

31 August 2011

Mr John Pierce
Chairman
Electricity Supply Industry Expert Panel
GPO Box 123
HOBART TAS 7001

Dear Mr Pierce,

Review of Tasmania's Electricity Industry

Introduction

Alinta Energy welcomes the opportunity to make a submission in response to the Tasmanian Electricity Supply Expert Panel (the Panel), Issues Paper of 24 June 2011. Given recent business developments Alinta Energy appreciates the understanding of the Panel and the Secretariat in light of the timing of this submission.

Alinta Energy is an active investor in the energy retail, wholesale and generation markets across Australia. Alinta Energy has over 2500MW of generation facilities in Australia (and New Zealand), and maintains over 620,000 retail energy customers in Western Australia with a commitment to growth in the National Electricity Market.

Alinta Energy is therefore keenly interested in energy market developments across Australia and in all regions of the National Electricity Market as it pursues its forward growth strategy.

Overview

Alinta Energy supports the Panel's proposed Tasmanian electricity supply industry objective, consistent with the National Electricity Objective. Alinta Energy supports competitive markets and believes Tasmanian households and businesses are best served by efficient market driven outcomes.

In Alinta Energy's view the objective can be best met by pursuing the outcomes below.

1. Supporting a competitive and transparent wholesale market.
2. Facilitating retail contestability and potential retail entry.
3. Addressing structural impediments to effective competition including ownership and control of existing electricity supply businesses.
4. Ensuring inter-regional residues are available to market participants consistent with commitments made at the time of Tasmania's entry in the National Electricity Market and with arrangements in other regions.

5. Addressing the inconsistent outcomes arising from the existing management and operation of Basslink.

Discussion

Competitive outcomes in Tasmania's best interests

Alinta Energy is strongly of the view that markets operated on an economically efficient basis provide the best opportunities for potential new entry, allow existing participants to operate effectively and ensure the welfare of consumers is maximised.

In our view, the argument presented by some participants that Tasmania's small size prohibits retail and wholesale competition is not conclusive and arguably not in the interests of Tasmanian consumers.

We appreciate the existing Tasmanian arrangements, in tandem with the iconic nature of Hydro assets, discourages significant reform. Nevertheless, we believe the evidence in support of efficiently operated markets means the burden of proof should be placed on maintaining the status quo not against the case for reform.

Alinta Energy's expectation is that in conducting its review of the status quo, the Panel will recommend appropriate step-change in all of Alinta Energy's identified areas of concern (see above) unless robust quantifiable evidence indicates that the status quo is superior.

Tasmanian retail market – perspectives on new entry

Alinta Energy has a commitment to growth in its retail business across the National Electricity Market. As part of this strategy Alinta Energy has commenced signing up new customers in South Australia and commenced registering customer interest in New South Wales, Victoria and Queensland.

Unfortunately, given the Tasmanian market's out-workings, pursuing a Tasmanian strategy is seen as a second order issue in the absence of structural reform.

As it stands, Hydro Tasmania's market dominance, the Aurora Energy monopoly over non-contestable customers, the difficulty in accessing risk management instruments, and the political complexities presented by Government ownership of major energy supply businesses make Tasmanian entry unviable.

Effectiveness of wholesale electricity market

Alinta Energy notes the Panel's observation that "Hydro Tasmania is generally required to be dispatched to meet load, which gives it the capacity to be the marginal bidder, and therefore, the capability of setting Tasmanian spot prices without competitive threat" (p.21).

Alinta Energy agrees that in most circumstances Hydro Tasmania is able to set the regional price, although market outcomes do not necessarily demonstrate such behaviour. Nevertheless, this does not negate the existence of market power and that at times the

exercise of this power could have significant cost implication for market participants. As such, the threat of misuse of market power to damage third parties can be as powerful a tool to deter new entry and to compel existing participants to take specific actions as misuse of market power itself.

We share the view that the Tasmanian spot market outcomes present a major risk for potential market participants. Potential retailers, including Alinta Energy and generators seeking to enter into wholesale contracts with large-scale customers, would not be able to effectively hedge this risk.

We understand the Panel's view that this spot market risk in Tasmania is likely to incentivise participants to enter into contracts. We also note Hydro Tasmania's puts forth its willingness to contract with "all comers" as evidence that retailers and contestable customers in Tasmania have access to efficiently priced electricity.

However, our view is that the current arrangements ensure very limited entry into Tasmania by new participants, no entry by mass market retailers, limited market liquidity, and that existing participants have access to limited products; the oft cited "all roads lead to Hydro Tasmania" dilemma which can not ensure efficient outcomes.

Hydro Tasmania's non-scheduled generation

We note the issues regarding non-scheduled generation in Tasmania. Alinta Energy suggests that management of non-scheduled generation adds to the uncertainty of the Tasmanian market and is a further indication that reform is warranted to ensure the market can operate transparently and efficiently.

