05 July 2012

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY NSW 1253

Dear Mr Pierce,

NEM Financial Market Resilience

Alinta Energy welcomes the opportunity to lodge a submission in response to the Australian Energy Market Commission's (AEMC) issue paper: *NEM financial market resilience*, instigated by a Standing Council on Energy and Resources request and released on 8 June 2012.

As you are aware, Alinta Energy is a member of the industry working group formulated to work with the AEMC on this project and as such has had the opportunity to provide a range of inputs to the development of the issues paper.

For this reason, this submission represents additional reflections upon the matters contained in the issues paper noting that Alinta Energy generally agrees with the issues paper's representation of National Electricity market (NEM) financial relationships and the general conclusions of the AEMC.

Reflections on prudential and financial developments

Alinta Energy is an active investor in the energy retail, wholesale and generation markets across Australia, including in the NEM. 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 NEM.

Alinta Energy endorses the thoughtful approach, and especially the engagement of industry, that has characterised the development of this issues paper. Alinta Energy notes that the area of financial regulation and prudential matters is of growing interest to policy makers and regulators and as a consequence the risk of unnecessary or ill-fitting regulation is apparent. As such, the impact of unnecessary regulatory imposts should not be understated and has the potential to further undermine competition and new entry in a market that is already burdened with regulatory uncertainty and changing dictates.

As an entity challenging industry incumbents, Alinta Energy is particular sensitive to significant or unfavourable policy and regulatory changes which increase prudential obligations or could hamper Alinta Energy's ability to enter into financial relationships with a range of counter-parties. It is Alinta Energy's view, that the risk of ill-conceived regulation is best managed through the adoption of practices akin to those used by the AEMC in the development of the issues paper. For this, the AEMC is commended.

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Nature of NEM financial relationships

The AEMC has correctly established and illustrated the primary relationships that exist between participants in the NEM. The AEMC goes on to characterise these relationships as creating a high-level of financial interdependency.

Alinta Energy agrees this is correct in that, energy market participants rely on relationships with other participants and third parties to transfer, manage and minimise risk. The issue is probably best characterised as: where one participant encounters financial difficulties it may result in the risks that party carries, for itself or on behalf of other parties going unmanaged, or exacerbating costs associated with managing risk.

It is the dispersion of risk across participants, across classes of risk management vehicles which reduces risk faced by individual participants and the industry overall which stymies contagion. Therefore, it is that inability to have risk managed, as was intended, and the ensuing costs that creates the potential for financial difficulties to be transmitted between parties.

Nevertheless, in reality each of these relationships bears different degrees of risk, and hence financial interdependency, and potential for transmitting financial difficulties, including in some cases none at all.

Alinta Energy notes it should be clear that participants are the most aware of these risks and how to manage them in the context of individual business interests.

Purpose of entering into contracts

A further point, generators enter into contracts, in the issues paper's words, to place bounds on the future electricity prices that they will receive. It is important to note that in the case of a generator the purpose of entering into contracts is capturing value that is not available in the spot market. Where contracts would be expected to trend to long-run marginal costs to cover fixed costs in the medium term, spot prices are driven by short-run marginal costs curves of the available generation.

This is highlighted to demonstrate that the financial relationships have a net positive outcome as they provide access to the risk premium, that retailers are willing to pay to avoid spot market peaks, on a more sustainable and guaranteed basis. The absence of such a relationship would expose retailers to greater spot price risk and ensure generators were unable to recover their fixed capital costs.

Working group participants and history of financial difficulty in the NEM

Interestingly, one of the working group participants has since effectively ceased to exist. The financial stresses facing that business, which was a large supplier of hedge contracts and an active market participant trading multiples of its capacity in the forward markets, did not disrupt the market and the transition to new ownership transpired smoothly. Likewise, Alinta Energy's current business structure was borne of the failures of another market participant.

Retailer of last resort

Alinta Energy agrees that upon initial analysis issues regarding the retailer of last resort process may create difficulties should a large retailer encounter difficulties whatever the source of initial failure. While many of those difficulties may be resolved by the fact that many entities have nominated to be retailer of last resort, it is correct that these provisions have been untested in such a scenario. Further work in this area is a sensible approach.

Regulatory failure

Alinta Energy believes the role of regulatory failure, as arguably contributed to the outcomes in California needs to be considered as part of the NEM financial resilience project.

For instance, the current drivers of jurisdictional regulators to push down wholesale energy price components of regulated prices and general uncertainty associated with State-based regulatory processes could potentially give rise to significant risks in the market for generators and retailers that could lead to cascading default.

Another identifiable issue is the range of credit supports required, for example those lodged with individual networks service providers of themselves can be significant and could lead to failure. Alinta Energy supports the review of these arrangements with asset owners for participants generally and in the case of business failure and the exercise of the retailer of last resort.

Conclusion

Alinta Energy welcomes the issues paper and broadly supports the papers approach and conclusions. Alinta Energy continues to offer assistance, as required, in relation to this matter and supports an assessment of the retailer of last resort arrangements as well as key financial obligations.

Yours sincerely,

Jamie Lowe
Manager, Market Regulation