19 December 2018

Australian Competition & Consumer Commission
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Submitted via email:
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Monitoring of Electricity Supply in the National Electricity Market

Alinta Energy (**Alinta**) welcomes the opportunity to provide a submission to the Australian Competition & Consumer Commission (**the ACCC**) *Monitoring of Electricity Supply in the National Electricity Market* (**Discussion Paper**).

Alinta is an active investor in energy markets across Australia with an owned and contracted generation portfolio of nearly 3,000MW, including 1,700MW of gas-fired generation facilities and 1,070MW of thermal generation facilities, and in excess of 1.2 million electricity and gas customers including more than 620,000 in east coast markets.

Introduction

The National Electricity Market (NEM) is an inherently complex and sophisticated market. As such, the ACCC faces a material task in developing an appropriate methodology for its new monitoring powers. Nonetheless, Alinta endorses the prudent approach and engagement with industry that has characterised the ACCC's development of this new role to date.

Of late Alinta notes that the area of energy markets and consumer pricing is of heightened interest to various policy makers, regulators and both state and federal governments. At the time of drafting this submission there remain several material market changes under consideration, not least of which is consultation on the methodology for determining pricing under a "Default Marker Offer". Such a change in the market, the Default Market Offer, were it to be introduced has the potential to materially impact the process for any monitoring activities, the potential for additional regulation to be developed by other jurisdictional regulators, based on the ACCC's findings, is apparent.

As such, it is worth noting from the onset that Alinta holds the view that the markets which underpin the NEM are largely robust and resilient. While the NEM is experiencing substantial challenges of late, in Alinta's view the NEM continues to operate robustly and entities have well developed and sophisticated risk, retail, and wholesale management expertise underpinned by their continued market participation.

In relation to the direction and interpretation of the ACCC's future monitoring powers, Alinta is of the view that the primary focus of the ACCC should be:

- market framework analysis and barriers to entry;
- the importance of robust cost-benefit analysis in any regulatory change;
- the role of Government intervention, policy stability and predictability necessary to support ongoing generation investment in the NEM; and
- the operation and investment decisions of government owned businesses and whether these are market driven or influenced by non-commercial factors.

The remainder of Alinta's submission should be framed in this context.

Analysis of the wholesale market that the ACCC could produce to complement the existing work of other agencies monitoring wholesale prices.

Alinta has long supported the principle of increased transparency within the NEM and considers that incremental enhancements to information disclosure are likely to improve pricing efficiency and risk management. To that end, Alinta currently contributes to a wide variety of wholesale trade information exchanges, many of which are made available in public wholesale reports as well as to NEM regulators through:

- AEMO's Electricity Statement of Opportunities;
- ASX trade reporting;
- State jurisdictional bodies;
- the AER's existing monitoring and compliance reporting functions including the newly established "Wholesale Electricity Market Performance Reporting" powers;
- ASIC's existing powers including participant risk management processes, futures and OTC positions under existing surveillance and licensing powers;
- the AFMA electricity derivative survey which provides accurate annual turnover data for the exchange and OTC electricity derivative markets. Alinta has participated in the AFMA survey process since 2013 and can attest to the robustness of survey process and the value of its results to both participants and market observers; and
- It is also worth noting other existing information sources on OTC prices and volumes which are currently produced by energy brokers within the OTC market.

Alinta is of the view that the utilisation of the existing information sources, would provide an efficient and least cost alternative to the establishment of any new ACCC wholesale monitoring functions. The range of information listed above is well known to market participants through normal business operations. These existing sources of information act to provide transparency as well as ensure consistency of observations across the numerous publicly available market reports from other regulatory bodies.

Alinta is of the view that the utilisation of the aforementioned existing information sources are likely to meet the ACCC's wholesale monitoring objectives at least cost.

Contract Market Liquidity and Vertical Integration

Alinta notes the ACCC's draft approach will assess structural features of the market including vertical integration. Section 3.2.4 requires that the ACCC assess whether vertically integrated electricity suppliers are restricting competition and new entry and then further outlines that the ACCC will analyse the extent of vertical integration by considering a range of associated factors.

While the presence of vertical integration in the NEM is an interesting component of the market and is worthwhile of study, the existence of vertical integration, in and of itself, shouldn't be viewed as an indication of any wholesale (or retail) market deficiency. Broadly speaking, vertical integration is simply a risk management strategy.

To illustrate, vertical integration occurs simply to provide risk and price insurance to participants. In the case of a retailer, the purpose of vertical integration is to avoid greater spot price volatility risk. In the case of a generator, the purpose of vertical integration is to capture value over a longer time horizon that may not be available in the spot market. Both occurrences decrease risk in the market.

For example, in the longer term (contract market), generators will bid at their long run marginal cost to cover their fixed costs, however in the short term (spot market) prices are driven by short run marginal costs of all available generation in the market at the time. As such, in some scenarios, vertical integration can represent a positive outcome where retailers are able to avoid spot market price risks on a more continued and guaranteed basis and whereby generators are more able to recover their fixed capital costs on a guaranteed basis. Therefore, in this scenario vertical integration is a beneficial risk management strategy which should in turn put downward pressure on prices and therefore be of benefit for the end consumer.