Operation and management of Basslink

Alinta Energy shares the concern that the current strategic bidding of Basslink, permitted pursuant to the Basslink Services Agreement, undermines the commitments made to the Australian Competition and Consumer Commission at the time of Tasmania's entry into the National Electricity Market.

Additionally, we understand the issue regarding the bidding of Basslink at times of constraint in order to gain preference in the Victorian region and believe this matter substantially undermines the competitive intent of the National Electricity Market.

Alinta Energy is concerned that one generator has the ability to receive preferential treatment in its bidding on the basis of its relationship with a third party. Alinta Energy recommends this matter be addressed immediately.

Inter-regional residues (IRRs)

The non-availability of IRRs is a particularly poor development in the Tasmanian region. IRRs are necessary instruments for parties wishing to provide retail products or pursue wholesale customers based in the Tasmanian region.

The reason for the absence of an open and transparent market for price discovery and purchase of IRRs is unclear. It has been expressed to Alinta Energy that the process is particularly complicated and appears designed to prevent parties from obtaining IRRs.

Alinta Energy actively uses settlement residues to hedge positions, and pursue trading opportunities across the National Electricity Market. This strategy applies to all regions except Tasmanian where limited trading opportunities, given the market's size, have no prospect of developing in the absence of IRRs availability and more diverse market participation.

Competitive neutrality

As a general principle, Alinta Energy supports private ownership of electricity supply businesses and appropriate regulation by Government and its associated agencies. The situation in Tasmanian with 86 per cent Government ownership of generation and the absence of retail contestability raises concerns regarding competitive neutrality and the appropriateness of a Government owning and regulating energy supply businesses.

Preferred Reform Options

Retail sector

Alinta Energy believes there is genuine retailer interest in entering the Tasmanian Market where Aurora Energy exclusively serves some 227,000 households. However, the following reforms are required to facilitate private sector entry, investment and competition:

1. Tasmanian non-contestable retail interests, currently operated by Aurora Energy, should be packaged and auctioned off, in two or three parcels, to private investors.
2. Following an appropriate establishment period, full retail contestability should be introduced consistent with the recommendations of the Office of the Tasmanian Regulator.

Generation assets

While Hydro Tasmania has diligently served the needs of Tasmanian consumers Alinta Energy regards the existing Tasmanian generation sector ownership arrangements as sub-optimal going forward. As such, Alinta Energy recommends:

1. The break-up and sale of Hydro Tasmania's assets, consisting of 29 power stations, numerous water facilities, lakes and dams, along yet to be determined lines. Alinta Energy understands in the order of five, but no less than three, asset parcels can be identified for sale to the private sector.
2. Aurora Energy is divested of its interest in its Tamar Valley generation assets for sale to the private sector.

Alinta Energy understands that this proposal, despite its potential benefits, is potentially a radical step for the Tasmanian region. In the absence of the necessary climate to pursue this

preferred strategy we suggest that gentrader rights, as developed in New South Wales, be developed in Tasmania.

While gentrader rights are themselves not without complexity we believe the position in Tasmania, with large-scale hydro, is fundamentally easier to manage through gentrader rights than is the case for coal-fired generation. This is because of the limited supply complexities, the absence of mining licenses, the absence of mine emissions and environmental concerns, and the fuel type, water, does not require the support of mine planning, operations, management and maintenance, a significantly detailed input for coal-fired generation.

Basslink

The operation of Basslink requires reform to ensure appropriate competitive neutrality in the National Electricity Rules and in practice. Alinta Energy recommends:

1. The Ministerial Notice in force prior to 4 May 2008 be reinstated as a short-term solution to alleviate Hydro Tasmania's ability to bid below -\$1000.
2. The Panel investigate, or refer to the appropriate authority, the Basslink Services Agreement, with a view to its discontinuation.
3. Basslink, as Tasmania's only connection to the rest of the National Electricity Market, be rolled into the regulated asset base or managed independent of Hydro Tasmania and other business owners in Tasmania, given the competition implications.
4. The process of auctioning IRRs be brought into line with the sale of Settlement Residue Auctions and administered in the same manner, as opposed to the existing opaque process controlled by Hydro Tasmania.

Conclusion

Alinta Energy welcomes the Panel's detailed analysis on the development and issues arising in the Tasmanian electricity supply sector and look forward to the Panel's consideration of this submission and the development of the reform options outlined above.

If you have any queries in relation to this submission please do not hesitate to contact Mr Jamie Lowe on, telephone, 02 9372 2633.

Regards

A handwritten signature in blue ink, appearing to read "Gary Stanford".

Gary Stanford
Executive Director, Wholesale