



22 December 2014

Elizabeth Walters
Assistant Director Electricity
Economic Regulation Authority
Level 4, Albert Facey House,
469 Wellington Street, Perth WA 6000
Via email: publicsubmissions@erawa.com.au

Dear Elizabeth,

2014 Annual Report to the Minister on the effectiveness of the Electricity Generation and Retail Corporations Regulatory Scheme – Discussion Paper

Alinta Energy (**Alinta**) welcomes the opportunity to comment on the Economic Regulation Authority's (**ERA's**) Discussion Paper: 2014 Annual Report to the Minister on the Effectiveness of the Electricity Generation and Retail Corporation (**EGRC**) Regulatory Scheme (**the Regulatory Scheme**).

Alinta understands that the Regulatory Scheme was implemented as part of the remerger of Synergy and Verve Energy on 1 January 2014 to ensure a "level playing field" for government and private sector businesses could be maintained in the South West interconnected system (**SWIS**). Specifically the Regulatory Scheme attempts to ensure this occurs through placing a number of restrictions on Synergy's operations in respect to ring fencing, business segregation, transfer pricing and non-discriminatory wholesale electricity trading activity.

As a private sector participant in the Wholesale Electricity Market (**WEM**), Alinta supports the Regulatory Scheme which aims to provide competitive neutrality to ensure efficient market outcomes occur.

To this extent Alinta welcomes the approach adopted by the ERA in its Discussion Paper of providing additional information regarding how the Regulatory Scheme works in practise. This is especially relevant given that industry stakeholders are still continuing to fully grasp the practical realities of the Regulatory Scheme (particularly with respect to the ring-fencing arrangements) and its associated effectiveness. Going forward Alinta supports the ERA in continuing to increase transparency around the Regulatory Scheme and in particular how this has been implemented by Synergy.

The remainder of this submission outlines a number of concerns for the ERA to take into consideration in its assessment of the effectiveness of the Regulatory Scheme. A number of aspects of the scheme where further transparency would be beneficial for industry are also identified.

Segregation Requirements

Ensuring appropriate ring-fencing arrangements are in place for Synergy is essential for the neutral operation of the energy market. Given the dominance of Synergy, it is important that it does not have the ability to unduly preference its business operations over other market participants. Alinta understands that the Regulatory Scheme has adopted an approach to ring fencing whereby there are

restrictions on the flow of a number of pieces of specified information (“restricted information”) between Synergy’s individual business units.

While Alinta appreciates that the ring fencing approach that has been adopted ensures that broader interactions within Synergy are not inappropriately restricted (i.e. the ability for Wholesale Business Unit (**WBU**) to provide input into regulatory consultations), the approach is heavily reliant on all necessary information to ensure competitive neutrality is maintained as being identified as “restricted information”. It is an open question as to whether this wholly occurs in practise.

Alinta has some concerns that some information that is currently classified as “restricted information” does not incorporate wholesale fuel contract information (gas and coal). As a consequence the main (and most variable) components of Synergy’s wholesale electricity costs can currently be made available to Synergy’s retail business unit. Alinta notes that once provided with the main component of any wholesale costing it is relatively easy to back solve to work out the appropriate transfer price to be provided to wholesale electricity.

Similarly Alinta considers that while the existing regulations make appropriate reference to Synergy’s dominance in electricity markets, there is a degree of risk that Synergy’s participation in gas markets is not subject to the same regulatory scrutiny, potentially allowing for inappropriate information to be shared within between Synergy’s wholesale and retail gas units to the potential detriment of competitive neutrality.

To ensure that competitive neutrality is being maintained Alinta recommends the ERA considers whether:

- the ring fencing approach adopted in specifying restricted information is the best available, i.e. whether it would be more effective to ring fence WBU in its entirety;
- the regulatory definition of “restricted information” has appropriately captured all relevant information which may directly or inadvertently provide Synergy with an unfair competitive advantage, including primary fuel information; and
- there is any need for restriction on Synergy’s participation in the gas market.

