AGL ENERGY LIMITED

of 2014

RE: PROPOSED ACQUISITION OF MACQUARIE GENERATION (A CORPORATION ESTABLISHED UNDER THE ENERGY SERVICES CORPORATIONS ACT 1995 (NSW))

ANNEXURE CERTIFICATE

This is the annexure marked "**BAR 31**" annexed to the statement of **BRETT ALAN REDMAN** dated 23 March 2014

Annexure BAR31

Filed on behalf of (name & role of party) AGL Energy Limited
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15 January 2014

Liza Carver
Partner
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By email: liza.carver@ashurst.com

Dear Ms Carver

AGL Energy Limited – proposed acquisition of Macquarie Generation

I refer to your submission and the report prepared by Frontier Economics in relation to AGL Energy Limited's (**AGL**) application for informal clearance of its proposed acquisition of Macquarie Generation (**the proposed acquisition**).

The Australian Competition and Consumer Commission (**ACCC**) has conducted market inquiries with a range of interested parties in relation to the proposed acquisition. These market inquiries have raised potential competition concerns. To assist AGL to understand these potential concerns, a summary of the substantive issues raised by interested parties is set out in **Attachment A**. This summary should not be regarded as representing the ACCC's view, or an exhaustive review of the competition concerns that the ACCC may have following its consideration of market inquiries.

The ACCC will soon be formally considering the proposed acquisition in light of its market inquiries, including whether to publish a Statement of Issues. In order to properly assess these market concerns, the ACCC would welcome any further submission from AGL on the issues outlined at **Attachment A**. In addition, the ACCC requests further information and documents from AGL as outlined at **Attachment B**.

Subject to AGL's timely response, preferably by no later than **cob Wednesday 22 January** 2014, the ACCC expects that it will be in a position to form a view in relation to the proposed acquisition by the current proposed decision date of 5 February 2014.

If AGL claims confidentiality over some or all of the information provided to the ACCC, the ACCC will accept that information on a confidential basis provided:

- there is no restriction on the internal use, including future use, that the ACCC may make of the information consistent with its statutory functions;
- the confidential information may be disclosed to the ACCC's external advisors and consultants on condition that each such advisor or consultant will be informed of the obligation to treat the information as confidential; and
- the ACCC may disclose the confidential information to third parties (in addition to its external advisors or consultants) if compelled by law or in accordance with section 155AAA of the *Competition and Consumer Act 2010* (Cth).

If you have any queries in relation to the content of this letter, please contact Mark Rakers on (03) 9290 1803 or Jeremy Jose on (03) 9290 6940.

Yours sincerely

Rami Greiss
General Manager
Merger Investigations Branch

<u>Potential competition concerns</u>

Market participants have raised competition concerns in relation to the markets for the wholesale supply of electricity and hedge contracts in NSW. Specifically, market participants have raised concerns that the proposed acquisition may result in:

- *Coordinated conduct between the major gentailers*: Market participants have raised concerns that the proposed acquisition would result in the vast majority of NSW generation and electricity retailing being controlled by AGL, Origin and EnergyAustralia – these companies would account for over two thirds of generation capacity and almost 80% of generation output in NSW and almost 75% of electricity retail customers. This would give rise to an increased likelihood and material risk of coordinated effects in the supply of wholesale electricity and/or hedge contracts. The proposed acquisition would align the interests of these major vertically-integrated gentailers, particularly in NSW and more broadly in the NEM. The proposed acquisition may result in an increased risk of coordinated effects in both the spot price formation process as well as the price formation process of hedging contracts. This is due to the repeated and regular interaction between the major gentailers in the wholesale spot market across multiple regions of the NEMs, as well as in trading of hedge contracts where coordinated conduct may be facilitated due to the regular interaction of generation and retail arms of vertically-integrated gentailers with their gentailer competitors and independent retailers. These companies would have a common incentive to decrease the availability of competitively priced hedge contracts and engage in conduct to increase the level and volatility of wholesale electricity prices and thereby increase their returns from generation and reduce competition at the retail level from smaller retailers and potential market entrants.

