26 November 2012

Presiding Commissioner Philip Weickhardt
Productivity Commission
Locked Bag 2, Collins St East
Melbourne VIC 8003

By email – electricity@pc.gov.au

Dear Commissioner,

Electricity Network Regulatory Frameworks – Draft Report

Alinta Energy welcomes the opportunity to make a submission in response to Productivity Commission, *Electricity Network Regulatory Frameworks*, Draft Report (the Draft Report) released in October 2012. Alinta Energy welcomes the analysis of the Commission which largely endorses the case for ongoing reform in the electricity sector and notably in the area of network regulation.

The purpose of this submission is to reflect upon issues where Alinta Energy has relevant experience to assist the Productivity Commission in its finalisation of this inquiry. Alinta Energy's experience is drawn from participation in gas and electricity retail, wholesale and generation markets with approximately 700,000 retail customers and over 2500MW of generation facilities in Australia (and New Zealand).

As an active participant in the energy market, Alinta Energy has first-hand experience of the markets development and would be directly impacted by a number of the recommendations contained within the Draft Report. While many of the recommendations reflect previous analysis undertaken in respect of this sector, some of the recommendations are less developed.

Retail pricing regulation

Alinta Energy endorses the Commission's recommendation that retail price regulation should be removed where it has been demonstrated that competition exists in a region. Further, Alinta Energy notes that the recent experience in South Australia demonstrates that retaining retail price regulation, where it has been shown that competition exists, may ultimately lead to suboptimal outcomes as regulators unnecessarily interfere in a market to artificially suppress prices instead of allowing competition to grow. This intervention creates uncertainty for retailers which will reduce competition and work against the long-term interests of customers.

Time-based pricing

Time–based pricing is available in a number of forms: at one extreme this could conceptually be 5-minute price changes while at the other end of the spectrum price blocks shaped around off-peak/peak, weekday/weekend times. The information and level of engagement needed to respond to the most granular cost-reflectivity is likely to be beyond most consumers and of limited benefit. Whereas, while large time blocks may be easier to implement they may lead to more muted response.

Nevertheless, Alinta Energy favours time of use pricing blocks as an initial driver of consumption education and demand management with a longer-term goal of more granular pricing being available

in the market as product consumers can select. How this is applied to network versus energy charges may also vary based on consumer experience.

The evidence illustrates that even a modest response to time-based pricing will likely lead to improved economic outcomes in consumption and network investment.

Smart meters

Alinta Energy welcomes further analysis on any smart meter roll-out; however, as a general principle mandated roll-outs should be resisted given the potential for significant costs and costs-benefit trade-offs that are likely to be overstated. Alinta Energy supports a deregulated approach to metering services and time of use charging.

The analysis on smart meters can not capture the potential technology advances that can enable better customer engagement and information without smart meters (i.e. in-built energy consumption readers on appliances, data readers on power outlets) or through alternative forms of enhanced metering. While Alinta Energy agrees that smart meters are one method of improving customer demand management it is not the only method and thus government mandated roll-outs should be resisted.

Further, Alinta Energy has some reservations about obligations being placed on distribution and retail companies to educate consumers about smart meters and time-based pricing in an environment where the roll-out and rolled-out products are determined centrally and not by the companies themselves.

Hardship policy

Alinta Energy endorses proposals for a common approach to the identification and management of customer hardship. Customer hardship is an ongoing feature of society where at risk individuals or families face financial challenges over periods of time. These challenges should be recognised and treated in a consistent apolitical manner.

Alinta Energy believes a consistent and balanced approach to customer hardship will encourage community acceptance of greater competition for electricity services and cost-reflective time of use pricing.

Distributed generation

Alinta Energy endorses the position that governments should as soon as practicable discontinue subsidies for rooftop photovoltaic units and other forms of distributed generation. The use of feed-in tariffs and the out workings of the Small Renewable Energy Scheme has led to an uneconomic glut of installed embedded generation which has resulted in significant costs to the community that have not been appropriately addressed.

Alinta Energy continues to hold concerns about the long-term impacts on the market and consumer welfare of these high-cost electricity generation and carbon abatement options.

Network regulation and public ownership

Alinta Energy is not deeply engaged in the regulation of network businesses and can only note the degree of complexity surrounding the network regulation process and the limited ability of interested parties to comprehend the scope of determinations.

