23 September 2014

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear Mr Pierce

Alinta Energy welcomes the opportunity to make a submission in response to the *NEM Financial Resilience, Second Interim Report* (the Report or the Review) and appreciates the detailed work undertaken by the Australian Energy Market Commission (AEMC) to date.

Alinta Energy is an active investor in the energy retail, wholesale and generation markets across Australia. Alinta Energy has around 2500 megawatts of generation capacity in Australia (and New Zealand) and a growing retail customer base of over 750,000.

Alinta Energy has engaged extensively with the AEMC for the duration of the Review including as a member of the industry working group.

While Alinta Energy remains disappointed with some of the language used by the AEMC in explaining the normal conditions of uncertainty that surround many markets, including financial relationships in the National Energy Market (NEM), the AEMC has made a range of detailed recommendations and observations.

The purpose of this submission is to highlight the AEMC recommendations that Alinta Energy believes will clearly and unambiguously strengthen the financial resilience of the NEM and express caution in relation to those recommendations that require further justification.

Additionally, while the AEMC's work in this area is not without merit, Alinta Energy cautions against any general move or tendency towards engagement in issues outside the AEMC's established energy markets advice and rule making remit. Aspects of the Review fit this trend. The AEMC's strength lies in assessing the economic efficiency benefits of rule change proposals and potential energy markets reforms not assessing general economic and social policy matters.

Discussion

Alinta Energy notes the AEMC's analysis of the various risks and current arrangements to mitigate and manage risks in the NEM. Given the duration of the Review it is not unsurprising the AEMC has presented a detailed overview of risks to financial stability and current arrangements to address those risks. This work will provide useful guidance to interested parties and government.

Nevertheless, Alinta Energy is concerned where the Report infers concern where it is not justified. Given the nature of risk it could be suggested the Report gives the flavour that failure to eliminate or substantially reduce all risks, be they to participates or to NEM financial stability overall, is of concern. This language, while in the context of the entire report may be less concerning, can be unconstructive, especially if selective statements are misinterpreted or gain widespread attention.

This language, which the AEMC has elected to use, needs to emphasise that in many instances risk should not be eliminated. The very interaction of participants in a market creates risks and in turn rewards which benefit society. Allusions to unmanaged risk, especially where entity risk management practices are sound and industry regulation is already burdensome, without an appropriate weighting as to costs and benefits of any change versus the status quo can be unhelpful and definitely speculative.

Thus it is comforting the AEMC has concluded that increased prudential regulation, mandatory stress testing and increased transparency measures would be largely counterproductive, definitely not worth the large additional cost, and would not resolve the key issues confronting the NEM. Alinta Energy continues to endorse this view.

Likewise, the AEMC's conclusions in relation to the G20 measures are appropriate. Alinta Energy has long held the view that such practises would provide no benefit to industry or participants while creating the potential to distort participant decisions making and thus increase market risk.

Clarification of market suspension rules to allow a participant to continuing generating at the time of financial distress is a practical and pragmatic proposal that will benefit both the entity encountering financial distress and the market at the time of said entities distress. Alinta Energy endorses the AEMC's analysis of this issue and supports the recommendation progressing to a rule change.

Importantly, the AEMC has made a number of important recommendations in relation to matters which directly concern the operation of the Retailer of Last Resort (ROLR) scheme which will have the effect of reducing the potential for NEM financial instability. Given the AEMC firmly holds the view that the ROLR is required to manage failure of entities in the sector and ensure a relatively smooth customer transition, Alinta Energy supports any steps taken to ensure it meets its objectives.

- Clarification of ROLR cost recovery arrangements will ensure the designated ROLR can quickly recover costs that are allowed within short timeframes.
- Improving the ability of the Australian Energy Regulator to delay designation to assess the potential for multiple ROLRs is also sensible as a method for diffusing the risks that arise from large scale customer transfers.
- Encouraging large customers to implement their own ROLR arrangements will minimise financial obligations on the designated ROLR and should encourage participation by a larger number of retailers as ROLRs.
- Delaying the provision of credit support while not without some risk to the market is a measured and appropriate response that provides quantifiable benefits in the circumstance in which a ROLR event arises. This relates to both Australian Energy Market Operator credit support and network credit support.
- The proposal to improve information held by the Australian Energy Regulator and the Australian Energy Market Operator acknowledges that a key risk to ROLRs is the inability to hedge an unknown group of customers that they may be transferred during a ROLR event.

Alinta Energy is much less comforted by calls to introduce a special administrative regime arrangement that would treat the electricity sector differently to other parts of the economy for the purposes of managing administration and insolvency.

Additionally, Alinta Energy does not see the benefits associated with the proposal to create a NEM Resilience Council which will seek to intervene where a 'systemically important market participant' (SIMP) encounters financial distress.

In short, the creation of a central decision making point, which in this instance means a council of public service officials to the exclusion of business owners, company management or administrators (but ultimately dependent on the knowledge provided by those parties), may provide little more than false comfort on paper and creates a number of uncertainties about what action government may or may not take in the face of a large vertically integrated entities failure.

The AEMC suggests the NEM Resilience Council escalate instances where a SIMP may be imminently facing financial distress. This presupposes a high degree of insight for parties outside the actual market. Further, the expectation that the NEM Resilience Council can make anything more than a guess at the likely financial consequences is curious. The greater likelihood is that government reaction and potential market intervention may actually impede the ability of financially stable market participants to insulate their businesses from the financial shock of a large vertically integrated failure.

Further, the classification criteria and reasons for failure are important considerations. It is difficult to see the AEMC's proposals as anything but a move towards a 'too big to fail' criteria for energy sector participants. While not inoculating those large entities from competitive dynamics of the market it does suggest the potential to leverage government for a form of support or assistance that isn't available to other participants. This is not a competitive outcome, and portends moral hazard.

It has been previously noted that many of the large entities are more likely to encounter financial distress as a result of poor investment decisions and exposure to large foreign currency positions as opposed to NEM financial interdependencies or contagion. In this environment, what cause is there for government to consider anything other than allowing a large vertically integrated participant to suffer the consequence of its choices?

While the AEMC is not explicitly recommending financial support by Government in the event of a SIMP encountering financial distress, the Report holds open the possibility of government loans or guarantees and other alternative mechanisms available to the NEM Resilience Council. It is difficult to see, in the event of financial distress with unknown implications, how a SIMP's leveraged expectations of financial assistance or market intervention will not be front and centre in the minds of a committee of public officials not operating within the market.

It is not clear to Alinta Energy that the risks, costs and policy changes touched upon by the AEMC in the Report justify changes to cater for the newly designated 'SIMPs'. Alinta Energy suggests these recommendations provide tenuous benefits when compared with the more concrete proposals that directly concern the operation of the NEM.

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

Yours sincerely,

Jamie Lowe
Manager, Market Regulation