- *Barriers to entry and expansion for smaller* retailers: Market participants have raised concerns that the proposed acquisition will result in smaller retailers being significantly reliant on the major vertically-integrated gentailers for access to hedge contracts and that AGL is not a viable wholesale counterparty for supporting expansion and entry of smaller retailers. The proposed acquisition will have the effect of raising barriers to expansion and deterring new retail entry in NSW. The major vertically-integrated gentailers, which will account for a significant proportion of generation capacity in NSW (as noted above), will not have the incentive to supply actual or potential competitors with competitively priced hedge contracts that would enable their retail competitors to discount and compete against their own product offerings. Notwithstanding any excess generation capacity of AGL post-acquisition, AGL will have an incentive to withhold competitively priced hedge contracts from smaller retailers in NSW. Such retailers represent a small proportion of hedge contract volumes in NSW and therefore withholding access of competitive priced hedge contracts to smaller retailers would not result in any significant detriment to AGL and would afford protection to its NSW retail interests. Such an incentive to hinder retail entry/expansion would not be held by an alternative owner of Macquarie Generation that is either non-vertically integrated or which does not directly compete for the supply of retail electricity to residential and small business customers. In contrast, in the counterfactual to the proposed acquisition, smaller retailers would have significantly increased certainty of access to hedge contracts encouraging their further entry and expansion.

- *Reduced liquidity of hedge contracts:* Market participants have raised concerns that the proposed acquisition will result in a substantial reduction in the liquidity of the hedge contracting market which is likely to raise input costs for non-vertically integrated retailer competitors.

Attachment B

Information request

Price impacts beyond FY2017

1. The Frontier report discusses the modelling analysis of the price impact of the proposed acquisition for the period FY2015 to FY2017. The ACCC notes that the Information Memorandum for the proposed sale of Macquarie Generation provides that average wholesale electricity prices are projected to materially increase from FY2018 onwards as the supply/demand balance begins to stabilise.

   Provide details of Frontier's modelled price impacts of the proposed acquisition from FY2018 to FY2020, including annual average spot price forecasts and price duration curves for each NEM region.

Further detail on the modelling results

2. In order to further understand the implications of the Frontier modelling analysis we would like more detailed information on the modelling results. Specifically, we would like for each modelled demand point, the demand (MW) in each region, the duration (hours) of that demand point, and details of each Nash Equilibrium found for that demand point, including the prices in each region, the output of each strategic and non-strategic generator, assumptions about hedge levels for each strategic generator, together with assumed behaviour of wind and hydro generation (for both the acquisition and the counterfactual cases).

Sensitivity of the modelling to varied hedging levels for AGL generation

3. The ACCC wishes to explore the sensitivity of the Frontier modelling results to different assumed levels of hedge contracting for AGL.

   (a) What impact does assuming a hedging rate of 0%, 25% and 50% for all of AGL's generation assets across the NEM have on the modelling analysis of price impacts of the proposed acquisition?

   (b) For each assumed hedging rate, we would like to understand what outputs change as a result of a varied hedging rate. Provide detailed information on the impact of the varied hedging rate on the modelling results and details for each modelled demand point, the demand (MW) in each region, the duration (hours) of that demand point, and details of each Nash Equilibrium found for demand points, including the prices in each region, the output of each strategic and non-strategic generator, assumptions about hedge levels for each strategic generator, together with assumed behaviour of wind and hydro generation (for both the acquisition and the counterfactual cases).

In responding to the items below seeking impacts to the modelling analysis applying varied assumptions, provide modelled price impacts for the period FY2015 to FY2020.

Treatment of forecast supply

4. The Frontier report notes that mothballing assumptions have been applied in the treatment of available generation capacity based on announced mothballing as published by AEMO, including the assumption that the Playford B power station is mothballed for the forecast period and that Tarong power station is mothballed [700MW] until FY2015 and re-enters the market in FY2016.

