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Ms Wana Yang
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Review of the Operation of the Wholesale Electricity Market
Economic Regulation Authority
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Dear Wana

DISCUSSION PAPER: ANNUAL WHOLESALE ELECTRICITY MARKET REPORT TO THE MINISTER FOR ENERGY

Alinta Energy (Alinta) appreciates the opportunity to provide a submission to the Economic Regulation Authority (the Authority) on strategic, policy or other high-level issues, including those raised in its Discussion Paper, that may be impacting on the effectiveness of Western Australia's Wholesale Electricity Market (WEM) in meeting the Wholesale Market Objectives (Market Objectives).

Alinta is an Australian energy company with interests in ten power station assets, which are diversified by geographic region, fuel type, customers and operating mode. Alinta also supplies gas and electricity to more than 680,000 retail, commercial and industrial (C&I) and small to medium enterprise (SME) customers in Western Australia and Victoria, and employs more than 750 people across Australia and New Zealand.

This submission is made by Alinta for and on behalf of Alinta Pty Ltd and Alinta Sales Pty Ltd, which are both wholly-owned subsidiaries of Alinta. Alinta Sales Pty Ltd is registered as both a Market Customer and a Market Generator in the WEM.

Comments on the Authority's 2010 Annual WEM Report

Before responding to the Authority's invitation to comment on strategic, policy or other high-level issues that may be impacting on the effectiveness of the WEM in meeting the Market Objectives, Alinta considers it opportune to comment on a number of the findings and/or recommendations made in the Authority's 2010 Annual WEM Report to the Minister for Energy.

Firstly, in its 2010 Annual WEM Report, the Authority recommends that the five (potentially conflicting) Market Objectives be replaced with a single overriding economic efficiency objective as it considers this would provide a better framework for prioritising the Market Objectives. The Authority also notes that having an overarching (single) objective would better align the WEM with the overriding objective in the *Electricity Networks Access Code 2004* (Access Code).

Alinta is supportive of the *Electricity Industry Act 2004* and the Market Rules being amended to impose economic efficiency objective as an overriding WEM objective, and for the five current Market Objectives to be retained as guiding principles.

Secondly, the Authority recommended that the effectiveness of Demand Side Management (DSM) in meeting the (current) Market Objectives be more clearly assessed.

A recent review commissioned by the IMO Board of the Reserve Capacity Mechanism (RCM) recommended 'harmonising' the treatment of demand-side and supply-side providers of capacity by imposing the same minimum requirement to any resource that qualify for Capacity Credits. The consultant, the Lantau Group, suggested that eliminating the 24 to 48 hour availability class would greatly improve alignment between the economic value of demand and supply-side capacity providers. While such a change to the Market Rules appears to be a step in the right direction, it falls a long way short of truly levelling the playing field faced by demand-side and supply-side providers of capacity.

In this context, the Lantau Group noted that a range of other operational impediments also existed with respect to DSM resources, including notice period differences and limitations on consecutive trading periods that affect the dispatch of DSM resources by System Management, and that these should be eliminated to the extent possible so that the economic value of capacity provided by demand-side and supply-side providers was made workably equivalent.

The IMO has since indicated that a new working group will be formed to address the issues raised in the Lantau Group's report, and that the Terms of Reference for the group are currently being developed and will be presented to the Market Advisory Committee in December 2011. However, it is unclear that such a group will be an effective forum through which to clearly assess the effectiveness of DSM in meeting the Market Objectives, having regard to the long-term interests of consumers, as recommended by the Authority.

For example, while DSM appears to date to have been considered exclusively in a wholesale **energy** market context, there may be merit in also more actively considering the contribution DSM could make to promoting economically efficient investment in electricity transmission networks.

These issues and a number of others, including for example the Authority's recommendation that the *Electricity Networks Access Code 2004* be amended to impose a requirement on Western Power to provide timely information about access to available network capacity to allow generators to make efficient locational decisions, highlight the need for the Office of Energy to play a more active role in the evolution of the Market Rules, and to progress associated amendments of the *Electricity Industry Act 2004* and associated legislation, to ensure the WEM continues to develop in a manner that is both efficient and consistent with, and reflective of, broader policy objectives.

The 2011 Issues Paper

Impact of a potential re-merger of Verve Energy and Synergy

The Verve Energy Review (also known as the Oates Review) concluded that in the first three financial years since disaggregation, Verve Energy in aggregate lost \$454 million before tax, which was \$508 million less than the \$54 million profit originally forecast for the period. However, it also found that Verve Energy had incurred expenses seemingly unrelated to the split of Western Power into four successor entities, including around \$320 million related to 'plant issues and disasters' and a further \$175 million due to 'network charges netback'.

