Economic Regulation Authority
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Submitted online to: www.erawa.com.au/consultation

EGRC REGULATORY SCHEME: 2020 EFFECTIVENESS REVIEW

Alinta Energy appreciates the opportunity to provide feedback on the effectiveness of the EGRC regulatory scheme.

Alinta Energy has material concerns that the scheme is currently not achieving its fundamental objectives to:

1. prevent anti-competitive cost-shifting between Synergy's business units - given Synergy's generation business has lost an average of $338m p.a. since 2018, while Synergy's wholesale and retail businesses have posted commensurate profits.

2. provide a competitive benchmark price - given Synergy appears to have suppressed its standard product prices well below its portfolio cost of generation over several years, and recently below balancing prices.

3. enable participants to rebalance their portfolios given only two buy transactions have occurred during the past four years. Further, the only buy transactions were met with price reductions discouraging any transactions since.

If unaddressed, Alinta Energy believes that these failures will undermine the scheme's primary objective: maintaining private sector investment. This is because:

- Any systemic profit shifting to the Wholesale Business Unit (WBU) and Retail Business Unit (RBU) by Synergy from the Generation Business Unit (GBU) creates an artificial market for the pricing of customer loads in the SWIS with the result being an inability for private investors in retail and wholesale markets to compete on an even footing. Alinta Energy considers that the long-term impact of such practices will include the exit of existing investors and the inability to attract new private investors to compete and innovate in the sector. Alinta Energy has observed the recent growth of Synergy's load, as private investors without subsidy are progressively struggling in securing the offtake required to underwrite new projects, or to support their existing portfolios.

- A dominant participant like Synergy suppressing wholesale prices while accessing any form of GBU subsidy will signal to investors that they will not be able to recover the costs of new projects; and

- A lack of cost reflective rebalancing opportunities forces competitors into unviable contract positions, especially where Synergy can offer below its portfolio/unsubsidised costs to secure new or recontract existing loads.

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Alinta Energy considers that if the EGRC scheme doesn't address these key issues, and the pricing strategies are maintained, private sector investment and competition will be forced out. The only option is for taxpayers to pay for the new capacity that the SWIS requires to maintain security and reliability absent of any competitive pressure to do so in the most efficient and innovative manner. This would be in addition to the $315m taxpayers are already forecast to subsidise Synergy's generation business over the next four years via the "System Security Transition Payment"; and the $862m subsidy Synergy will receive under the "Asset Investment Program" during the same period.[1]

The current, critical juncture of the SWIS' energy transition will amplify the costs of this potential market failure and ultimately increase the burden on taxpayers.

The WOSP outlines that the SWIS urgently requires investment in ESS capacity and storage to maintain reliability and security during its transition from fossil fuels. Incentivising this investment from the private capital markets (rather than relying on intervention) is the key objective of the government's Energy Transformation Strategy.

To avoid increasing subsidies to the electricity industry during WA's energy transition, Alinta Energy strongly recommends that the EGRC regulatory scheme be reformed to include regulations that require Synergy's transfer price, Standard Products, and wholesale prices to reflect the costs of its generation free of distortions, therefore encouraging more competitive outcomes, signals and pricing.

The remainder of Alinta Energy's submission will outline in more detail the evidence for how the EGRC scheme is, in Alinta Energy's view, not currently achieving its objectives. Then, it will present the long-term implications if these issues are not addressed. Finally, it will conclude by further discussing the proposed solutions for the ERA's consideration.

Synergy's financial results and subsidies indicate that profit shifting is occurring between the BUs

ERA's 2017 review identified that an objective of the EGRC scheme is to discourage anti-competitive "profit shifting" and ensure pricing is at "arm's length."[2]

However, Synergy's financial results suggest that Synergy's GBU is selling below its cost to the advantage of its WBU and RBU.

Since FY2018, Synergy's generation business has made a loss of at least $200 million, and an average loss of $338m. Meanwhile, Synergy's retail and wholesale business units have earned an average profit of $126m and $96m p.a., respectively.

[1] Government of Western Australia, *2021-22 Budget Papers Western Australia State Budget*, September 2021, p.798, p.794. Budget Paper No.2.
[2] Economic Regulation Authority *Report to the Minister on the Effectiveness of the Electricity Generation and Retail Corporation Regulatory Scheme 2017*, May 2019, p.8.

Synergy Segment profit/loss ($'000)			
FY	**GBU**	**RBU**	**WBU**
2021[3]	-177,643*	243,472*	7,113*
2020	-234,362	213,874	100,168
2019	-577,733	65,002	70,267
2018	-200,699	100,174	116,642

Alinta Energy believes that Synergy's generation would not be priced this way if the businesses were truly operating at arm's length, as is intended by the EGRC scheme.

