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Economic Regulation Authority
Level 4, Albert Facey House,
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Submitted via: www.erawa.com.au/consultation

Electricity Generation and Retail Corporation regulatory scheme: 2023 effectiveness review

Alinta Energy appreciates the opportunity to provide feedback on the 2023 EGRC Effectiveness Review.

We strongly disagree with the ERA's proposal to restrict access to Synergy's standard products to participants that have less than 0.5TWh of generation per annum.

We recommend that this proposal should not be progressed noting that:

- Although the ERA states it will reduce costs, we consider that it would increase costs by:

    1. Increasing the cost to serve of participants who are prohibited from participating.
    2. Undermining price discipline and potentially increasing sell prices for the retailers ERA aims to support.
    3. Creating inefficiencies.
    4. Reducing utilisation of standard products, which would reduce liquidity.

- Although the ERA considers that removing 'speculative trades' is beneficial, we note that:

    1. Speculative trades provide a net benefit by supporting pricing discipline and should not be prohibited.
    2. Prohibiting other participants from making speculative trades is unlikely to improve access for retailers.
    3. No 'speculative trades' means no rebalancing of portfolios – a stated objective of the scheme.

- Although the ERA considers that restricting participation for gentailers would improve the scheme's effectiveness by helping to ensure access for participants without generation, we note that:

    1. It is unreasonable to prioritise access for pure retailers over participants with generation >0.5TWh because:

    a) These participants require access to hedging as well and the restriction creates an uneven playing field.
    b) A product sold to a pure retailer does not provide more benefit than a product sold to a participant with >0.5TWh.
    c) The current arrangements provide equal opportunity for participants to access standard products – smaller retailers are not locked out.

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d) The purpose of the standard products regime is not to exclusively support small retailers – it includes an objective to "allow participants to rebalance their portfolios". Restricting access for participants with generation capacity would abandon this objective, noting that only these participants would be in a position to use 'buy' products.

2. Access for smaller retailers may not improve.

3. Synergy is not the only participant who sells to smaller retailers, and other gentailers may leverage standard products that would otherwise go unutilised to sell to retailers.

- Although ERA considers that the proposal "would facilitate future changes in the buy-sell spread" and thereby provide "further benefits to the market by improving price discovery", we note that:

  1. The argument that restricting access would provide benefit by facilitating a reduction in the buy sell spread is totally dependent on assumptions that the current access arrangements are preventing a narrower spread, and that the Minister will agree to narrow the spread, in contrast with previous decisions.

  2. A narrower spread may not benefit the retailers that ERA aims to support. Given that Synergy has been observed to set its buy price low to avoid buying energy, a larger spread would keep the sell price lower than it would be with a narrower spread.

  3. The spread may become irrelevant. By removing generators with greater than 0.5TWh generation p.a., the proposal could remove all participants that would use buy products, leaving Synergy to set its sell price without concern for where this would place the buy price.

The table below details these responses to the ERA's supporting arguments for their proposal to restrict access to standard products.

We also disagree with the proposal to remove the disclosure obligations. ERA proposes to remove these obligations considering that overall financial results of each unit are not sufficient to prove anti-competitive behaviour has occurred. We consider that these results could still provide a useful indicator which is better than no transparency at all. For example, they could support grounds for seeking further information. We note that improving or at least retaining the current level of transparency would also provide broader benefits to Synergy's shareholders and general public. With the government making numerous and significant direct investments to support the transition, it is important that shareholders can track the performance of these investments.

Alinta Energy's views on the ERA's arguments for restricting access to standard products

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<tr><th>ERA considers that restricting access to standard products:</th><th>Alinta Energy's response</th></tr>
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- **"Will reduce costs"**[1]

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1) Restricting access would put upward pressure on prices by:

a. Increasing the cost to serve of participants who are prohibited from participating.

Standard products help participants lower their cost to serve, even where they have generation exceeding the 0.5TWh p.a. For example, standard products would help these participants reduce their exposure during an outage or where their load exceeds their generation. It can also reduce their costs where the standard product price is less than the cost of their generation. Removing access for these participants increases their costs to serve.

Although the ERA notes that the proposal does not prevent vertically integrated entities with access to significant generation assets from negotiating customised wholesale electricity contracts with Synergy; we note that if there were not a substantial benefit in accessing standard products compared with negotiating a customised product (which are not subject to the same controls around their price, terms and availability), and Synergy did not continue to remain dominant in the WEM, there would be no reason for ERA to propose restricting access.

b. Undermining price discipline

As recognised in the paper, having participants in the scheme that may sell to Synergy where they perceive that they are overpriced (ERA refers to these as 'speculative trades') incentivises Synergy to maintain pricing discipline and correct prices where they are too high.

For example, where Synergy sets its buy price too high, a participant may arbitrage this by selling to Synergy. If the seller's predictions are correct, it would receive a premium over the market price during the period. Synergy would respond to this arbitrage by reducing its buy prices, which also lowers sell prices and benefits retailers.

