8 November 2019

Tom Walker
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235
Submitted electronically

Coordination of Generation and Transmission Investment Implementation – Access and Charging EPR0073

Alinta Energy welcomes the opportunity to provide a submission on the proposed access reform model: *Coordination of Generation and Transmission Investment Implementation*.

Alinta Energy is an active investor in energy markets across Australia with an owned and contracted generation portfolio of nearly 3,000MW and in excess of 1.2 million electricity and gas customers.

Alinta Energy recognises that the NEM is undergoing significant transition, justifying the further investigation and wholistic study of methods for improving the NEM's generation and transmission investment signals.

However, Alinta Energy considers that the strategic direction considered within EPR0073 does not justify the introduction of the CoGATI model as currently proposed, specifically:

1. The case for the proposed access model appears disproportionate to the identified issues given the wide range of risk management tools currently available to participants.

2. If implemented in its current form, the proposed model would have a material cost impact, undermine investor confidence and increase barriers to entry.

3. Alternative simplified and less ambitious approaches to CoGATI reforms, consistent with first principles, should be considered.

The case for CoGATI has not been adequately made

Current risk management tools effectively manage congestion risks

The objective of the proposed access model is to co-optimise investment planning between generation and transmission as well as providing participants with risk management tools to

alleviate their risk of dispatch congestion. In turn, this is thought to lead to a more efficient and liquid contract market, minimising the expected total system cost borne by consumers.

These required objectives imply that the current planning and dispatch arrangements in the NEM are sub-optimal and that network congestion currently impairs or limits the ability of generators to sell forward contracts or increases the basis price at which they are willing to sell contracts to market, leading to inflated costs for consumers.

Alinta Energy considers that the materiality of this objective needs to be thoroughly modelled and quantified. Whilst congestion may be a problem for some generators seeking to access the market, the actual costs this imposes on the market is quite low.

Indeed, participants currently manage these congestion risks, and any corresponding risk exposure to the spot market, effectively through a combination of processes which dynamically utilises their generation assets in conjunction with the following tools:

- Access to OTC derivatives in the contract market
- Access to exchange traded products
- Operational bidding in the Spot Market to ensure dispatch
- Access to financial products which provide payouts under certain market scenarios
- Access to insurance products
- Utilisation of wider portfolio hedges

In Alinta Energy's view, these tools and practices effectively manage congestion risks in the NEM in an exceptionally low-cost manner.

A material benefit has not been demonstrated

It is contended that the CoGATI model will minimise prices for consumers in the longer term by minimising the total system cost of building and operating both generation and transmission over time, as well as increasing the range of risk management products available to participants through TFRs.

Alinta Energy appreciates that there are inherent difficulties in modelling the impacts of dynamic regional pricing at this stage of the reform process. However, without a clear understanding of potential settlement and commercial impacts, the case for engaging in a thorough and rigorous debate remains problematic.

Whilst Alinta Energy understands significant modelling is expected to be undertaken in the later stages of the CoGATI process, it should be acknowledged that past analysis of the market inefficiencies of rebidding around congestion are thought to be relatively small. Such a significant and material piece of network reform warrants a comprehensive benefit cost analysis that includes:

- Potential dispatch outcomes at the portfolio level
- Cost of acquiring access imposed on incumbent and new entrant generators
- Costs to AEMO and the market
- Wealth transfer between participants

- Cost impact to consumers

This would allow a level of quantitative analysis to be presented in conjunction with the wider CoGATI model, allowing for complexities to be raised, and questions posed about the scale of the changes required to implement the scheme envisaged. It should also require a clearly defined, and materially high, hurdle for it to proceed, with clear market benefits, and identifiable and quantified costs and risks.

There remains a great deal of uncertainty around the impact of implementing CoGATI in the NEM and it is difficult to envisage the process gaining extensive industry support in the format it has been presented. Alinta Energy would encourage the AEMC to progress with the construction of a rigorous cost benefit analysis as a matter of priority in proceeding to the next stage of consultation.

The proposed solution is not proportionate to the identified problem

The development of effective regulatory policy requires proposals to be proportional to the clearly defined problems they are seeking to solve. In the case of CoGATI, Alinta Energy is concerned that the problems are not material enough to justify the introduction of the proposed access model. In seeking to address several perceived market inefficiencies, the CoGATI model represents a significant and highly complex change to the existing wholesale market.

Over time, operational anomalies appear under every market framework; in this case congestion, race to the floor bidding, and deficient locational signals appear to be the anomalies the proposed solution is seeking to rectify. However, the risk presented by the CoGATI model is that new strategic anomalies (which are unforeseen) will arise under dynamic regional pricing which may be more inefficient and expensive than the congestion risks CoGATI is seeking to address.