The recent WA state budget provides further evidence of Synergy's unbalanced and unsustainable financial performance across its business units. Synergy's GBU will receive a subsidy of almost $100m in FY2022 and will receive at least $315m over the next four years.

The "system security payment" compensates Synergy to "operate its electricity generation fleet to ensure the security and reliability of the market". The fact that this exists suggests Synergy is underbidding its electricity for retail sale and not recovering its costs in the market and that it will continue to do so.

Table 8.4

SYNERGY FINANCIAL VIABILITY SUBSIDIES

	2020-21 Estimated Actual $m	2021-22 Budget Estimate $m	2022-23 Forward Estimate $m	2023-24 Forward Estimate $m	2024-25 Forward Estimate $m	**Total 2021-22 to 2024-25 $m**
Distributed Energy Buyback Scheme	0.8	3.5	5.3	6.3	6.1	**22.1**
Feed-In Tariff	15.7	-	-	-	-	**15.7**
Over-the-Counter and Paper-Bill Fee Recovery	3.0	3.0	3.1	3.1	3.2	**15.4**
Re- and De-energisation Fee Recovery	3.9	3.4	3.0	2.5	2.0	**14.8**
Renewable Energy Buyback Scheme	42.1	39.0	35.6	33.5	30.2	**180.4**
System Security Transition Payment	-	98.7	82.4	76.9	57.4	**315.3**
Tariff Equalisation Contribution Recovery	90.2	91.2	92.1	91.6	93.6	**458.7**
Wholesale Electricity Market Reform	14.5	4.4	4.7	4.3	-	**27.9**
TOTAL	**170.2**	**243.4**	**226.1**	**218.2**	**192.5**	**1,050.3**

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Standard Products do not provide a competitive benchmark price

The Merger Implementation Group intended for the Standard Products regime to provide a competitive benchmark price for the wholesale supply of electricity on a non-discriminatory basis.[5]

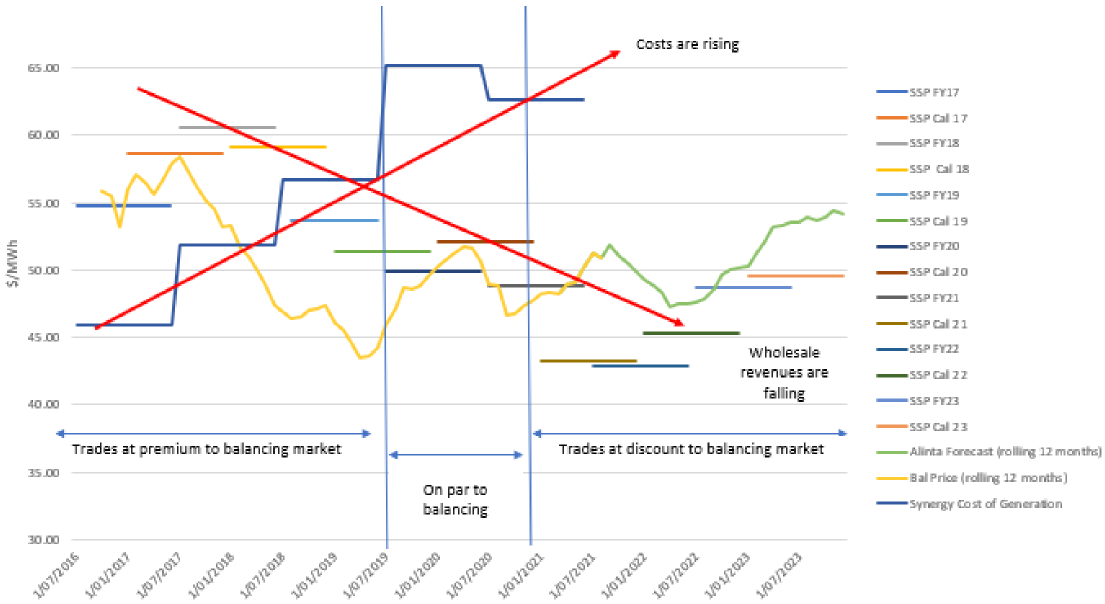
Alinta Energy considers that the regime is not meeting this objective because Synergy's Standard Product sell price is below its cost of generation (calculated using the costs and generation data published in Synergy's financial reports) and even falling below balancing prices.

[3] *The 2021 figures exclude Q4 results as they are based on Synergy's 31 March 2021 Quarterly Report.
[4] Government of Western Australia, 2021-22 Budget. Economic and Fiscal Outlook, September 2021, p.308.
[5] Economic Regulation Authority, EGRC Report to the Minister, June 2016, p.51.

Per the chart below, the difference between Synergy's costs and wholesale prices has been growing over the past 3 years, with the latest Standard Product sell prices (horizontal lines) falling below balancing prices (yellow line).