Restricting participation to retailers removes participants who can arbitrage Synergy position. As noted in the paper, the remaining retailers are unlikely to make these trades because they would increase their market exposure, given their short position.

This reduces pressure on Synergy to correct overpricing and could therefore increases prices all else being equal.

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[1] Discussion Paper, p5.

	This is supported by academic studies. A 2016 American Economic Review article observed that "*in the presence of dominant players and limited participation in the arbitrage market, a forward-market price premium arises. By initially curtailing supply, large firms can flex their market power to drive up prices in the forward market.*"[2] ERA considers that the risk of reducing pricing discipline can be managed by ensuring the value of the buy-sell spread is appropriate.[3] However, this is unlikely in the short-term considering that: - As noted by the ERA, this will only be considered in future reviews, - the spread has rarely been modified in line with the ERA's repeated recommendations and may not be narrowed despite the ERA's recommendations. Additionally, tightening the buy sell spread may not impose pricing discipline where all the participants that would use buy products have been removed from the market. With no risk of these products being used, Synergy would have more flexibility as to where it sets its sell price. This could increase prices for the retailers that ERA aims to support through its proposal. Further, with no possibility for buy transactions, and more sophisticated players barred from participating, it would be difficult to observe whether Synergy's standard products are efficient. **c. Creating inefficiencies** Besides potentially undermining price efficiency by reducing pricing discipline, restricting access may also create inefficiencies by creating intermediaries for standard products. If their access is regulated, participants with over 0.5TWh of generation would have an incentive to buy standard products from other retailers who would extract a margin, increasing costs compared to the status quo. **d. Reducing utilisation of standard products, which reduces liquidity** Removing participants with over 0.5.TWh of the generation from the scheme could remove a substantial portion of demand and leave standard products on the shelf. If these products go un-used due to the restriction, there would be less liquidity in the market, all else being equal, and thereby put upward pressure on price.
• **"Substantially reduces the possibility of**	**1) Speculative trades provide a net benefit – not a net cost to the market and should not be prohibited.**

[2] Ito, Koichiro and Mar Reguant. 2016. *"Sequential Markets, Market Power, and Arbitrage."* American Economic Review, 106(7): 1921-57.

[3] The ERA states that: "This risk arising from limiting the provision of standard products to hedgers can be managed by ensuring the value of the buy-sell spread is appropriate, which the ERA will consider in future reviews.

speculative trades in standard products. Small retailers and generators do not have commercial incentives for speculative trades, as such trades substantially increase their financial risk." [It is implied that reducing this type of speculative trade will be beneficial because it will reduce the risk to Synergy as the sole supplier of standard products; and it will reduce the likelihood that speculative traders beat 'hedgers' to purchasing standard products.]	**a) Speculative trades support efficient pricing** As recognised by the ERA (and discussed above), speculative trades incentivise Synergy to maintain pricing discipline. In the absence of this arbitrage, Synergy may not reduce its prices to correct mispricing, increasing costs to retailers and undermining the objectives of the scheme to provide an efficient benchmark price. It would also be difficult to discern whether Synergy's pricing is inefficient. ERA considers that the risk of reducing pricing discipline can be managed by ensuring the value of the buy-sell spread is appropriate.[4] However, as noted above, this is unlikely in the short term because the: - ERA notes that this will only be considered in future reviews, - the spread has rarely been modified in line with the ERA's repeated recommendations. **2) Prohibiting other participants from making speculative trades is unlikely to improve access for retailers.** As recognised by the ERA, retailers are unlikely to engage in speculative trades on Synergy's buy products because of their short position. Consequently, they will not be impacted by other participants doing so. **3) No 'speculative trades' means no rebalancing of portfolios – a stated objective of the scheme.** The paper equates any generator selling to Synergy (using buy products) as a speculative trade and notes that retailers do not use these products because of their short position. Consequently, by prohibiting participants with generation capacity from participating, the ERA would effectively remove buy transactions. The scheme would no longer support participants rebalancing their portfolios, it would only support retailers accessing supply.
• **Helps to ensure that entities without access to significant generation assets continue to have access to standard products during the transition in the WEM, while Synergy's position in terms of sale and**	**1) It is unreasonable to prioritise access for pure retailers over participants with generation >0.5TWh because:** **a. These participants require access to hedging as well and the restriction creates an uneven playing field** Even participants with enough capacity to cover their position will require hedges during outages. And a participant's load may far exceed their generation. Limiting access to hedging for these participants defeats the objective of the scheme to provide these at a "competitive" and "non-discriminatory basis" hedges and to "allow market participants to rebalance their portfolios".

[4] This risk arising from limiting the provision of standard products to hedgers can be managed by ensuring the value of the buy-sell spread is appropriate, which the ERA will consider in future reviews.

