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Manager, MCE Secretariat
Department of Resources, Energy and Tourism
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Dear Secretariat

Separation of generation and transmission – consultation regulatory impact statement

Introduction

Alinta Energy welcomes the opportunity to make a submission in response to the Ministerial Council on Energy (MCE), Standing Committee of Officials (SCOO), Consultation Regulation Impact Statement (RIS) on the separation of generation and transmission.

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 and South 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 (NEM) as it pursues its forward growth strategy.

Overview

Alinta Energy welcomes SCOO's analysis of the potential issues arising from co-ownership of generation and transmission but does not believe this issue is a pressing concern in the NEM. The RIS highlights the absence of co-ownership in the NEM and provides no evidence that co-ownership for the purposes of exercising market power will arise.

We suggest as the RIS is primarily concerned with the exercise of market power arising from co-ownership it does not consider when co-ownership may be efficient or effective. On this basis, the RIS suffers from seeking to eliminate potential risk not manage inefficient outcomes. We contend that there is no evidence to suggest that the exercise of market power by a co-owned entity is inevitable.

Alinta Energy agrees that there are some instances when co-ownership by a competitor may give rise to specific concerns. However, a prohibition on co-ownership in its entirety is not supported given in some instances co-ownership (i.e. when constructing an asset for use in connecting generation or in diversifying an investment portfolio) should be permitted in the

absence of evidence that would contravene section 50 of the *Competition and Consumer Act 2010* (CCA).

Alinta Energy has no doubt that a potentially anti-competitive arrangement would be strongly resisted by industry participants. In such a circumstance, it is entirely appropriate that industry would support Australian Competition and Consumer Commission (ACCC) action and that action should be progressed through the existing legal channels. On this basis, Alinta Energy supports Option A in the RIS.

Nevertheless, while Alinta Energy supports Option A we are not opposed to strengthening the ring-fencing provisions concerning information disclosure between related entities in the National Electricity Rules (NER). However, this does not extend to the full gamut of changes proposed in Option B particularly in relation to additional discretionary powers for the Australian Energy Regulator. The Australian Energy Regulator plays an important role in the industry but we are not supportive of this extending to decisions on potential mergers.

Alinta Energy does not support Option C. We believe any specific provisions would be heavy-handed and a threshold percentage for cross-ownership would also be entirely arbitrary.

Likelihood and significance of co-ownership concerns

Alinta Energy is not convinced the issue of generation and transmission co-ownership requires detailed amendment given the absence of issues arising in this area.

Generator interest in transmission is likely to be driven by: (a) a localised need based on substantial generation investment which creates a transmission requirement not immediately provided by a Transmission Network Service Provider (TNSP) (or in the absence of a connected network); or (b) an attempt to stabilise financial returns through access to the regulated asset base.

The first of these, a localised desire to construct and own transmission, is impeded by the existing NER and Alinta Energy supports progress of this matter, including allocation of appropriate property rights, in the Australian Energy Market Commission's Transmission Frameworks Review.

The second is only a hypothetical at this stage given the absence of co-ownership for this purpose. The current consolidation of the industry continues to be focused on competing vertically integrated players diversifying their portfolios in generation and retail and transfer of ownership of generation from the public sector to the private sector.

Should a generation business actively consider an opportunity for transmission investment it would be analysed against the same financial hurdles and expected rate of return as core business. On this basis, we consider it unlikely to be where generators are likely to direct scarce capital and are businesses in which they are unlikely to have a competitive advantage.

Many of the examples cited in the RIS to justify revision of the current provisions are hypothetical. In other words, the existing provisions have not encouraged co-ownership to flourish or an abuse of market power as a consequence of co-ownership. The RIS lacks

evidence to support the desire for change notwithstanding the general theoretical validity of the concepts put forward.

