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17 February 2012

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

By email - contact@electricity.tas.gov.au

Dear Mr Pierce,

Review of Tasmania's Electricity Industry

Alinta Energy welcomes the opportunity to make a submission in response to the Tasmanian Electricity Supply Expert Panel (the Panel), Draft Report, December 2011.

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), with retail energy customers in Western Australia, South Australia and Victoria and a commitment to growth across the National Electricity Market (NEM).

Alinta Energy is an active contributor to energy market developments across Australia, and in all regions of the NEM, as it pursues its forward growth strategy.

Response to Issues Paper

Alinta Energy's submission in response to the Issues Paper provided support for the Panel's proposed Tasmanian electricity supply industry objective, consistent with the National Electricity Objective and suggested the objective could best be met by pursuing the outcomes below.

- Supporting a competitive and transparent wholesale market.
- Facilitating retail contestability and potential retail entry.
- Addressing structural impediments to effective competition including ownership and control of existing electricity supply businesses.
- 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.
- Addressing the inconsistent outcomes arising from the existing management and operation of Basslink.

To support these outcomes Alinta Energy recommended the Panel consider the recommendations detailed below.

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

- 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 or as a fall back position, in the absence of the necessary climate to pursue this strategy, Alinta Energy suggest that gentrader rights, as developed in New South Wales, be developed in Tasmania.
- Aurora Energy is divested of its interest in its Tamar Valley generation assets for sale to the private sector.
- The Basslink 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.
- The Panel investigate, or refer to the appropriate authority, the Basslink Services Agreement, with a view to its discontinuation.
- Basslink, as Tasmania's only connection to the rest of the NEM, be rolled into the regulated asset base or managed independent of Hydro Tasmania and other business owners in Tasmania, given the competition implications.
- The process of auctioning IRRs be bought 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.

Position adopted by the Expert Panel in the Draft Report

The Draft Report provides a detailed overview and analysis of the issues germane to the Tasmanian electricity supply industry. As it pertains to the matters of interest to Alinta Energy the Panel's key findings and recommendations are generally endorsed.

Competition – the wholesale and retail markets in Tasmania

- *The Panel has concluded that large retailers are not currently active in Tasmania but the state presents potentially attractive commercial opportunities.*

Alinta Energy endorses the Panel's view and also notes that the Panel should not underestimate the attractiveness of the State of Tasmania to energy businesses with a less established presence in the NEM.

For larger retailers their willingness to enter Tasmania reflects an extension of their existing mainland NEM retail interests. Whereas Alinta Energy's NEM retail business is in the early stages of development and therefore Tasmania could be more attractive as: (a) Tasmanian's are yet to benefit from retail competition and hence marketing opportunities exist for a range of brands; and (b) Tasmania presents an opportunity for large-scale customer acquisition through sale as opposed to relying on organic turnover away from existing large retailer incumbents.

- *Hydro Tasmania possesses and periodically signals significant latent market power through the spot and contract markets. This is a deterrent to entry into the retail market by efficient, large scale, national retailers.*

Alinta Energy notes the view that Hydro Tasmania has latent market power. Alinta Energy agrees that Hydro Tasmania has the potential to control price outcomes in the Tasmanian region at a point in time. Nevertheless, we have some concern with the conclusion that new entrants are deterred because Hydro Tasmania could raise prices, in effect to a level that would incentivise new entry, and keep them at that level. We suggest a more nuanced analysis of the factors concerning new entrant retail in Tasmania.

If a retail business looked to enter the Tasmanian market in not only the commercial and industrial sector but in residential mass market it would be required to manage a significant range of commercial and regulatory risks. Additionally, the period of commitment to this market is likely to be particularly lengthy, i.e. 10 years in order to get customer scale. This differs markedly to retail entry for sectors of commercial and industrial load. This contrast is critical to the analysis.

For a commercial and industrial load, a retailer could enter into a discrete contract with Hydro Tasmania for one to five years to cover an individual major load customer (as is occurring in Tasmania now); however, this approach is not possible for broader mass market retail. For mass market retail customers, retail businesses will be required to purchase a range of products, including sculpted products, to match the variable and sometimes unpredictable mass market load they acquire. Further, long-term retention of customers is critical to generating financial returns in a competitive environment with thin margins.

As a consequence of these differences, one large load for a fixed period versus an ongoing large number of small customers, retail businesses need to be able to manage risks on an ongoing basis more cautiously. In the absence of retailers owning generation in that region, this will necessarily entail use of bilateral contracts and derivative markets.

Attempting to rely on Hydro Tasmania for all contractual arrangements, on an ongoing basis, where a long-term commitment to mass market customers is required, presents an unacceptable commercial risk. Retailers need to know that upon entering a new market a range of risk management arrangements exist and they are not entirely dependent on one party; in this instance Hydro Tasmania. Alinta Energy contends this is the critical reason why Hydro Tasmania's position must be addressed.

