation to the NSW region and its Murray generation facility to the Victorian region.

EnergyAustralia believes the Snowy Hydro proposal will increase competition between generators in adjacent regions and will require them to adopt a more competitive contracting and bidding strategy than business as usual. In EnergyAustralia's opinion this should deliver more competitive prices through the spot, wholesale contract and retail contract markets as generators compete to win market share, both in terms of physical volume and contracts. In the long term this should result in cost savings for consumers. The continued heavy opposition by both the Victorian generators and NSW generators highlights, in our opinion, their concerns that abolishing the Snowy region will expose them to a more competitive wholesale market.

EnergyAustralia believes the benefits the market will receive from a more competitive contract market (for example reduced contract prices) will far outweigh the overall IT implementation costs. We have undertaken an analysis of the IT system changes required by EnergyAustralia to implement the proposed abolition of the Snowy region and estimate the costs to be approximately \$5,000.

Abolition of the Snowy region is viable and straight forward due to the minimal demand within the region. EnergyAustralia can attest that since the SEM/NEM inception, EnergyAustralia has written no contracts against the Snowy regional node. Therefore abolition of the Snowy region would result in minimal disruption to IT systems, billing systems and trading activities.

The revised timetable by NEMMCO for the implementation of the regional boundary changes involving the Snowy region from the original date of 4 November 2007 to 1 July 2008 to allow for the modification of approximately 2500 converting constraint equations could be reduced if NEMMCO outsourced some of the work to third party contractors. Given the importance of the issue EnergyAustralia would encourage the AEMC to make this enquiry to NEMMCO in response to NEMMCO's letter to the AEMC dated 5 March 2007.

In EnergyAustralia's view, market participants have already commenced transitioning their trading

portfolios in expectation that the Snowy Hydro proposal will be implemented. In this instance it could be expected that market participants should be able to manage a shorter timeframe than normally required. As a general Rule principle the implementation period following notice of a decision regarding a change in regional boundaries should be maintained for a minimum of 3 years, especially if that change adds extra layers of complexity and/or increases the number of regions within the market.

Split Region Proposal

EnergyAustralia does not support the Macquarie Generation proposal which seeks to split the Snowy region in two. This proposal will increase price volatility and reduce competition in the NEM. The need for retailers to access more instruments to construct an effective hedge will see more volatile prices in the new regions and will ultimately increase risk premiums. Ultimately, any increase will be borne by customers through higher retail electricity prices.

Any increase in regional reference nodes in the NEM would have a profound effect on the market. It would increase the risk and complexity of trading between Victoria and NSW and would require retail contracts and mass market supply arrangements to be updated. This will impose additional system and transaction costs, along with time and resources for most market participants. We have undertaken an analysis of the IT system changes required by EnergyAustralia to implement the proposed abolition of the Split Region proposal and estimate the costs to be approximately \$15,000. However, we believe ongoing compliance and management of contracts against two additional regions will materially add to our front office cost structure.

The MCE policy states that a regional boundary change is needed for material and enduring constraints and, in the absence of transmission investment, to build out constraints. The Murray to Tumut constraint is in line with the MCE policy, however the Split Region proposal is at odds with this as the constraints north of Tumut and south of Murray are not material and enduring in EnergyAustralia's opinion.

CSP/CSC Proposal.

The current congestion pricing and negative residue management arrangements for the Snowy region (CSP/CSC) trial should remain in the Chapter 8 derogation section of the Rules. EnergyAustralia believes the CSP/CSC trial is still in the early days of its development and is yet to be proven as a permanent solution to the constraints in the Snowy region.

EnergyAustralia recognises the CSP/CSC trial has been successful in resolving some of the problems that arise when certain constraints between Murray and Tumut in the Snowy region bind, however the CSP/CSC mechanism has had limited success in achieving the objective of firming up the inter-regional settlement residues. EnergyAustralia believes the CSP/CSC mechanism has resulted in reduced market liquidity for the NSW node and has failed to address the payout uncertainty in the SRA process.

Conclusion

There appears to be limited scope for material improvements in the short to medium term to alleviate the incidence of regional congestion between the Murray and Tumut connection nodes given the nature of the terrain in and around the Snowy region. EnergyAustralia believes that Snowy Hydro's proposal will address the legacy issues of this region and provide a long term solutions to addressing intra-regional congestion. EnergyAustralia supports the AEMC's belief that the "Snowy Hydro proposal is likely to promote greater competition leading to more efficient dispatch, pricing, and inter-regional trading" and believes abolition of the Snowy region will lead to a more stable NEM regional structure.

EnergyAustralia believes the Split Region proposal will result in increased price volatility, materially increase the complexity of trading between Sydney and Melbourne and reduced competition in the NEM. The CSP/CSC proposal is based on a trail that is still to be proven as a permanent solution to the constraints in the Snowy region and should therefore remain as a time limited derogation only.

Should you have any questions in relation to this submission please contact me on (02) 9269 4911 or Philip Dixon-Flint, Regulatory Strategy Manager, on (02) 9269 2317.

Yours sincerely



Tim O'Grady
Executive General Manager Retail