21 December 2015

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,

2015 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: 2015 Annual Report to the Minister on the Effectiveness of the Electricity Generation and Retail Corporation (EGRC) Regulatory Scheme (the Scheme).

Alinta understands that the Regulatory Scheme was implemented as part of the re-merger 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) post - merger. Alinta notes that the Scheme is targeted at giving effect to the Government's stated commitment "…to sustained private sector participation in the electricity sector"[1].

Alinta supports the basis of the Scheme but takes the view it cannot remain a static instrument but rather that it must evolve and undergo amendment to remain fit for purpose. In that regard, at a minimum, Alinta notes that the Scheme lacks an overarching statement of its objective. Alinta suggests that this in not in accord with best regulatory practice and supports the ERA's Key Finding from its 2014 Report[2] that the Government's objective be made explicit in the Scheme.

Including a stated objective would provide a proper and necessary basis upon which the ERA can better effect its obligation to review the effectiveness of the operation of the Scheme which would undoubtedly be to the benefit of both the market (more confident that regulatory processes are properly targeted) and the Government (higher level of assurance that the Scheme is properly designed to facilitate the Government's requirement of sustainable private sector participation in the electricity market).

In the absence of a stated objective, Alinta notes and supports the ERA's interpretation of the Scheme's objective "…is to ensure a level playing field for competitors and new entrants and provide confidence to market participants to encourage participation in the market."[3] In Alinta's view this aligns closely with the commitment stated in the Minister's 2nd Reading Speech. Furthermore, Alinta notes that a level playing field is a key underpinning of efficient markets and is especially relevant in

[1] Second Reading Speech for the Electricity Corporations Amendment Bill 2013 in relation to the EGRC Regulatory Scheme.
[2] 2014 Report to the Minister on the Effectiveness of the EGRC Regulation Scheme, Pg 9.
[3] 2015 Annual Report to the Minister for Energy on the Effectiveness of the EGRC Regulatory Scheme – Discussion Paper, Pg 6.

Alinta Sales Pty Ltd • (ABN 92 089 531 984) trading as Alinta Energy
A The Quadrant Level 13, 1 William Street, Perth WA 6000 Australia
T +61 8 9486 3000 • F +61 8 9486 3951 • W alintaenergy.com.au

an electricity market where a government owned entity dominates both the wholesale and retail markets segments.

Level Playing Field – transparency is key

A level playing field is the hallmark of workably competitive markets. In the context of the WEM, where vertically integrated Synergy owns or has control over the majority of generating plant and supplies over half the consumed load, ascertaining what a level playing field should look like requires consideration.

Apart from the Wholesale Market Rules, which disallow manipulation of the clearing dispatch price where market power exists i.e. requirement to bid at Short Run Marginal Cost, the other main instrument to control the market power of the dominant player is the Scheme.

While the Scheme requires Synergy not to favour its Retail Business Unit (RBU) in offering wholesale supply, Alinta is concerned about the lack of transparency in relation to the wholesale transfer price between the Wholesale Business Unit (WBU) and RBU. This lack of transparency has been an express concern of the market for some time and has resulted in complaints[4] to the Minister for Energy about the pricing behaviour of RBU. This is an indicator of a lack of confidence by retail competitors in the regulatory arrangements embedded in the Scheme related to wholesale pricing arrangements between WBU and RBU and needs to be addressed.

Assurance is required that RBU contestable customer pricing is not supported by cross-subsidy from the Tariff Adjustment Payment paid to Synergy to compensate for the difference between franchise tariffs and the associated cost of supply. In this regard Alinta recommends the ERA consider the merit of recommending the Scheme be amended to require Synergy to publish separate audited financial statements for its franchise and contestable electricity customer segments. If the segment statements disclose a financial loss for supplied contestable electricity customers then it would present evidence that RBU is relying on cross-subsidies to price inefficiently and indicate that the Scheme is ineffective. Alinta posits such financial disclosure would also act as a restraint on Synergy pricing at inefficient levels to avoid regulatory scrutiny and consequent potential damage to its reputation.

Prudent risk management practice in businesses with wholesale and retail operations typically requires that a product transfer price is established below which the retail arm is disallowed from pricing. Alinta acknowledges that the Scheme prohibits WBU from offering RBU wholesale supply on more favourable terms than that offered to competitors, however it is not clear to the extent that RBU has sought formal wholesale supply offers from WBU and therefore the extent to which the caveat applies to RBU's supply portfolio. This lack of clarity around the transfer price arrangements between WBU and RBU in regard to contestable customers reduces the market's confidence in the Scheme's effectiveness in mitigating Synergy's market power.