Nevertheless, Alinta Energy remains supportive of pursuing reforms that drive greater efficiencies especially during a period where customers have encountered significant network related price rises. Where structural reforms, like ownership changes, or improved regulatory engagement, have a

strong likelihood of delivering outcomes in the long-term interests of customers they should be preferred over the status quo.

Balance between network reliability and supply-side

The Commission rightly examines the issues around network reliability and costs to customers of maintaining high reliability standards. Alinta Energy agrees that understanding the point at which the costs of further reliability increments exceed the additional benefits to customers is critical to manage the cost increases in network investment.

Nevertheless, it may be the case that the community, if tested adequately, expects the level of reliability that is generally present in most jurisdictions. Alinta Energy is not endorsing the level of expenditure that has occurred, and suggests the timing as opposed to the quantum is part of the problem, but notes that the potential for underinvestment could also be a cause of future community concern if appropriate reliability is not maintained.

Additionally, it is likely that customer preferences will differ across Australia due to cost, topography and climate and thus the pursuit of any national framework should not form a blunt instrument that disallows individual preferences to be acted upon.

One further point, which Alinta Energy proposes be subject to Commission consideration is the relative imbalance between the value of customer reliability and the Market Price Cap in the National Electricity Market. Practically, networks and generation are both substitutes and compliments and thus investment in either can delay the need for investment in the other. Hence, network investment can de delayed if additional generation, either embedded or large-scale occurs at private expense. However, given the value of customer reliability is significantly higher than the Market Price Cap it is likely that network solutions will always be favoured.

Australian Energy Market Operator

Alinta Energy has watched with interest the ongoing debate about the role of a national planner in the National Electricity Market and the Australian Energy Market Operator's (AEMO) potential to fulfil this expanded role. Currently, AEMO fulfils the role of the National Transmission Planner which does not carry out transmission investment decision-making for all networks but fulfils an important informational role.

Interestingly, industry has been generally apprehensive to accept this approach and general conclusions have been that the profit incentives for individual network service providers provide a better approach to network planning and procurement.

Alinta Energy is not convinced that AEMO as the national not-for-profit planner is an ideal outcome, nor does Alinta Energy support the current role AEMO plays in Victoria; however, it is correct that there is an inherent tension with profit driven network providers determining planning outcomes. In each instance, putting aside the reams of current and past analysis, the uncertainty with these approaches turns upon the ability of parties controlling planning decisions (through the RIT-T or otherwise) to be guided by their own preferences due to revenue incentives, market operational benefits or philosophical preferences. Alinta Energy encourages further analysis in this area and is in-principle comfortable with additional independence around the conduct of the RIT-T.

Optional firm access model

Alinta Energy supports progression of the optional firm access model. In principle the optional firm access model should resolve dispatch uncertainty by:

- providing firm access over the network underpinning an investor's ability to recover fixed

costs of a life-long asset and reducing exposure to contract for difference payments;
- maximising the use of physical assets as a hedge against customer load; and
- reducing disorderly bidding and occurrences of inefficient negative price outcomes.

In principle the optional firm access model should provide clear locational signals and hence:

- new asset locational decisions should not undermine existing generation investment or degrade flow paths; and
- it should ensure transmission frameworks are better matched to future connections growth including significant anticipated renewable generation.

In short, Alinta Energy would be more comfortable investing under a transmission framework where network access for the life of the asset is understood. As understanding network access provides greater revenue certainty.

The optional firm access model should also improve inter-regional certainty:

- by providing a firmer inter-regional product which can be relied upon by market participants;
- reducing the need for inefficient double up between settlement residue and hedge contracts;
- enhancing competition for the benefit of customers and promote new entry; and
- providing incentives to maintain networks and inter-connectors which are better coordinated with new generation investment requirements and retail competition.

Alinta Energy's support is tempered by the complexity of the model and a belief a staged approach to implementation would be more appropriate. Alinta Energy's submission to the Australian Energy Market Commissions *Transmission Frameworks Review* proposed a graduated implementation with proposed simplifications. Alinta Energy argued that the significance of this change means practical success should outrank academic purity of the model at this stage in particular.

In these terms, the model could be segmented into its component parts. Each part can be implemented and the market allowed time to adjust to the change arrangements. A potential sequencing of steps may be as follows:

- develop a single firm access standard, rather than the tiered approach with scaling factors, in consultation with industry;
- allocate grandfathered access to existing participants access rights based on the single firm access standard and to inter-connectors;
- implement planning arrangement consistent with the firm access standard and develop a pricing methodology in conjunction with industry for new entrants or generators seeking access in excess of their grandfathered access rights based on the firm access standard;
- implement access settlement;
- develop a methodology for generators acquiring access rights across the inter-connector informed by experience of intra-regional access settlement; and
- develop TNSP incentives and methods for trading access rights.