Ordinarily, the sell price should trade at a premium to balancing prices to reflect Synergy's risk in fixing its future offtake prices 1 year in advance. This had traditionally been the case, but since FY2018, Standard Product Prices have declined from ~$60/MWh for FY2018 products, to $43/MWh for FY2022 products. During the same period, Synergy's cost of generation has increased far above both balancing prices and Standard Product prices – from ~$45/MWh in FY2016 to $60 - 65/MWh in FY21.[6]

Synergy's Standard Product sell prices vs its weighted cost of generation and balancing prices



Alinta Energy notes that the ERA's analysis also found that Synergy's Standard Product prices do not provide a competitive benchmark price. The ERA concluded that Synergy "has been setting the buy price lower than it required to cover its margin."[7]

Interestingly, adding the $98m system security subsidy Synergy will receive in FY21 will reduce its cost of generation to ~$47/MWh – that is, in line with the present Standard Product sell prices. This suggests that Synergy is relying on subsidies in determining its Standard Products (and transfer) prices and consequently, this distorts pricing signals in the market. Regardless of whether this is the case, it indicates the magnitude of the difference between Synergy's efficient, competitive price, and where it is currently offering its Standard Products.

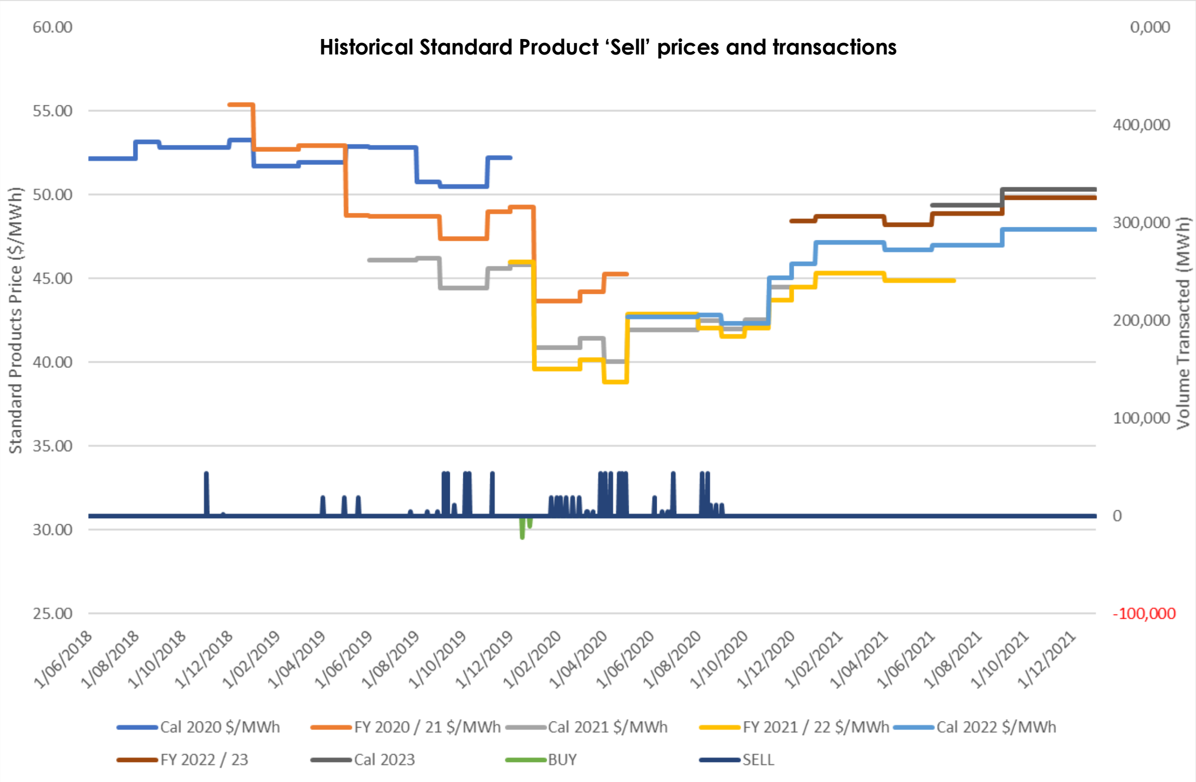
Standard Products do not allow participants to rebalance their portfolios

The Merger Implementation Group intended for the Standard Products Regime to enable participants to rebalance their portfolios (at the margins) with simple products.[8]

[6] Synergy's generations costs in the chart represent a volume weighted average, calculated using the costs and generation data published in Synergy's financial reports.
[7] Economic Regulation Authority, *Electricity Generation and Retail Corporation regulatory scheme: 2020 effectiveness review - Discussion paper*, August 2021, p.13.
[8] Public Utilities Office, *Electricity Generation and Retail Corporation Regulatory Scheme – Response to 2016 Report to the Minister for Energy on the effectiveness of the Scheme*, June 2019, p.8.