Furthermore, some of the perceived risk may be overstated. The idea that a generation or retail player would rely on a strategy of owning transmission to develop their business profitability through the misuse of market power seems relatively unlikely. It ignores the range of variables that would need to be aligned in order for such a strategy to work, notwithstanding the risk of legal sanctions, the loss of return from pursuing the normal course of business, and the potential for competitor co-owners to retaliate.

As such, it is not surprising that the current instances of co-ownership raise no concerns for the MCE. Co-ownership is focused on enabling generation not impeding competition. This further emphasises the arbitrary nature of suggestions supporting a percentage cap on co-ownership or strengthening of provisions to circumvent section 50 of the CCA.

Hence, any change to prevent potential anti-competitive distortions would be disproportionate given the absence of evidence and the likelihood generators will only seek or wish to own transmission networks at the margins.

Hence, while market power requires appropriate checks generally, especially if it provides a strategic threat or is misused to damage a competitor, we see no reason not to endorse the continued use of existing CCA provisions to guard against and take action in response to issues of market power in the energy sector.

Stated issues with the existing CCA provisions

We have some concern with arguments that suggest an inability to stop a merger or co-ownership should be read as inability to stop misuse of market power. We agree that economic theory has an important role to play in assessing potential market impacts of mergers; however, it requires appropriate scrutiny and should be supported by demonstrated evidence, either specifically or generally by industry support.

In this regard, it is appropriate for the ACCC to vigilantly pursue plausible instances of lessening of competition suggested by economic theory; however, the court is the appropriate place to decide such outcomes. For instance, an analysis of examples like *AGL v ACCC (2003)* is likely to demonstrate that the evidential bar was set at an appropriate level and hence the findings of the court were appropriate. Something explicitly acknowledged by Justice French in his decision.

Acadia CRE in its 2006 report for the Energy Reform Implementation Group stated:

The TPA, as it currently applies, is effective, provided the ACCC is able to gather evidence to substantiate its *a priori* assessments of market power and the effects of mergers on competition. The provisions of section 50 allow the ACCC to address all in-principle sources of lessening of competition, across all types of horizontal and vertical electricity industry mergers. (p.ii)

Alinta Energy supports these views.

We appreciate that the current process requires a substantial critique of the economic theory based on evidence. But, we believe this is as it should be, including placing the onus of proof on the ACCC to “monitor behaviour and gather sufficient evidence of a breach” (p.16) following a merger. Clearly, if there is no obvious breach or market power impacts, then action is not warranted and the need for a stronger limit on co-ownership is disproved. Conversely, a successful court outcome does not prove that co-ownership should never occur but that the ACCC has rightly identified merger behaviour that requires attention in a specific instance.

It should be noted that in a competitive market, participants should have more incentive to report and support action against an alleged misuse of market power by a competitor (for example who co-owned a transmission network). As such, Alinta Energy supports the status quo. This support is significant given the measures canvassed in the RIS are purportedly in the interests of the generation sector to which Alinta Energy belongs.

Areas for further consideration

Alinta Energy would have concerns if a competitor was to own and operate the network with absolute discretion; however, Alinta Energy sees room for general improvement in the operation and management of the network currently which would by and large allay these concerns.

Information disclosure

Alinta Energy is not opposed to strengthening of the ring-fencing provisions concerning information disclosure between related entities. However, this does not extend to the full gamut of changes proposed in Option B particularly in relation to additional discretionary powers for the Australian Energy Regulator.

While Alinta Energy’s view remains that a case-by-case application of section 50 of the CCA is appropriate when assessing proposed mergers including co-ownership of generation and transmission, it is also appropriate that the regulatory framework, any co-owned entity would exist within, provides participants with certainty and security.

Like many industries before it, Alinta Energy is confident that appropriate management separation or “Chinese walls” can be constructed to ensure appropriate restrictions, supported by provisions and penalties, are in force to protect commercially sensitive information. Within the industry at present relationships exist along similar lines.