<u>Nodal pricing</u>

Alinta Energy suggests it is a mischaracterisation to suggest the optional firm access model is a step towards nodal pricing. The model exposes generators to local marginal prices based on specific events for the purposes of shoring up the ability to hedge in regionally based commodity markets. It does not attempt to promote exchange at the node.

While a review of the benefits of nodal pricing may of itself be of interest or beneficial in 10 years; Alinta Energy does not believe this is contingent on the optional firm access model, is a out working

of implementation of such a model, or a desirable outcome for the National Electricity Market with or without progression of the optional firm access model.

Governance

Alinta Energy understands the focus of discussions around the separation of the Australian Energy Regulator (AER) and the Australian Consumer and Competition Commission (ACCC) are directed towards network regulation. Nevertheless, it needs to be recognised that the AER's scope extends beyond this area and there are well established policy reasons why a separate regulator is not desirable.

It could be equally argued that an improvement in outcomes across the board could be achieved by consolidating the AER as a critical component of the ACCC. The absence of a separate regulator would be consistent with all other significant industries (like communications, insurance, aviation et al) and is arguably preferably in areas where overlap between the interests of the AER and the ACCC exists. In fact, there is no guarantee separation would not lead to duplication and thus is undesirable for this reason alone; whereas a single regulator is able to direct resources to where they are most valued which at times will be energy (i.e. during price setting) and at other times will not.

Enhanced resources is a pragmatic solution; however, the debate around separation of the AER from the ACCC is a distraction from real energy market reform which is needed in the area of regulated prices, government ownership of assets, cost concerns associated with network investment, green schemes and consistent approaches to consumer hardship.

Regarding consumer advocacy, the creation of a single body has some merit although Alinta Energy questions whether such a body would be capable of representing the interests of all consumers during policy reviews and rule-making processes. Consumers have wide ranging views and disparate interests and direct engagement between consumers and consumer groups and the primary decisions making institutions should be preferred in addition to ensuring the AER/ACCC engages in issues where its expertise can be drawn upon.

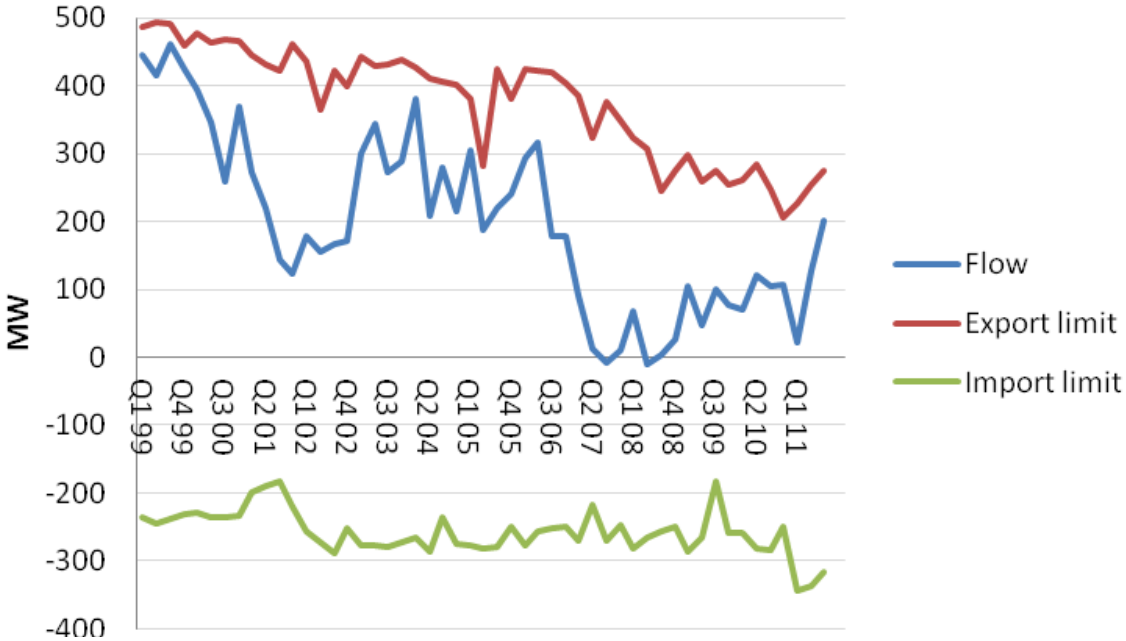
Expedited rule changes and Ministerial powers

The proposal to fast-track changes to the market frameworks where analysis has already occurred by a party outside of the National Electricity Market is of concern to Alinta Energy. The desire for action is understandable; however, streamlined decisions can potentially lead to further costs whether in network, retail or generation that will ultimately impact consumers if they are not appropriate.