Wholesale Acquisition

To ensure that Synergy does not discriminate between its Retail Business Unit (**RBU**) and competitors when offering wholesale supplies; the Regulatory Scheme places a number of obligations on Synergy including developing appropriate policies for supplying wholesale electricity to retail or electricity generation competitors.

Alinta believes it is timely and appropriate to consider how effective in practise the Regulatory Scheme has been in obligating Synergy to comply with non-discriminatory objectives. As such, Alinta supports the ERA in conducting an assessment of whether Synergy has shown undue preference to its own retail and generation arms over third party generators and retailers.

More broadly, Alinta notes that there is a general lack of transparency around a number of aspects of Synergy’s wholesale acquisition of electricity. This includes lack of details around how Synergy applies its transfer pricing operations for the RBU, in comparison to that provided to other participants through the standard products regime. Similarly, it’s unclear how individual Synergy

business units treat risk in the market. For example, some organisations centre their risk profiles within one businesses unit in order to focus their risk profiles into one accessible and transparent segment. In relation to Synergy's operations it is unclear to Alinta how risk is treated, for example whether RBU may be able to take risk in the wholesale market by taking a long position and on-selling into the Balancing market.

To assist in its understanding of the remerged regulated business operations Alinta requests further transparency with respect to:

- the methodology used in practise when setting prices between WBU and RBU; and
- whether RBU can indirectly take risk in the wholesale market, and if so whether this may circumvent the broader intentions of the Regulatory Scheme.

Compliance

To ensure the Synergy is complying with its obligations under the Regulatory Scheme a number of audits are required to be undertaken annually by the Auditor General at different times during the year, including:

- a Financial year audit, which covers segmentation of Synergy's operations, financial administrations, segregation arrangements, wholesaling obligations and wholesaling arrangements; and
- a Calendar year audit which covers certain segregation obligations (disclosure of restricted information, information technology controls, training, separate work areas and separation of management roles).

Following the completion of the review's, if the Auditor General forms an opinion that Synergy has not complied with one or more of its obligation this will be referred through to the ERA for investigation and enforcement, potentially through civil penalties. These audits are in addition to the annual review of the effectiveness of the EGRC Regulations which must be undertaken by the ERA.

The ERA's Discussion Paper outlines some general concerns with respect to the mismatch in timing of the review's by Auditor General and ERA which may at times result in a duplication of work. To the extent that improvements could be made to the Regulatory Scheme to ensure that processes can be better aligned, Alinta supports such initiatives.

More broadly Alinta is concerned that the current compliance arrangements may result in significant delays between the occurrence of a non-compliance by Synergy and its identification as part of the relevant annual audit process. This may mean that inappropriate or anomalous behaviour could persist for a number of months before it is identified through the annual processes, which would be to the detriment of the broader market.

Similarly, Alinta notes that under the existing regulatory scheme if any occurrence of non-compliance is detected the ERA may elect to impose civil penalties on Synergy, which are payable to the State Government's consolidated account. Intuitively, the effectiveness of an incentive scheme which in practise results in money being paid from a government owned business back to the State Government in the event of a non-compliance, could be interpreted as being an ineffective deterrent .

To ensure the effectiveness of the overall compliance regime contained with the Regulatory Scheme, Alinta supports the ERA in considering whether:

- the Auditor General's audit processes and the ERA's annual review of the effectiveness of the EGRC Regulatory Scheme can be better aligned;
- there are any refinements to the Regulatory Scheme that can be made to ensure that any responses to a potential are non-compliance are immediate; and
- an alternative payment structure for any civil penalties would be more appropriate, i.e. that applies monies through to impacted parties rather than the State Government's consolidated account.

Conclusion

Effective markets have a robust framework which fosters an environment of full and transparent competition, regardless of the ownership arrangements in place. While the market structure of the Western Australian energy market is to a degree unique because of the size and ownership arrangements of Synergy, an effective Regulatory Scheme which increases transparency can go some way to alleviating potential issues. To this end, Alinta welcomes the ERA's consideration on the issues as outlined above.

If you would like to discuss this submission please don't hesitate to contact myself on 9486 3009, or Mr Anders Sangkuhl on 02 9375 0962.

Yours sincerely

Fiona Wiseman
Wholesale Regulation Manager