Interestingly, Alinta Energy believes these concerns, while not as intriguing as a number of the other hypothetical scenarios, would be one of the more pressing issues should co-ownership become widespread. As such, the ring-fencing guidelines, as they relate to information flows, would need to be readily enforceable.

Regulation of transmission to meet investor and user needs

Alinta Energy notes the concerns regarding the operation of the network. This includes transmission service quality, connection of competing generators, line rating changes, and transfer of costs at the margins.

Where these actions were blatant and caused specific measurable damage to a competitor the market would expect the ACCC to take appropriate action. In this regard, the CCA is appropriate to pursue such lessening of competition and we believe provides an appropriate response to misuse of market power.

However, more generally many of these issues would be less concerning if they were more appropriately managed in the market currently, regardless of ownership. For instance:

- the methodology for determining line ratings has not been resolved and should be revisited;
- the costs associated with line maintenance and unexpected outages are already of concern to generators and Alinta Energy supports greater use of appropriately weighted performance incentive schemes;
- the occurrence of congestion has a bearing on generator profitability and there is scope to improve how it is managed and the costs faced by TNSPs to induce efficient behaviour;
- it should not be assumed the current connections process is responsive to the commercial needs of generators - generators across the NEM have expressed concern at how connections processes vary in time, scope and cost classification from region to region;
- recognising transfer capability at time of investment to enable guaranteed dispatched under system normal conditions when a generator is competitively priced would resolve a number of the concerns raised in the issues paper; and
- a deficiency in the current framework is that building a connection or transmission asset does not provide a generator with ownership rights in the NEM, despite the associated expenditure, which impedes new entry and serves to undermine the commercial viability of potential projects. Alinta Energy queries the benefit of this arrangement.

In short, the issues of connection and transmission performance are critical; however, co-ownership does not immediately suggest poor performance in these areas just as separation does not lead to exemplary performance. Furthermore, it should not be assumed that the framework currently provides the correct incentives to ensure networks are managed to meet the commercial requirements of generators.

Alinta Energy suggests ensuring networks are regulated to meet all users needs, regardless of ownership, is an area requiring improvement in the NEM and will be of greater benefit than further regulating potential co-ownership.

Application of competitive pressure

There is a view that any competitive pressure on TNSPs, even at the margins in tailored transmission investment to meet specific generator commercial needs including a connection, is a positive outcome. It is considered that competitive pressure will improve TNSPs

responsive to network users' commercial requirements. Alinta Energy supports further work in this area.

Definition of transmission and its role in connecting new transmission

Finally, from a practical perspective the definition of transmission in the NER includes all high voltage lines including those which are essential for connection assets.

Clearly, there is no economic benefit in banning generators from owning such lines and little regulatory value in attempting to create a complicated regulatory framework which precludes some transmission assets but allows others to be owned by generators.

It does, however; make sense to permit generators to construct or purchase, and own transmission assets to facilitate generation and encourage investment.

Conclusion

Alinta Energy appreciates that cross-ownership concerns and rules, such as those in Victoria, supported market reform during the 1990's. However, we do not believe that co-ownership or monopoly transmission makes the exercise of market power inevitable. To date, experience and market consolidation has not raised any real concerns, outside of economic theory, that exercise of market power is a threat to market integrity.

As such a proposed limit, like percentage of allowable cross-ownership, is arbitrary and misdirects energy towards prohibiting potential innovation and efficient investment instead of establishing a regulatory structure that provides superior outcomes regardless of ownership.

While Alinta Energy appreciates that an absolute ban, or an effective ban, is easier and appeals to some, it is not warranted based on the evidence. Additionally, it is not necessary given section 50 of the CCA remains an appropriate safeguard against potential lessening of competition and that the CCA generally adequately equips the ACCC to pursue market participants where misuse of market power exists.

We look forward to your consideration of this submission. Should you have any queries in relation to this matter please do not hesitate to contact me on, telephone, 02 9372 2633.

Yours sincerely,

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

Jamie Lowe
Manager, Market Regulation