At present only the processes conducted by the Australian Energy Market Commission have the ongoing and developed input and buy-in of industry. Therefore, it is imperative that the well tested and robust assessment processes under the auspices of the Australian Energy Market Commission be used to consider potential market framework changes. To do otherwise may create a perception of heightened risk in a sector that has already be subject to significant regulatory upheaval that undermines investment. Equally, providing powers to the South Australian Minister may not be ideal.

Inter-connectors

Alinta Energy agrees that inter-connector notional capacity is reasonable; however, degradation of that capacity is cause for concern. One example is the Heywood inter-connector capability between Victoria and South Australia. This has become pronounced in recent years.



A group of privately owned generators – including Alinta Energy, AGL Energy, GDF Suez and Energy Australia – in a submission to ElectraNet regarding an assessment of the inter-connector commented:

> *This reduction in export capability has reduced both the reserve margin available to South Australia from other National Electricity Market regions and South Australia's ability to access lower cost interstate power. From a commercial perspective, this undermines confidence in inter-regional trading as parties are not able to effectively manage basis risk. In turn, this reduces contract liquidity and overall competition in the market. Ultimately this limits the benefits of the National Electricity Market for South Australian consumers.*[1]

From Alinta Energy's perspective the drivers of the degradation of the inter-connector and the wider transmission system were confirmed in general terms by ElectraNet and AEMO. This included the levels of high generation in the South-East of the State, an area known for its high levels of wind generation.

For the Commission the issue is not does inter-connector capacity need to be increased, and Alinta Energy notes the current assessment of inter-connectors that are underway, but do the current arrangements disincentive maintenance of inter-connector capability and how does this impact inter-regional trade.

Alinta Energy is an active participant in the Victorian and South Australian retail markets with generation in South Australia. If assets were perfectly transferable it may be preferable to have generation assets split between both markets and not located singularly in South Australia. Nevertheless, with hedge availability in corresponding regions and ongoing inter-connector operation this issue can be minimised and managed. If that were not the case then the Commission's assertion that locational incentives could be impacted by state-based hedging arrangements as opposed to engineering efficiency or fuel drivers could be correct.

[1] Alinta Energy, AGL Energy, Energy Brix, International Power – GDF Suez, Origin Energy and TRUenergy, Submission to Electranet/AEMO - South Australia-Victoria (Heywood) interconnection upgrade, 30 January 2012

However, as it stands, state-based hedging arrangements are appropriate and viable where supported by inter-connectors that are not degraded. The optional firm access model is one potential proposal to manage this degradation of inter-connectors and ensure state-based hedging arrangements don't undermine generation locational decisions.

Market power

The issue of market power in the National Electricity Market is one that stirs significant academic interest but remains based in conceptual possibilities as opposed to evidential reality. Alinta Energy does not believe that market power has been demonstrated to be an issue of significance in the National Electricity Market and does not believe inter-connector capability is a primary determinant of market power. On the contrary, the ability to influence inter-connector outcomes will evolve as a inter-connector is developed and it is not the case that a larger inter-connector would be less impacted by generator bidding either side of the inter-connector.

In Alinta Energy's view the key point of analysis when it comes to perceptions of market power should be based around barriers to entry and the retail and generation ownership balance. In other words, where competition exists in a region, in either generation or retail, market power concerns are unlikely to be evidenced.

Alinta Energy does not support the provision of confidential contractual data and suggests to the Commission it is unlikely that contract data will be of much value. The complexity of bidding responses to hedge positions, physical developments, transmission constraints, fuel shortages or oversupply, and other factors makes the concept of regulatory investigation to identify discrete episodes of high prices based on a single factor untenable. Further, it suggests that there is an ability to identify between 'good' high price events and 'bad' high price events. This is misguided and has been previously illustrated as such.

Yours sincerely

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