However, Synergy's below-cost Standard Product prices prevent this.

This is evident in both the lack of transactions over the past four years, and the disproportionate number of sell transactions compared to buy transactions. The chart below shows that there have been only two buy transactions in the past four years (shown in green). Synergy responded to these transactions (from Alinta Energy) by significantly decreasing prices, further restricting the ability for participants to rebalance their portfolios.



Alinta Energy notes that the ERA also identified that the current scheme dissuades participants from re-balancing. The discussion paper noted that: "Retailers are reluctant to purchase a greater quantity of electricity through standard products than they can sell to retail customers, as the price to sell any surplus (the buy price) is so far below the forecast average balancing price that they are most likely to make a loss on the transaction." Further, the ERA found that even where it reduced the buy sell spread, Synergy opted not to increase its buy prices to levels commensurate with its margins.

How these failures undermine private sector investment

The Merger Implementation Group's overarching objective for the EGRC scheme was to maintain private sector investment.[9]

However, if unaddressed, Alinta Energy considers that the issues discussed above will dissuade any new investment and may even force the exit of incumbents.

The first concern - Synergy's profit shifting to the WBU and RBU - enables Synergy to consolidate

[9] Economic Regulation Authority, *EGRC Report to the Minister*, June 2016, p.51.

the system's load, preventing investors and incumbents securing the offtake required to underwrite their projects, or even support their existing portfolios.

Alinta Energy presents its own contract position as evidence for this dynamic.

[redacted]

[redacted]

This issue is compounded by the third concern – that is, the scheme not supporting participants to rebalance their portfolios. [redacted]

The second concern – that the scheme does not provide a competitive balancing price as Synergy has been able to suppress prices likely below its portfolio costs for several years and continues to do so – dissuades new investment by signalling that wholesale prices will be insufficient to recover the costs of new projects.

Implications for government and taxpayers

If these concerns force incumbents from the market over the longer term and prevent new investment, Synergy, via subsidies, would need to pay for the new capacity and retain the existing assets required to maintain the reliability and security of the SWIS without material pricing correction.

The current, critical juncture of the SWIS' energy transition will increase the size of the investment taxpayers will need to underwrite. That is, it will fall to taxpayers, rather than private sector investment to pay for the storage that is required to prevent minimum loads reaching critical levels during the middle of the day; and the flexible capacity increasingly required to ramp to the evening peak and provide ESS.

These subsidies would be additional to the ~$1.2bn[10] taxpayers are already required to pay Synergy over the next four years.

Proposed solution

Alinta Energy recommends introducing regulations that prevent Synergy from pricing below the transparent cost of its generation; and profit-shifting between its business units.

Alinta Energy also supports extending non-discrimination requirements to foundation customers. Alinta Energy does not suggest this will rectify the issues discussed, but it may reduce Synergy's ability to discount prices even further for the RBU's contestable foundation customers in a manner that creates competition risks.

While Alinta Energy supports the intent of the ERA's proposals to reduce the buy sell spread and to require Synergy to publish more detailed financial reporting; it does not consider these measures will meaningfully ameliorate the issues discussed. This is because:

- as noted by the ERA, when the spread was reduced in 2020, Synergy did not adjust its prices to be commensurate with its costs of generation. Further, without regulations on pricing below cost of supply, Synergy can continue to keep both the buy and sell prices far below their competitive levels - as they are now - and the scheme's current failures will remain.

- Even the current financial reporting requirements provide clear evidence for Synergy's profit shifting, yet this transparency does not dissuade Synergy's behaviour.

Conclusion

In Alinta Energy's view, there is clear evidence that the EGRC scheme is not achieving its objectives to:

1. prevent cost-shifting between Synergy's business units;
2. provide a competitive benchmark price; and
3. enable participants to rebalance their portfolios.

These failures undermine the scheme's primary objective to maintain private sector investment by driving incumbents to early exits and dissuading the investment in new technologies that the SWIS requires to enable its energy transition.

To ameliorate this risk and avoid taxpayers being required to subsidise Synergy's operation

[10] This figure represents the sum of the System Security Transition Payment and the Asset Investment Program, and therefore excludes subsides required to cover Synergy's renewable energy buyback schemes and the difference between its regulated tariffs and regulated revenue.

beyond the intent of the scheme; Alinta Energy recommends the urgent introduction of regulations prohibiting Synergy from pricing in a manner that directly impacts competitive neutrality and has created competition related risks and profit shifting between its business units.

Thank you for your consideration of Alinta Energy's submission.

Yours sincerely

[redacted]

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