Alinta acknowledges that Segregation and Transfer Pricing Guidelines 2013 shed some light on these arrangements but it remains unclear how the settlement process between WBU and RBU works for contestable loads. Noting that Synergy has supplied the ERA with the relevant Additional Price Mechanism documents, which are not publicly available, Alinta seeks the ERA's assessment

[4] Refer: ABC News article 13 October 2015; WA electricity retailer Synergy accused of misusing market power - ABC News (Australian Broadcasting Corporation); accessed 18 November 2015.

as to whether this mechanism works to provide RBU with an advantage not otherwise available to retail competitors making wholesale supply transactions with WBU.

If the ERA concludes that an advantage arises through the Additional Price Mechanism transactional relationship between WBU and RBU which tilts unacceptably the playing field in RBU's favour then Alinta would welcome the ERA's assessment as to what changes in the Scheme are needed to ensure RBU and retail competitors compete on a level playing field.

In addition Alinta requests the ERA consider whether the transparency benefits to the market as a whole from requiring Synergy to publish documents and records related to the Additional Transfer Price Mechanism and Forecast Obligations (related to additional load), as set out in clauses four and five of the Segregation and Transfer Pricing Guidelines 2013, would outweigh the cost of the loss of confidentiality in regard to Synergy's operations in the contestable market segment.

Standard Product Arrangements – reasonable spread

The Standard Product Arrangements (**SPA**) require Synergy to offer specified products at minimum quantities on a quarterly and annual basis. In effect, Synergy must offer to sell and buy 5 MW per week in units of 1 MW and must offer a minimum of 150 MW for sale and 100 MW for purchase over a year. The sell and buy prices offered are linked by a mandated maximum spread factor which from 1 January 2015 was reduced from 25% to 20% i.e. the minimum buy price is set at 80% of the sell price.

The SPA represents a forward price curve against which generators and retailers can hedge the price risk of the STEM and Balancing Markets. Its genesis is the merger of Verve Energy and Synergy which created the dominant vertically integrated entity in the market; its apparent purpose is to provide other market participants with access to mandated products to manage price risk over the short to medium term. In Alinta's view, it is a necessary adjunct to the formal market arrangements that adds needed liquidity and optionality to the wholesale market; in theory it goes some way towards creating a level playing field.

Alinta notes, however, that the take up of the SPA products has been limited to date[5] which suggests in practice it has not met the market's need for a viable alternative to the contract market and it has not adequately underpinned the level playing field as it is designed to do. Alinta believes its usefulness and value to the market would be improved if the mandated maximum spread was reviewed against buy/sell spreads in other competitive wholesale electricity markets. A reduced spread would assist in price discovery, ensure Synergy prices more efficiently and better support achievement of the level playing field objective.

It's likely the current dominance of Synergy in the WEM will not result in the spread reducing to optimal levels and thus require the regulations to continue to specify the maximum spread that Synergy can apply. Alinta therefore supports the ERA's proposal to develop a methodology for specifying the mandated buy/sell spread and suggests the spread be reviewed no less than annually to take account of material changes in market structure and conditions.

[5] Only 14 transactions have been executed to date; 2015 Annual Report to the Minister for Energy on the Effectiveness of the EGRC Regulatory Scheme – Discussion Paper, Pg 10.

Compliance

Alinta notes the Scheme requires the Auditor General to undertake annual financial and calendar year audits each dealing with different compliance requirements. There could be a substantial lag between non-compliant behaviour occurring and it being reported and then referred to the ERA for investigation. This is concerning, not only in regard to disclosure of restricted information but also in regard to discriminatory pricing behaviour.

Alinta notes this was a key finding in the ERA's 2014 report and supports ERA recommendations as to increased frequency of external review of Synergy's compliance with the Scheme, if not as a whole, then those elements that potentially deliver unfair advantage to Synergy, such as discriminatory wholesale pricing to RBU and management of restricted information. In addition, to improve the market's confidence in Synergy's compliance with its obligations, Alinta supports the ERA recommendation that Synergy be required to self-report breaches for non-compliance with the Scheme.

If you would like to discuss this submission please don't hesitate to contact myself on 9486 3306

Yours sincerely

John Rhodes
Wholesale Regulation Manager