The ACCC refers to the AEMO Wind Integration Studies Report 2013 which provides AEMO's assumed retirement/mothballing of NEM generation by 2020, including 1,644MW of black coal plant in NSW, 884MW of brown coal plant in Victoria, 240MW of brown coal plant in South Australia and 190MW of black coal plant in Queensland.

Further, the ACCC understands that given the continuing oversupply of capacity, certain power stations have been operating in limited capacity, such as the Northern power station (which has been operating in limited capacity during the summer months).

(a) Provide AGL views on the plant/s most vulnerable to retirement/mothballing in the NEM from 2015 to 2020 based on the above AEMO assumptions for each region of the NEM. In responding, specify whether any plant may be retired, as opposed to mothballing of generation units.

(b) What are the implications for Frontier's analysis if there were additional generation retirements or shutdowns:

   i. What impact does applying the above AEMO assumptions of likely retirements/mothballing by 2020 have on the modelling analysis of price impacts of the proposed acquisition?

   ii. What impact does applying reduced available capacities for plant which are operating in limited capacities have on the modelling analysis of price impacts of the proposed acquisition?

5. The Frontier report states that the Liddell power station is likely to be retired in the next 5 to 10 years due to its marginal economic viability arising from unreliability and high maintenance costs. Does AGL have any intentions to mothball or retire the Liddell power station following the proposed acquisition? If so, provide details.

6. The ACCC wishes to explore the sensitivity of Frontier's modelling results to a reduction in forecast supply. What impact does applying a shutdown of the Liddell power station have on the modelling analysis of price impacts of the proposed acquisition?

Major industrial customers

7. AGL's submission states that there is a significant risk of demand contraction resulting from closure of aluminium smelters such as Point Henry and Tomago and/or other major industrial energy customers. In the event that the Point Henry and/or Tomago smelters were to exit from manufacturing in Australia, this would significantly increase AGL's net length to the Victorian and New South Wales spot price, post-acquisition.

   (a) Provide AGL's views on:

      i. the likelihood that the Point Henry/Tomago smelters will exit the market,

      ii. the potential for an AGL owned Macquarie Generation to lose the Tomago contract in circumstances where terms cannot be agreed for renewal of this contract.

   (b) To what extent does a change in the assumed level of generator contracting by Macquarie Generation/Loy Yang A (reflective of a scenario where the Point Henry and/or Tomago smelters load is not hedged against the generation of these plants) impact on the modelling analysis of price impacts of the proposed acquisition?

Forced outage rates

8. The Frontier report notes that AEMO's NTNDP estimates of forced outage rates have been applied for existing generation, including a forced outage rate of 10.76% for Liddell and 6.88% for Bayswater. The ACCC queries the accuracy of the NTNDP estimates forced outage rates, given that: (i) the ACCC understands that the historic forced outage rates for both Liddell and Eraring are similar in recent years; (ii) the Information Memorandum for the proposed sale refers to the reduced capacity of the Liddell power station due to subdued market conditions; and (ii) AGL's submission highlights that Bayswater has had increasing forced outage rates (12.4% in 2013).

   The ACCC considers that in modelling the price impacts of the proposed acquisition, historic outage rates should be taken into account in treatment of available capacity within each portfolio of generation. The ACCC is concerned that the modelling approach of de-rating all generation plant at a flat outage rate throughout the year has the potential to supress the impact of forced outages during high price periods such that the pricing impacts of the proposed acquisition may be understated.

   What impact does applying historic forced outage rates in the treatment of available capacity within each portfolio of generation have on the modelling analysis of price impacts of the proposed acquisition?

Sale of Delta Electricity

9. AGL's submission provides AGL's view that neither Origin Energy or EnergyAustralia are likely to seek to acquire Delta Electricity, being the Vales Point and Colongra power stations. Provide AGL's reasons for this view.

<u>Document request</u>

1. Provide copies of the document/s that comprise AGL's Wholesale Energy Risk Management Policy and Wholesale Energy Risk Management Framework, as summarised in Annexure A of AGL's submission.