In terms of potential savings that might be associated with an amalgamation of common administrative, or 'support', functions, the Verve Energy Review estimated these at just \$5 million per year, although noting that "...there may also be some benefits available through the operational optimisation of the merged entity's expanded generation portfolio which would comprise Verve's assets and Synergy's contracted generation."

While respecting that the Government is entitled to adjust policy settings and review market arrangements, private sector investment in the WEM was premised on competing in a market inextricably linked to, and dependent on, the separation of the State's dominant generation and retail businesses (i.e. Verve Energy and Synergy).

In its 2008 Annual WEM Report, the Authority concluded that the incentives for investment in new capacity would be significantly affected by a re-merger between Synergy and Verve Energy, and would be likely to substantially undermine the liquidity of bilateral contracting, making it harder for new generation proponents to secure contract support for new generation development. Alinta agrees with this assessment as a re-merger of Verve Energy and Synergy would provide a strong disincentive for Verve Energy to enter into transactions with other generators, or if it were to enter into these transactions, may provide Synergy with access to sensitive operational and commercial information that would enable it to compete unfairly with its competitors in the retail market.

For these reasons, a re-merger of Verve Energy and Synergy would create a significant risk that existing levels of competition in the generation and retail segments of the WEM would be undermined due to the changed risk profile faced by private sector participants. This changed risk profile would also be likely manifest in a significant erosion of the enterprise value of private sector WEM participants.

Rule change process

Alinta commented on the WEM rule change process as part of its submission to the Authority's 2009 Annual WEM Report. Alinta remains of the view that the Market Rules and associated processes do not place a sufficient obligation on submitters of Rule Change Proposals to clearly articulate the issue that is being addressed in the Rule Change Proposal, the outcome that the Rule Change Proposal is intended to achieve, and also to provide at least some empirical evidence to support the submitter's argument for how the Rule Change Proposal will achieve the desired outcome, while being consistent with the Market Objectives.

To a large extent, these outcomes would appear to simply reflect the low evidence threshold set in the Market Rules for rule changes and the restricted role assigned to the IMO. For example, it would appear that there is no obligation under the Market Rules for the submitter of a Rule Change Proposal to ensure the amendments it proposes to the Market Rules are likely to be the most effective of the potential alternative options that might be available. In addition, the Market Rules do not oblige the IMO to consider whether there is an alternative to the amendments proposed in a rule change proposal that might be more consistent with the Market Objectives.

Market Rule 2.4.3(e) allows the IMO, in assessing whether or not to make Amending Rules, to have regard to any technical studies that it considers are necessary to assist in assessing the Rule Change Proposal. To the extent that Rule Change Proposals do not provide empirical evidence to support the submitter's argument for how the Rule Change Proposal will achieve the desired outcome, allocating additional resources to the IMO may allow it to commission additional technical studies to examine these points. However, Alinta remains unconvinced that shifting the obligation to provide evidence in support of the Rule Change Proposal from its originator to the IMO is necessarily desirable.

In its 2010 Annual WEM Report, the Authority concluded that, given the relatively small size of the WEM and at this stage of market development, it was more practicable for the IMO to have a dual role in managing the Rule Change Process (including deciding whether to accept Rule Change Proposals) and administering the Market Rules, although it has now suggested it may be timely to revisit this issue.

Consistent with its submission to the Authority's 2010 Annual WEM Report, Alinta considers there exist significant potential for conflicts of interest to arise given the IMO is responsible for determining whether or not to amend the Market Rules, for operating the WEM, and for enforcing the Market Rules. In the National Electricity Market, these three roles are performed by separate entities, being the Australian Energy Market Commission (AEMC), the Australian Energy Market Operator and the Australian Energy Regulator.

Alinta remains of the view that structural separation of responsibility for determining whether or not to amend the Market Rules, for operating the WEM, and for enforcing the Market Rules, would assist in avoiding at least a perception that the potential conflicts faced by the IMO may be resulting in outcomes that do not best achieve the Market Objectives.



Should the Authority require further information on any of the above issues, I can be contacted on 9486 3749.

Yours sincerely

Corey Dykstra
Manager Wholesale Regulation
Alinta Energy (for and on behalf of Alinta Sales Pty Ltd)