Alinta Energy is concerned that the introduction of CoGATI as it is currently presented would fundamentally introduce a range of both "known unknowns" and "unknown unknowns" into the NEM, and that these risks may be equally or more inefficient than those practices which CoGATI seeks to address. As such, Alinta Energy considers that the proposed model may be disproportionate to the identified problems.

International comparisons are not always relevant

The CoGATI report makes numerous references to international jurisdictions where nodal pricing is in operation. Whilst informative for reference purposes, consideration should be given to where points of regulatory difference exist and the unique underlying localised market conditions underpinning those differences.

For example, some market settings may naturally give rise to nodal pricing, because of geographic constraints or market power considerations. However, it is hard to draw meaningful comparisons for such conclusions without a corresponding detailed analysis of the market jurisdiction in question. For example, the New Zealand wholesale market has no wholesale market price cap, but has significant competition regulation and market making

provisions, thus dynamic regional pricing may provide a natural fit for the dynamics of that particular market.

Differences between nodal pricing regimes in international markets will always exist and may simply reflect localised market conditions. Thus, caution should be exercised in drawing like for like conclusions with international jurisdictions and seeking to apply them to the NEM.

Material impacts on market

Regulatory uncertainty and increased costs

Alinta Energy remains concerned that the shift to dynamic regional pricing will create significant regulatory uncertainty at a time when the broader NEM is already undergoing an unprecedented transition.

This risks creating financial instability through the contracts market as NEM participants attempt to navigate the significant complexity in managing potentially several thousand nodal prices as well as managing the purchase of firm access rights between physical generation capacity and load points.

If implemented, the proposed CoGATI model may impose large costs on incumbent and new generators alike who would be forced by their internal risk policies to purchase a level of network access that is likely to be lower than the existing level of access they currently have in the NEM. This additional complexity will create additional risk premiums in the contracts market, resulting in increased costs which are passed on to end use electricity consumers.

Uncertain firm access rights

Alinta Energy remains concerned that the CoGATI access model does not necessarily guarantee generators the level of access they require to maintain their existing level of contracting, or that financial compensation will be sufficient to cover any losses incurred due to transmission outages and other scenarios.

As such, all generators, both those with TFR's and those without, will be faced with a level of basis risk under the CoGATI model. For example, a generator who holds TFRs may have their worth rescinded under transmission outages or similar scenarios, and consequently still be subject to the price at that local node.

Internal risk management policies at individual generator companies will necessarily apply a level of conservatism to the risk that firm access rights may not exist, either because they have not been able to be purchased, or they were not able to be fully relied upon under certain scenarios. As such, prudent risk polices will require generators to possibly sell less hedge contract volumes than they otherwise would have under an unconstrained model. In addition, this would increase the possibility of generators being exposed for potentially long periods to localised prices.

Alinta Energy is concerned that the impact of such an arrangement would favour large vertically integrated participants over smaller participants or non-integrated retailers. The size

of Alinta Energy's portfolio means, unlike large participants, it does not gain the advantage of a natural hedge against constraints. This additional complexity will create additional risk premiums in the contracts market, in turn increasing costs which are passed on to consumers.

Undermining investment confidence

Attracting private sector investment in the NEM requires a clear market design that is subject to predictable changes. Fundamentally, it must be recognised that investments made in the energy industry are done so with a 25-year time horizon.

As outlined in Alinta Energy's submission to the Energy Security Board's Post 2025 Market Design Issues Paper, continued changes to a market's core design creates significant investment uncertainty that undermines current and future investment. Policy makers and Regulators should be purposeful in progressing only those reforms that are consistent with a co-ordinated market design. Therefore we recommend that the AEMC's CoGATI review be merged into the ESB's 2025 review process and considered holistically as part of that process.

Timing pressure of proposed reforms

Given the scale of the CoGATI reforms proposed, in addition to the unprecedented amount of other competing reforms currently being undertaken by various regulatory and governance bodies, Alinta Energy considers the proposed implementation time of July 2022 to be unachievable.

The theoretical benefits arising from CoGATI could only take place with simultaneous regulatory and procedural changes throughout the NEM. This includes ASX processes/products, AFMA processes, banking/brokered products, AEMO settlement processes and many changes to individual companies trading systems. Collectively, these regulatory changes are significant and would require unprecedented resourcing.