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<td>acquisition of energy is changing.</td>
<td>Although the ERA notes that the proposal does not prevent vertically integrated entities with access to significant generation assets from negotiating customised wholesale electricity contracts with Synergy, if there were not a substantial benefit in accessing standard products compared with negotiating a customised product (which are not subject to the same controls around their price, terms and availability), and Synergy did not continue to remain dominant in the WEM, there would be no reason for ERA to propose restricting access to a swathe of the market. However, given that access to standard products does provide an advantage, that Synergy does remain dominant, and that participants with a generation position still require hedges, the prohibition of these participants creates an uneven and would put them at a relative disadvantage in the retail market.

b. A product sold to a pure retailer does not provide more benefit than a product sold to a participant with >0.5TWh.

A ‘sell’ standard product could reduce the cost to serve for both parties equally. Further, participants with some generation may apply comparatively more competitive pressure on Synergy compared with a pure retailer, and removing them from the market for standard products would reduce this pressure and could reduce the utilisation of standard products overall.

c. The current arrangements provide equal opportunity for participants to access standard products.

The retailers that the ERA aims to support with its proposal are not forced out by participants with >0.5TWh of generation – they have equal opportunity to purchase them, and they will not miss out if they make a purchase at the same time as another participant – the quantity would be split between the two.

d. The purpose of the standard products regime is not to exclusively support small retailers – it includes an objective to “allow participants to rebalance their portfolios”. Restricting access would abandon this objective.

‘Rebalancing’ implies an ability for participants to be able to make both buy and sell transactions – a participant could not rebalance it was only permitted transactions in one direction. However, in restricting access to retailers, standard products would only be used in one direction. As recognised by the paper, retailers would likely only use sell products, noting their short position; gentailers who are in a position to use buy products would be excluded.

2) Access for smaller retailers may not improve.

The quota for Synergy to offer to buy/sell 5MW per week would still allow one participant to buy the entire weekly volume, leaving no access to standard products for others for the rest of the week.

3) Synergy is not the only participant who sells to smaller retailers.</td>
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	Standard products supports market liquidity which allows other gentailers to sell to these retailers. Removing this access makes it harder for these gentailers to rebalance their portfolios and thereby undermines their ability to sell to smaller retailers.
• **May facilitate future changes in the buy-sell spread, providing further benefits to the market by improving price discovery for market participants.**	**1) The argument that restricting access would provide benefit by facilitating a reduction in the buy sell spread is totally dependent on two dubious assumptions**: a. That the participation of participants with >0.5TWh generation has increased the cost of Synergy offering standard products and that this is the reason why the spread could not be reduced in the future (even though the Minister decides whether to implement a narrower spread, not Synergy). b. The restricted participation will reduce the perceived risk of a narrower spread and the Minister will reduce the spread in line with the ERA's recommendations. This would contrast with recent history where changes to the spread being have been far less frequent and much smaller than the ERA's recommendations. **2) A narrower buy sell spread may not be beneficial to the retailers that ERA aims to support through its proposa**l. As recognised by the ERA, the participation of gentailers may incentivise Synergy to keep its buy price low, and in this case a larger spread results in a lower sell price compared with a narrower spread. This benefits retailers – as recognised by the paper, they are likely to be participating in sell products only and are highly unlikely to use buy products given their short position. **3) The spread may become irrelevant.** By removing generators with greater than 0.5TWh generation p.a., the proposal could remove all participants that would use buy products, leaving Synergy to set its sell price without concern for where this would place the buy price. We note that given Synergy's dominant position in the market, the margin it includes in its retail offers, on top of the standard product price is far more consequential to whether smaller retailers can compete compared with the buy/sell spread. A narrower spread will not have any material impacts on competition if Synergy is able to offer much narrower margins on top of this price in its own retail offers compared to competitors.
• **Addresses Synergy's concern that a reduction in the buy-sell spread could expose**	**1) Exposing Synergy to the risk of acquiring standard products is necessary to maintain pricing discipline.** As mentioned above, Synergy being made to acquire energy is a key driver of pricing discipline and the occurrence of buy transactions should therefore be perceived more as a benefit of the scheme than an issue to avoid.

Synergy to the risk of acquiring more energy to service demand for standard products	**2) By removing the risk that Synergy acquires standard products, the ERA would forgo a key objective of the scheme – to allow participants to rebalance their portfolios.** As stated in the paper, a key aim of the scheme is to "allow market participants to rebalance their portfolios". 'rebalancing' implies an ability for participants to be able to make both buy and sell transactions – it could not rebalance it was only permitted transactions in one direction. If the goal is to avoid exposing Synergy "to the risk of acquiring more energy to service demand for standard products", the goal is to effectively prevent participants from being able to use buy products to balance their portfolio and omit this objective from the scheme's functions.

Thank you for your consideration of Alinta Energy's submission. If you would like to discuss further, please contact me at oscar.carlberg@alintaenergy.com.au or on [redacted]

Yours sincerely

[redacted]

Oscar Carlberg
Wholesale Regulation Manager