17 December 2013

Mr Neville Henderson
Chairman
Reliability Panel

Lodged via: www.aemc.gov.au

Dear Commissioner

ROAM Draft Report

Alinta Energy would like to take this opportunity prior to the release of the Reliability Panel's report being issued in 2014 to outline a number of issues with the ROAM draft report.

In short, while the ROAM report contains a range of informative data, Alinta Energy is not confident the modelling exercise undertaken by ROAM is fit for purpose and it is not clear it will necessarily support the analysis of the Reliability Panel.

Alinta Energy understands the ROAM analysis is a departure from previous modelling exercises and reflects the criticisms of a select number of participants during the 2010 Reliability standard and settings review. Not all participants shared these concerns at the 2010 review.

Unfortunately, the decision to dramatically move away from the extreme peaker model to the cap defender model has led to an exercise in which outcomes are highly dependent on modelling assumptions, market structure and bidding behaviour.

It appears that the modelling outcomes are disproportionately impacted by rebidding assumptions and present supply conditions and thus does not represent the value of lost load upon which Alinta Energy believes the Market price Cap (MPC) should be based.

Initial comments on ROAM outcomes

Some key charts in the ROAM draft report can be used to illustrate why the modelling may not be fit for purpose, even if it has drawn some very interesting conclusions in their own right.

Before discussing the relevant charts, the outcomes may also be problematic for another reason. ROAM has indicated that the objective is "to determine the MPC required such that if the reliability standard were to be breached, that a new entrant, merchant peaking generator would be incentivised to enter the market".

Alinta Energy notes the use of a cap defender raises some issues of internal consistency. The rationale for investing in a future cap defender and of selling hedge as currently seen would be to defend against future MPC incursions at the existing level of $13,100 or future MPC increases. But that investment would not come about should the MPC be lowered or not likely to rise.

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In other words, the MPC is an input to participant behaviour not only an output of the modelling. Under a model with a lower MPC the rationale for investment (and operation, why would you sell caps?) would be entirely different.

Figure 1 (shown on next page), shows the difference between the modelling scenarios. One is immediately taken aback by the large difference between the extreme peaker model and the boundaries of the cap defender scenarios. This suggests that assumptions are key drivers of outcomes in the modelling, as is often the case, and thus caution and further investigation is warranted.

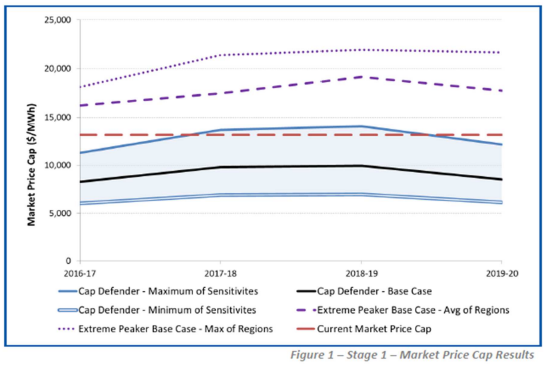

Figure 1 – Stage 1 – Market Price Cap Results

ROAM commentary confirms this with a raft of input sensitivities around demand forecasts, carbon pricing, demand side participation, gas prices, alternative Cumulative Price Threshold (CPT) and MPC multipliers, and the Renewable Energy Target; large differences between these sensitivities gives rise to questions about the value of the outcomes overall.

The importance of assumptions and the importance of market structure and bidding become particularly clear when examining outcomes on a regional basis. This is most notably the case for the cap defender models where there has been an attempt to "include consideration of market factors which influence the drivers of generation investment in the NEM". See figure 5.2.

Where capital costs are the primary driver and need to be recovered in the energy only market it is not surprising that regional outcomes are more closely aligned. See figure 5.4.

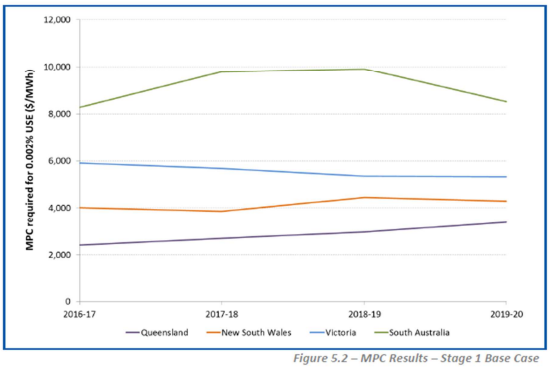

Figure 5.2 – MPC Results – Stage 1 Base Case

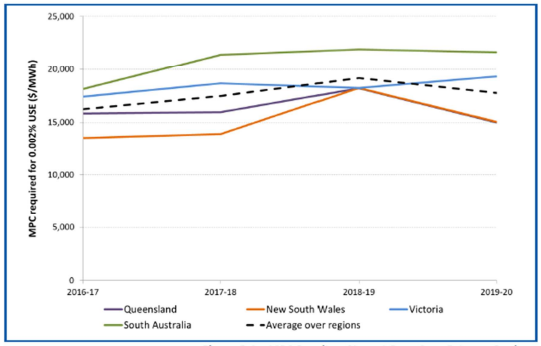

Figure 5.4 – MPC Results – Stage 1 Base Case Extreme Peaker

Interestingly, the price duration curves illustrates how a cap defender model is not reflective of the market and that the best way to model a return on investment in a cap defender model is to assume higher levels of concentration, no bidding at short-run marginal cost and that market structures are unlikely to change or evolve. These are interesting assumptions.