Furthermore, vertical integration may add efficiency gains in terms of reducing transaction costs or facilitating better risk management practises and associated financing costs.

Accordingly, Alinta considers that the ACCC should be cautious in drawing implications on barriers to entry from the presence of vertical integration in the market.

Retail electricity prices

Alinta notes the direction requires the ACCC to monitor electricity prices faced by customers in the NEM. Similar to the wholesale section above, Alinta notes that there are already a number of existing agencies that produce reports on retail electricity pricing based on both publicly available information as well as data provided directly by retailers.

Any data to be collected and reported on by the ACCC should be consistent with data sets used across other agencies. Any necessity placed on retailers to report inconsistent data sets will create inefficiencies and an administrative burden. Further it creates potential for conflicting results and findings across agencies, which would only undermine the credibility of the monitoring that had been undertaken. However, as with our view on wholesale market data, we hold similar views that utilisation of existing information sources are likely to

meet the ACCC's retail electricity pricing monitoring objectives at least cost. Likewise the timing on the submission and receipt of data consideration should be given to the standard cycle of financial reporting of retailers so as to ensure efficiencies in information provision. In particular lead time considerations for data submission to meet any required report publishing requirements.

When considering any methodology or data to be used in monitoring & assessing efficient retail prices, consideration must be given to the level of pricing reform that is currently underway. The potential introduction of a Default Market Offer (or Victorian Default Offer) along with initiatives for the introduction of "Reference Bills" may materially impact the monitoring & assessment process.

In assessing the relationship between wholesale & retail prices over time, whilst wholesale prices are a key contributor to the end retail cost other pricing factors (network costs, environmental scheme costs etc) will continue to influence end pricing to consumers. The impact of wholesale costs on retailer's costs is a function of the retailer's risk strategy in managing their exposure to the volatility in wholesale costs. As a result, the relationship between wholesale & retail costs will vary greatly between retailers and across regions. Likewise, individual customer acquisition strategies can impact that relationship, where a retailer is prepared to absorb a proportion of the wholesale cost for a potential reward of being more competitive in the market and as a result have a greater ability to acquire customers.

Therefore, the methodology of measuring any relationship between wholesale costs & retail pricing will be both difficult & complex, a meaningful assessment that can be applied across a range of participants will be difficult to achieve. Caution should be exercised in drawing assumptions on the broad impacts of wholesale costs on retail pricing.

Efficient Energy Markets

The discussion paper raises the issue of how efficient electricity markets can be expected to operate and measurements to determine efficient markets. Efficient markets can be categorised where there is effective competition, price dispersion, low barriers to entry and the ability to expand once market entry has been achieved.

Competition can be measured through a number of matrix, competitor rivalry, customer churn / switching, the type and number of offers available to consumers, inclusive of product innovation. The ACCC should look to use similar (if not identical) data points that are used by existing energy regulatory authorities such as the AER and AEMC, when reviewing the effectiveness of retail competition in the NEM.

Policy Issues

As previously highlighted there are a number of major policy initiatives, that are currently under consideration / consultation that will have a bearing on the approach and/or methodology used in any assessment exercise. The existence of these policy initiatives, in and of themselves highlight the need for any assessment methodology to be able to cater

for a level of market change. There are a number of pricing policy issues the ACCC needs to be aware of, these include the development of the "Default Market Offer", the "Victorian Default Offer", the "Retailer Reference Bill", and the Federal Government's "Electricity Price Monitoring and Response Legislative Framework"[1].

Other Issues - Regulatory burden and barriers to entry

Alinta notes the ACCC's broad approach to examining barriers to entry and the subsequent effect these barriers may have on competition. Alinta is supportive of this focus and strongly recommends the ACCC give substantial consideration to the issue of regulatory barriers and increasing government intervention.

The NEM is currently experiencing a significant period of transition. Understandably, this has led to a growing number of regulators, consumer advocacy bodies, authorities and government bodies at all levels expressing strong interest in the energy sector. With this, there is an exponentially increasing number of regulatory and government bodies undertaking (often overlapping) market reforms, reviews and even some highly publicised instances of government intervention occurring.

The quality and stability of regulatory and government decision making and policy settings is vital for the electricity sector given the long asset lives and the impact that regulatory uncertainty can have on the willingness for investors to commit significant capital. Nonetheless, the existing regulatory burden placed on participants and instances of government intervention (or even threatened intervention) presents a material and seemingly growing risk, one which should be considered appropriately.

In this vein, the seemingly low number of new entrant participants entering the NEM of late, shouldn't necessarily be interpreted as some form of market deficiency. Given the policy uncertainty and frequent government intervention which presently exists in the market, any new entrant investor would logically pause their investment decision until political uncertainties have been resolved. Alinta would urge consideration of this point in the ACCC's analysis.

[1] It should be noted that these reforms are in addition to several other "business as usual" major market reforms such Five Minute Settlement and Global Settlement, which are likely to have pricing implications.

Conclusion

Alinta looks forward to participating in the ACCC's ongoing consultation process and would encourage consideration of the points raised above.

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Yours sincerely,

[redacted]

[redacted]
Manager National Retail Regulation