- *While ever Hydro Tasmania remains the dominant spot market participant and the principal supplier of contracts, major national retailers will not enter the Tasmanian market and choice for households and small businesses will be stymied. Unlocking greater retail competition in Tasmania, and with it, effective customer choice, hinges on addressing this problem.*

Alinta Energy endorses this perspective for the reasons outlined above. Further, if new entrants were to fulfil the role of financial responsible market participant, a desirable outcome in Alinta Energy's view, this change is all the more critical.

- *The Panel has identified three reform paths which would create a more competitive environment for spot and contract market trading in the future. They can be represented firstly as a regulatory path, secondly, a means of introducing effective competition within the Tasmanian region and thirdly, as a means of increasing the size of the market available to Tasmanian consumers. These are:*
 - *Reform Path 1: An independent, regular auction of standard contracts from Hydro Tasmania to conduct a regular auction to provide retailers with confidence that appropriately priced hedging contracts will be available in the Tasmanian market on an ongoing basis on reasonable terms;*
 - *Reform Path 2: Creating competition in the trading of energy produced by Hydro Tasmania by establishing independent trading entities while retaining Hydro Tasmania as an integrated generating business; and*
 - *Reform Path 3: Increasing competition for Hydro Tasmania by combining the Victorian and Tasmanian NEM regions.*

The Panel has expressed a preference for reform path 2. Alinta Energy shares this preference and does not believe reform path 1 or reform path 3 are viable. On that basis, failure to implement reform path 2 would represent a significant failed opportunity for Tasmanian consumers to benefit from increased competition.

Alinta Energy supports meaningful reform and as such does not endorse reform path 1 as:

- it contrasts with the arrangements in other regions and is likely to embed a number of inefficiencies that undermine the benefits of reform;
- the ability to purchase sculpted products is likely to be limited by standard contract auctions (or will require the release of information that is commercially sensitive and therefore undermine any attempts to offer more complex hedges);
- the auction process is not as transparent as an open market and will be subject to lobbying given the need to appoint an entity to manage and regulate the process and manage the introduction of any changes (which may favour one participant over another);
- requires the development of another process for setting and managing auctions not unlike the retail tariff setting arrangements in a number of jurisdictions which introduces a range of new risks and requirements; and
- ensures Tasmania continues to be treated as a special case despite the absence of any convincing economic objectives that support such treatment.

Alinta Energy also has a number of reservations around reform path 3. Reform path 3 sounds like a simplistic solution and may appeal to those that consider the size of the Tasmanian market is problematic. Another argument in support of reform path 3 is access to Victorian region derivatives. While Alinta Energy recognises these views it does not support reform path 3 for the reasons enunciated below.

First, a merger of the Tasmanian region and Victorian region will further exacerbate already present dispatch inefficiencies in the NEM. As a general rule the introduction of such inefficiencies should not be supported especially for the purposes of avoiding proper and beneficial, but ultimately politically difficult, reform.

Further, one of the justifications of such a merger would be that Victorian based generators could more easily access Tasmanian customers. This may be correct; however, it confuses the reasons that Victorian and other mainland wholesale contract providers do not enter the Tasmanian region now – because of Hydro Tasmania and its control of Basslink – with the desired outcome – improved access to Tasmanian customers.

In the event that the issues with the wholesale market and Basslink are resolved then access to Tasmanian markets, and management of inter-regional risk between Victoria and Tasmania, will be on par with arrangements between any other two regions. This is a desirable outcome and one that allows a range of participants to pursue positions in the Tasmanian region for the purposes of accessing wholesale markets or commercial and industrial customers or retail market customers or all three.

Also, separate to the viability of reform path 3 for Tasmania, it is possible that merging the regions would be considered a market disruption event under ISDA contracts for the Victorian node. This is considered a particularly undesirable outcome and one that has the potential to create significant risk for all participants contracted to the Victorian node.

Finally, reform path 3 relies upon a separately managed National Electricity Rule change process administered by the Australian Energy Market Commission which will take a considerable amount of time to progress, and may be unlikely to win widespread support. Relying on an outside party to progress reform is effectively side stepping the opportunity to implement real and lasting reform via reform path 2 now.

Therefore, reform path 2 remains Alinta Energy's preferred approach to initiating the process that will allow Tasmanian consumers to realise the benefits of electricity sector competition. Reform path 2 is the most direct and appropriate method of introducing and maintaining competition in the wholesale market.

Alinta Energy believes competitive facing entities will be best placed to provide hedges to retail players on an ongoing basis and in a range of forms to best meet their varied business models. The complexity of bilateral and contractual arrangements between wholesale participants, sophisticated customers and retail market participants should not be underestimated. The ability to tailor hedges in a dynamic fashion will not be achievable under option 1.

There may be some concern about sizing the entities differently. Alinta Energy does not share this concern. For example three wholesale market participants, or an appropriate number, should provide a viable platform for wholesale competition even if unevenly sized. Additionally, Alinta Energy encourages the Government to make a commitment to privatising these entities in the same manner as has occurred in New South Wales.

