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Australian Energy Regulator
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Submitted via email: wholesaleperformance@aer.gov.au

Draft Statement of Approach- Wholesale Electricity Market Performance Monitoring

Alinta Energy (**Alinta**) appreciates the opportunity to provide a submission to the Australian Energy Regulator's (**AER**) Draft Statement of Approach; *Wholesale Electricity Market Performance Monitoring* (**Draft Approach**).

Alinta is an active investor in the energy markets across Australia. We have an owned and contracted generation portfolio of nearly 3000MW, including 1700MW of gas-fired generation facilities and 1070MW of thermal coal generation facilities. Alinta has a strong renewable investment strategy across Australia and is pursuing renewable energy projects at an increasing scale. Alinta currently retails electricity and gas to more than 830,000 customers including more than 300,000 customers in east coast markets.

The diversity of Alinta's portfolio, its investment strategy, product offerings, and first hand experiences across multiple jurisdictions has allowed it to develop a detailed understanding of wholesale electricity markets across Australia. Alinta is therefore well placed to provide informed comment in response to the AER's Draft Approach.

General comments

The National Electricity Market (**NEM**) is an inherently complex and sophisticated market. As such, the AER faces a material task in developing an appropriate methodology for its new wholesale electricity performance monitoring powers. Nonetheless, with its current roles in the NEM Alinta is of the view that the AER is well placed to further build on its existing responsibilities, and Alinta endorses the thoughtful approach and engagement with industry that has characterised the AER's development of this new role to date.

Broadly speaking, Alinta is comfortable with the AER's draft methodology, particularly the structure-conduct-performance approach. Alinta understands that the majority of the tools proposed in the structure-conduct-performance approach builds on the analysis and tools already utilised by the AER in reviewing high priced events and subsequent weekly reports, to provide a longer-term assessment of trends and patterns in NEM wholesale markets.

Of late Alinta notes that the area of wholesale energy markets is of heightened interest to various policy makers, regulators and both state and federal governments. Consequently, the potential for

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additional regulation to be developed by other jurisdictional regulations, based on the AER's findings, is apparent.

As such, it is worth noting from the onset that Alinta holds the view that the wholesale markets which underpin the NEM are largely robust and resilient. While the NEM is experiencing substantial challenges of late, in Alinta's view the NEM wholesale markets continue to operate robustly and entities have well developed and sophisticated risk and wholesale management expertise underpinned by their continued market participation. The remainder of Alinta's submission should be framed in this context.

The additional points outlined below are designed to help the AER in directing and interpreting its future analysis.

Vertical Integration, in and of itself, shouldn't be viewed as an indication of any wholesale market deficiency

Alinta notes the AER's draft approach will assess structural features of the market including vertical integration. The draft approach states that "*vertical integration can contribute to barriers to entry*" and then further outlines that the AER will analyse the extent of vertical integration by considering the share of generation capacity owned by an entity that has an associated retailer.

While the presence of vertical integration in the NEM is an interesting component of the market and is worthwhile of study, the existence of vertical integration, in and of itself, shouldn't be viewed as an indication of any wholesale market deficiency. Broadly speaking, vertical integration is simply a risk management strategy.

To illustrate, vertical integration occurs simply to provide risk and price insurance to participants. In the case of a retailer, the purpose of vertical integration is to avoid greater spot price volatility risk. In the case of a generator, the purpose of vertical integration is to capture value over a longer time horizon that may not be available in the spot market. Both occurrences decrease risk in the market.

For example, in the longer term (contract market), generators will bid at their long run marginal cost to cover their fixed costs, however in the short term (spot market) prices are driven by short run marginal costs of *all available generation* in the market at the time. As such, in some scenarios, vertical integration can represent a positive outcome where retailers are able to avoid spot market price risks on a more continued and guaranteed basis and whereby generators are more able to recover their fixed capital costs on a guaranteed basis. Therefore, in this scenario vertical integration is a beneficial risk management strategy which should in turn put downward pressure on prices and therefore be of benefit for the end consumer.

