

30 April 2007

Mr Chris Pattas
General Manager
Network Regulation South Branch
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Dear Chris,

SP AusNet Electricity Transmission Revenue Proposal

I refer to your letter of 30 March 2007 and 11 April 2007 related to SP AusNet's Electricity Revenue Transmission Revenue Proposal and the Australian Energy Regulator's (AER) determination that the proposal had not complied with Chapter 6A of the National Electricity Law (NER) in a number of respects. In particular I refer to the requirement that SP AusNet provide details of the terms of the management services agreement between SP AusNet and SPI Management Services

Please find attached SP AusNet's Prospectus and Product Disclosure Statement for the Initial Public Offering, issued in November 2005. There is a comprehensive description of the Management Services Agreement in section 17.15, from page 196 through to page 202 of the Prospectus.

SPI Management Services', a wholly owned subsidiary of Singapore Power International Pte Ltd has entered into a Management Services Agreement with SP AusNet Networks (Transmission) Ltd and SP AusNet Networks (Distribution) Ltd. This agreement is to last for ten years but includes rights of termination to all parties under certain circumstances.

As noted in the Revenue Proposal, the Management Company provides the following services to SP AusNet:

- Employee management;
- Business management;
- Evaluation of business opportunities;
- Management of regulatory compliance and relations with regulators;
- Financial and management accounting, including treasury & tax services;
- Asset Management Strategy;
- Management of information technology;
- Management and coordination of maintenance & engineering services;
- Public and investor relations;

- Legal and company secretarial services; and
- General administration and company reporting.

This structure is designed to allow flexibility and the strategic ability to undertake new projects as and when they arise in the future. However, all the costs incurred in this management services agreement that are allocated to the transmission business are the same type of costs that would be incurred by any transmission service provider.

The management company is reimbursed for the costs of providing these services through the service fee and receives further revenues under incentive arrangements. It is only elements of the service fee that are passed through into the regulated costs. None of the incentive arrangements result in a cost to the transmission business.

SP AusNet has allocated only the costs related to the provision of services to the transmission business into the regulatory accounts and not the price of the contract itself. This is to ensure that only appropriate costs are included within the base from which the forecast for the next regulatory period is developed.

The responses to specific matters raised in the your letter of 30 March 2007 follow

- *Information explaining how the costs of the contract are allocated between prescribed and non-prescribed services, on a year-by-year basis, including supporting documentation;*

The costs of the contract are allocated based between the electricity transmission, electricity distribution and gas distribution businesses based on an assessment of effort. The costs allocated to the transmission business are then allocated between the prescribed and non-prescribed services in accordance with the allocation of assets, which is currently 92% prescribed and 8% non-prescribed services. The detailed assessments of effort and assets are available for review by the AER if required. Please see the diagram below that shows the outcome of the allocation.

- *Information on how costs associated with the contract are recorded, for example, clarification as to whether all payments made from SP AusNet to SPI Management Services appear under the "management fees" item in the "corporate opex" section, or whether some payments are recorded elsewhere, and if so where;*

All payments that are reimbursement of costs from SP AusNet to SPI Management Services are included as management fees, and only as management fees. The costs are recorded separately from the performance fees in the financial records of SP AusNet. The performance fees are not allocated into the regulated costs

- *Information explaining how the costs of the contract are allocated between the electricity transmission, electricity distribution and gas distribution businesses, on a year-by-year basis, including supporting documentation;*

The costs of the contract are allocated between the electricity transmission, electricity distribution and gas distribution businesses based on an assessment of effort. The detailed assessments of effort are available for review by the AER if required. Please see the diagram below that shows the outcome of the allocation.

- *Details about how "only elements" of the service fee are passed into the regulated costs, as stated on p.22 of the Revenue Proposal, including supporting documentation; and*

- The costs are recorded separately from the performance fees in the financial records of SP AusNet. The costs are the elements that are referred to on page 22

of the Revenue Proposal. The performance fees are not allocated into the regulated costs, as the business considers that the incentive arrangements are in effect a sharing of a benefit, or incentive, that is paid to the regulated entity, between SPI Management Services and SP AusNet.

- *Details about the further revenues the related party receives under incentive arrangements including how these incentive arrangements do not result in a cost to the transmission business, as stated on p.22 of the Revenue Proposal, including supporting documentation.*

Please see pages 198 –199 of the SP AusNet prospectus. The incentive arrangements do not result in a cost to the transmission business as the business considers that the incentive arrangements are in effect a sharing of a benefit, or incentive, that is paid to the regulated entity, between SPI Management Services and SP AusNet.

- *SP AusNet has not provided details of the procurement process in respect of the management services and, in particular, details of whether or not the procurement process was a competitive process, as required by the Submission Guidelines.*

The procurement process was not competitive. A competitive procurement process was not relevant as the creation of SPI Management Services reallocated existing costs from SP AusNet to SPI Management Services. The allocation of only costs from SPI Management Services to the regulated entities returns the appropriate part of those costs to the regulated entities.

SP AusNet would be pleased to have further discussion of the management services agreement with the AER. To arrange for any further discussions, please contact either our Transmission Regulation Manager, Tom Hallam on telephone 03 9695 6617 or our Economic Regulation Manager, Patrick Murphy on 03 9695 6623.

Yours sincerely,



Charles Popple
General Manager, Regulation and Business Strategy

Treatment of Management Co Costs

*2007/08 year