Concern around hydrological risk in the context of a gentrader model is misplaced. First, security of supply should not be impacted by wholesale market competition and the basic fundamentals regarding drought and total inflows are driven by forces outside the wholesale market.

Second, management of water storage and the underlying physical assets need not be affected by reform path 2. Clearly, Hydro Tasmania and its staffs have world class expertise in the management of hydro-electric facilities, water storage and power generation. For these reasons, retention of that expertise under reform path 2 is prudent and supported by Alinta Energy.

Hence, by establishing gentraders to focus on driving competitive wholesale market outcomes and allowing Hydro Tasmanian to focus on first-class asset management, the electricity supply sector and Tasmanian customers will get the benefit of increased competition and efficiency without disrupting its existing world class asset management arrangements.

Alinta Energy also has reason to believe that management of Hydro-electric assets under a gentrader model will involve less complexity than the New South Wales model covering coal-fired assets. This is because of the limited control over 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.

It is important to note, and the Panel is encouraged to investigate, that existing assets are managed in a manner not dissimilar to that which would arise through reform path 2. For instance, in addition to the recent New South Wales putcomes, Alinta Energy understands assets in the NEM like Newport, Jeeralang, Bairnsdale and Yabulu have separate companies managing the assets versus owning the dispatch and trading rights.

Additionally, it is interesting to note that in New Zealand there are examples of operational separation of hydro-electric assets within the same catchment area and on the same river. Alinta Energy understands that this process has worked well and indicates that while implementation issues will arise in the development of a gentrader model, such issues do not outweigh the potential benefits to consumers of additional competition.

- *If wholesale market problems are properly addressed, there could be significant benefits in undertaking retail reforms that would deliver new entry in the retail market by making the customer base available through a competitive sale process.*

Alinta Energy has an established customer base in Western Australia and is looking to grow its NEM retail business. Alinta Energy is currently focussing on the Southern States of South Australia and Victoria. If the Government of Tasmania implements the preferred reform path, so that pursuing customers is no less attractive in Tasmania than other States, then adding Tasmania to Alinta Energy's current retail strategy makes commercial sense.

Retail issues

Alinta Energy views wholesale market reforms as the primary pre-condition to ensuring retail market entry and competition. Nevertheless, the Panel needs to ensure a number of appropriate steps are taken to facilitate retail market outcomes which maximise consumer benefits.

First, Alinta Energy supports the introduction of full retail contestability through the auction of Tasmanian non-contestable retail interests, currently operated by Aurora Energy, to private investors.

Auctioning customers in a sufficient number of packages, or across a sufficient number of new entrants through an appropriate auction process, is necessary to ensure Tasmanian entry is at least (if not more attractive) than pursuing market share in larger NEM regions.

Reliance on organic growth is not the preferred approach as it requires significantly more resources and makes Tasmania less attractive, given Aurora's dominant position, than existing regions where retail contestability exists. While organic growth is viable, especially for smaller players, it best follows an initial auction process that would remove the Government backed Aurora retail business.

Second, following wholesale market reform there is no rationale for Hydro Tasmanian to retain its Momentum retail business for the purposes of hedging energy in other NEM regions. Those assets, customers and contracts, should be packaged and auctioned as part of the reform process.

Thirdly, it is paramount that retailers are able to recover their costs of operating in the market by setting their own efficient prices. Without certainty of cost recovery retailers will not be incentivised to enter the market. Efficient price outcomes can be most effectively achieved through price deregulation, as exists in the Victorian market. Nevertheless, given the current Tasmanian market, if prices are to be regulated, Alinta Energy strongly endorses a light-handed regime managed by an independent regulator. For example, the Retail Price Movement methodology applied by the Essential Services Commission of South Australia.

Finally, retail regulation and licensing arrangements need to be light-handed and ensure that additional burdens are not introduced. In short, where a market participant operates in an existing retail market in the NEM, regulatory approval in Tasmanian should be a straight-forward and expedited process. If a burdensome regulatory environment arises retail entry can not be assured.

Basslink

Alinta Energy's submission to the Issues Paper raised a number of matters regarding Basslink which have not been appropriately addressed by the Panel. In that submission Alinta Energy recommended:

- 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;
- the Panel investigate, or refer to the appropriate authority, the Basslink Services Agreement, with a view to its discontinuation;
- Basslink, as Tasmania's only connection to the rest of the NEM, be rolled into the regulated asset base or managed independent of Hydro Tasmania and other business owners in Tasmania, given the competition implications; and
- the process of auctioning IRRs be bought 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.

These issues still require resolution in the context of the reform path adopted.

Conclusion

Alinta Energy commends the Panel's detailed analysis on the development and issues arising in the Tasmanian electricity supply sector and welcomes the Panel's consideration of this submission.

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

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'Jamie Lowe'.

Jamie Lowe
Manager, Market Regulation