Implementing a change as fundamental as CoGATI under a tight-time frame runs the risk that innocuous and seemingly insignificant errors may pass the attention of market participants and regulators, potentially creating distortions in the future. While Alinta Energy does not support the progression of the proposed reform, if it was to proceed, Alinta Energy suggests that a 5-year implementation program (at a minimum) is more appropriate.

It is again worth noting the ESB's 2025 NEM market design project, tasked with recommend changes to the existing market design by the end of 2020. The ESB's project and this review crucially intersect. To prevent duplication of separate (but fundamentally related) reforms, Alinta Energy supports the merging of these workstreams.

Merging the workstreams will ensure issues can be holistically assessed as well as guaranteeing reduced disruption to market participants and policy makers. This would also assist in somewhat lessening the significant regulatory burden arising from the myriad of other reforms currently underway.

Increased barriers to entry

Alinta Energy is concerned that under the CoGATI model, generators may be forced to reduce the total volume of forward hedge contracts they can offer to market, in order to meet prudent internal risk management policies. This effectively results in generators being forced to take on more localised price exposure and increases the likelihood of being exposed to any localised market power.

Under the existing NEM wholesale market arrangements, intra-regional hedge contracts are predominantly sold by generators within that specific pricing nodal state reflecting the underlying market structure. In moving towards the CoGATI model, the selling of inter-regional hedge contracts (even if supported by FTRs) becomes inherently riskier because of the nature of transmission outages and as such has a level of additional risk premium costs applied to it. Any decrease in the level of contracting has a negative impact for all market participants, but especially so for smaller retailers who do not have large vertically integrated portfolios and as such would face increased barriers to entry.

Preference for a simplified approach to access reforms

Consideration of first principles

Alinta Energy has long been committed to the delivery of transmission planning reforms which contribute to the achievement of efficient investment outcomes. However, the proposed reforms Alinta Energy and industry finds itself grappling with represent a material and untested change to the market which is not reflective of the reforms which have been outlined by generators through the various past regulatory reviews.

There is a growing view from the industry that CoGATI is attempting to solve several market issues, the totality of which threatens the viability of the reform package as a whole. Alinta Energy suggests that a scaled proposal, which addresses generators original concerns, would be less complex and more palatable to industry and result in lower costs for consumers. For example, Alinta Energy has long been committed to the achievement of the following objectives:

- The introduction of commercial drivers on transmission businesses, and commercial financing of transmission infrastructure, thus minimising the total cost of building and operating the system over time and subsequently minimising prices for electricity consumers.

- The co-optimisation of transmission and generation investment by promoting the efficient utilisation of spare network capacity when feasible.

- The shifting of some transmission investment risk away from consumers where possible.

- The construction of detailed analysis on whether obligations on transmission network service providers to upgrade or maintain lines to remote assets, or generation assets requires further contemplation within the NEM rules.

Alternative reforms within the transmission planning domain

At its core, congestion is driven by dynamic market conditions that cannot be readily changed in the short run. This is because congestion fundamentally arises from the lumpy nature of generator investments, namely: generator plant size, locational decision (often relating to fuel source), planning approvals and overall network capability.

Under the proposed CoGATI model, these challenges remain, and in addition, several new complexities would be introduced. As such, Alinta Energy has a strong preference for the introduction of alternative reforms within the transmission planning domain, progressed through the ESB 2025 process, which could include the following:

- Incentivise network businesses to be exposed to revenue consequences based on overall availability for both unplanned and planned outages. For example, annual benchmarking and assessment could be undertaken by the AER without the introduction of firm access rights.

- Elements of the Integrated System Plan could be further progressed to alleviate network constraints. The detailed regional analysis underling the ISP is directly targeted at identifying the least cost transmission investments in the NEM. If correctly and transparently regulated by the AER, methods of prioritising this investment will allow new generators to connect in a manner which forgoes the need for fundamental wholesale market reform, leaving the contracting market intact.

- Targeted reforms which manage the yearly fluctuations of marginal loss factors, may provide a stronger locational signal for connecting generators.

- The introduction of some co-investment optionality whereby connecting generators (or a group of connecting generators) contribute to some form of deep connection charging which allows them to bear the costs of connecting in an area of the network which would have otherwise been considered sub-optional. This approach would not be too dissimilar to the causer pays framework of the wholesale market.

Reforms correctly targeted to these areas are likely to be more less disruptive for industry participants as well as deliver benefits with limited impact on market outcomes.

Conclusion

We look 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 on anders.sangkuhl@alintaenergy.com.au or by phone 02 9375 0992.

Yours sincerely,

[Signed]

Anders Sangkuhl
Wholesale Regulation Manager