Furthermore, vertical integration may add efficiency gains in terms of reducing transaction costs or facilitating better risk management practises and associated financing costs. Accordingly, Alinta considers that the AER should be cautious in drawing implications from the extent of vertical integration. Rather than assessing the extent of vertical integration by considering the share of generation capacity owned by an entity that has an associated retailer, an alternative assessment could instead focus on whether vertical integration is reducing liquidity in contracts or futures markets and whether this is in turn creating a barrier to entry.

Ultimately, whether a barrier to entry is significant from a regulatory perspective will depend on whether it leads to market outcomes that depart significantly from competitive outcomes. As such, Alinta considers the extent of vertical integration should be assessed in the context of market outcomes, including but not limited to:

- Effect on liquidity of futures/contracts markets;
- Effect on pricing; and
- Effect on investment.

Information gathering powers should be used sparingly

Alinta supports the AER's draft approach to utilise only publicly available information in the first instance, when carrying out market monitoring functions. Nonetheless, the AER's draft approach still reserves the option to use section 28 powers of the National Electricity Law to acquire non-public information at its sole discretion.

Alinta believes the AER should use its section 28 powers with regards to acquiring non-public information sparingly. If the AER does use its' information gathering powers, care should be taken to ensure that the information gathered is complemented with a corresponding commentary and context from the relevant participant. This would help to ensure that the risk of the information being misinterpreted is minimised.

For example: compelling the provision of non-public electricity wholesale contract trade data from market participants would add little value without a corresponding detailed understanding on the physical and risk position of individual market participants. A retailer would be naturally short and a generator naturally long in the market. This information isn't particularly meaningful without a concurrent and detailed explanation of market participants' physical position, hedge position, trading strategy and future commercial intentions. Whilst this is a simple example, the point is apparent that there is a clear risk that if non-public information is requested, it would likely add little value, or worse still, normal and pro-competitive conduct may be inadvertently misinterpreted as undesirable.

Given there is currently wide variety of publicly accessible information available to the AER through AEMO's Electricity Statement of Opportunities workstream, AFMA's electricity derivative survey, ASX trade reporting, state jurisdictional regulators and the AER's existing monitoring functions just to name a few, Alinta's considers that AER's section 28 powers should be used sparingly, if needed at all. This would guarantee consistency in any AER findings across the numerous other publicly available market reports as well as ensure any additional costly reporting obligations on participants are avoided.

Regulatory burden and barriers to entry

Alinta notes the AER's draft approach in examining barriers to entry and the assessment of structural, strategic, legal and regulatory barriers to entry, and the subsequent effect these barriers may have on competition. Alinta is supportive of this focus and strongly recommends the AER give substantial consideration to the issue of regulatory barriers and increasing government intervention.

The NEM is currently experiencing a significant period of transition. Understandably, this has led to a growing number of regulators, consumer advocacy bodies, authorities and government bodies at all levels expressing strong interest in the energy sector. With this, there is an exponentially increasing number of regulatory and government bodies undertaking (often overlapping) market reforms, reviews and even some highly publicised instances of government intervention occurring.

The quality and stability of regulatory and government decision making and policy settings is vital for the electricity sector given the long asset lives and the impact that regulatory uncertainty can have on the willingness for investors to commit significant capital. Nonetheless, the existing regulatory burden placed on participants and instances of government intervention (or even threatened intervention) presents a material and seemingly growing risk, one which should be considered appropriately.

In this vein, the seemingly low number of new entrant participants entering the NEM of late, shouldn't necessarily be interpreted as some form of wholesale market deficiency. Given the policy uncertainty and frequent government intervention which presently exists in the market, any new entrant investor would logically pause their investment decision until political uncertainties have been resolved. Alinta would urge consideration of this point in the AER's analysis on barriers to entry.

Conclusion

Alinta appreciates the analysis and consultation undertaken by AER. Alinta remains supportive of assessments to confirm the robust health of the wholesale market in the NEM, however as outlined above, Alinta has raised a number of additional matters that the AER is encouraged to consider over the coming consultation.

Please contact Mr Anders Sangkuhl via email: anders.sangkuhl@alintaenergy.com.au or by phone 09 9375 0992 if you have any queries in relation to this submission.

Yours sincerely

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