The price duration curves given in Figure 5.6 do not, in Alinta Energy's view, represent realistic reflections of what happens in the market. In effect, the ROAM modelling has constructed a series of drivers which do not exist.

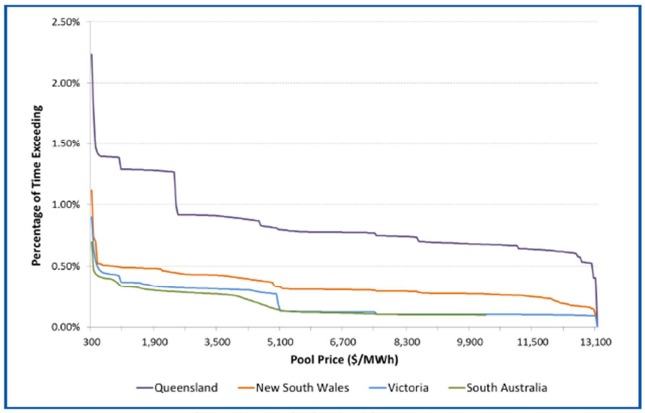

Figure 5.6 – Pool Price Duration Curves – Stage 1 Base Case – 2016-17

It's not clear how this level of conceptual complexity will assist the Reliability Panel or whether it has justified a move away from the extreme peaker model. The analyses are interesting and by no means a criticism of ROAM's work but rather a question whether it is fit-for-purpose.

The idea of an energy only market at the margins, Alinta Energy understands, is to ensure investment in peaking plant can achieve a return on investment, albeit with a CPT in place, in the market within a reasonable timeframe. Notwithstanding this, market prices have by most analyses only once breached the long-run marginal cost of open-cycle gas turbines over a year. That alone suggests there is a tendency to avoid the pricing of scarcity as peaks are capped by the MPC and curtailed by the CPT.

Analysis which fails to properly value the scarcity of energy at times of extreme demand, when an extreme peaker would be required, or of low supply, have failed to deliver the Reliability Panel with the level of analysis it requires to answer the questions at hand.

In practical terms, and while Alinta Energy could not envisage the MPC being reduced, the type of market that would be in existence under the range of lower MPC's illustrated by ROAM would not sustainably be the NEM as it exists.

Interestingly, the case presented of an extreme peaker with both higher and lower capital costs illustrates the type of analysis the Reliability Panel should be considering. Under this modelling almost all forward years require a higher, and sometimes much higher, MPC in order to ensure the investors revenue stream can cover capital costs.

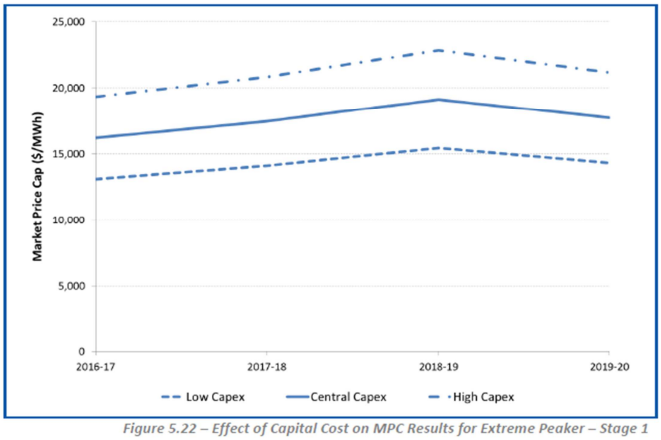

Figure 5.22 – Effect of Capital Cost on MPC Results for Extreme Peaker – Stage 1

This arrangement provides for a linear relationship between capital costs and the MPC. This is a logical outcome, even if less conceptually elegant, and is consistent with the previous recommendation to link the MPC with the Producer Price Index which was converted to the Consumer Price Index by the AEMC and has driven yearly MPC increases.

Alinta Energy appreciates that ROAM draft report is an input only; however, it suggests that additional modelling inputs may be required for the Reliability Panel to undertake a fulsome analysis. The Reliability Panel should be minded to consider questions on the rational for retaining the MPC or whether the risk to the market of a higher MPC is unsustainable as opposed to pondering question of lower MPC which should never come to pass.

Alinta Energy looks forward to further engagement with the Reliability Panel and welcomes the ROAM draft report as a first input into the important Reliability standard and settings review.

Yours sincerely,

Jamie Lowe
Manager, Market Regulation