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**Market Making Arrangements in the NEM – ERC0249**

Alinta Energy welcomes the opportunity to provide a submission to the Australian Energy Market Commission's (**AEMC**) Market Making Arrangements Rule Change *consultation paper* (**the consultation paper**).

Alinta Energy is an active investor in energy markets across Australia with an owned and contracted generation portfolio of nearly 3,000MW, including 1,700MW of gas-fired generation facilities and 1,070MW of thermal generation facilities, and in excess of 1.1 million electricity and gas customers including more than 630,000 in east coast markets.

Alinta Energy is committed to contributing to energy market development, across Australia and in all regions of the National Electricity Market (**NEM**) as it pursues its forward growth strategy.

## *Introduction*

In recent times, proposals for *compulsory* market making obligations have become more frequent, the recent Australian Competition and Consumer Commission's(ACCC) Retail Electricity Pricing Inquiry Recommendation 7, and Energy Security Board's (ESB) Market Liquidity Obligation both directly consider proposals to introduce *compulsory* market making mechanisms to address issues of contract liquidity.

Alinta Energy has long held the view that the current NEM design incentivises voluntary commercial activities through the existing market parameters. It is worth noting that over the NEM's history various new products have been organically constructed through mutually beneficial bilateral arrangements, with many participants, businesses and consumers taking advantage of these. This shows the market is functioning correctly.

## *Problem Definition: Market Liquidity and South Australia*

Alinta Energy considers a liquid market in energy contracts as an essential component in ensuring participants have appropriate access to the range of energy risk management products they need to suitably manage their portfolio. Deep and liquid markets also ensure a constant demand for any surplus contracts a participant may have to sell back to market as part of their normal portfolio optimisation activities.

In this regard, it is worth noting that Alinta Energy presently has no problems in regularly opening or closing out contractual positions across any of the products listed for trade on the ASX across various jurisdictions. This is not to say, that Alinta Energy is always able to gain the exact contracts for the exact duration and price that perfectly suits all of Alinta Energy's requirements, however on balance the market is suitably liquid enough to manage the requirements of a medium sized Gentailer business.

Nonetheless, of late South Australia has consistently been raised as one market where smaller retailers may have some difficulty in contracting. However, Alinta Energy would suggest that the provision of any compulsory market making obligations would not necessarily resolve those liquidity concerns economically or efficiently. It is worth noting that South Australia displays relatively unique characteristics being:

- Exceptionally high renewables generation penetration, especially from wind;
- Small demand profile, which is relatively peaky in summer months;
- Access to only one major interconnector in Victoria; and
- Sole reliance on gas generation sources to manage frequency and ancillary services.

These unique physical characteristics mean that even if a compulsory market making obligation were to exist, whereby large vertically integrated retailers are compelled to offer contracts to market, the same underlying risk profile would be present in the market, albeit held by a different participant. In this case, market making obligations could be interpreted as a regulatory solution to what is a physical problem, and arguably may only act to shift risk from one participant to another, who is perhaps worse placed to take on potentially unwanted contractual positions.

It is worth noting that relatively small markets such as South Australia, were few participants operate are unlikely to ever have the required demand to justify the introduction of an entirely new market making scheme for the reason that compulsory trading obligations will not increase the provision of hedges available beyond the natural limit of South Australia's existing physical generators[1].

Nonetheless, if the AEMC is of the view that the market conditions of the NEM do suffice the introduction of a market making scheme at this time, Alinta Energy see's merit in the rule proponent's proposal for the NER to mandate conduct of a *voluntary* tender process for market making responsibilities in the NEM. The rule proponent's proposal is fundamentally preferable to any compulsory market making obligations.

[1] If the issues of South Australian liquidity are truly thought to be a material and ongoing concern for the NEM (Alinta does not subscribe to this view) it is unlikely they could be resolved through any regulatory reform, except perhaps the merging of the SA and VIC nodes. Such a reform would increase contract liquidity in both regions and whilst it would turn inter-regional constraints into intra-regional constraints, on balance this may be more palatable for participants, not dissimilar to the issues currently in existence in North QLD. Such a reform is not without precedent (Snowy Region). Whilst clearly beyond the scope of this rule change proposal it is worth mentioning in passing.

### *Proposed Voluntary Market Making Tender Service*

Commercial arrangements entered into voluntarily maximise economic welfare and efficiency and also reduce the overall risk profile within the NEM. Undoubtedly, participants who seek to participate in a mutually beneficial contractual arrangement are best placed to determine their own risk and commercial appetite based on market expectations and their own unique business requirements.

For this reason, if a decision is made to progress a market making arrangement, Alinta Energy supports the rule proponent's proposal for the NER to mandate the conduct of a tender process for the provision of voluntary market making services in the NEM for the following reasons:

- There are strong efficiency arguments for establishing a consistent framework for the provision of contestable market making services, allowing brokers, the ASX or others to compete on a transparent basis.
- A voluntary market making tender process is fundamentally preferable to any mandatory market making obligation where participants may be obligated to provide products that may be beyond their financial risk capabilities.
- Compliance costs for participants under a voluntary mechanism are likely to be significantly lower than under a compulsory mechanism.
- Under a voluntary market making scheme participants won't be forced into contractual relationships with counterparties with inferior credit ratings, lowering the risk premiums which are subsequently applied to all other trades.
- A voluntary tender process minimises economic distortions by maintaining the free market philosophy of the NEM's design.
- Expert third party market making service providers (including international operators) may be encouraged to enter the NEM and support market development.
- Costs can be recovered from the successful tenderer's fee from customers whom voluntarily utilise the service, as opposed to the broader market as a whole.

### *ASX Market Making Scheme*

The AEMC is aware that presently the ASX is currently investigating the establishment of a Market Trading Scheme containing incentives to provide voluntary market making functions containing the following attributes:

- Two-way quotes with maximum spreads of AUD 4-6/MWh.
- Minimum quantities of 2 lots in SA and 5 in other NEM Jurisdictions.
- A minimum time period of 25 minutes during each market making session window on each day.
- A form of rebates based on a proportion of fees received by the ASX on each contract.

Alinta Energy would encourage the AEMC to carefully consider the development of this mechanism to ensure that this rule change determination does not undermine the business case of those participants whom may be already willing to voluntarily participate in the ASX Incentive Scheme.

## *Conclusion*

Alinta looks forward to participating in the ongoing consultation process and would encourage consideration of the points raised above.

if you have any queries in relation to this submission please contact me via email: anders.sangkuhl@alintaenergy.com.au or by phone 02 9375 0992.

Yours sincerely,

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