7 February 2014

Energy White Paper Taskforce
Department of Industry
GPO Box 1564
Canberra ACT 2601

Via email: EWP@industry.gov.au

Dear Secretariat,

Energy White Paper – Issues Paper

Alinta Energy welcomes the opportunity to make a submission in response to the *2014 Energy White Paper, Issues Paper* (the Issues Paper), released by the Department of Industry. Alinta Energy understands this submission to the Issues Paper will act to inform the development of the Energy White Paper (EWP).

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 a customer base of approximately 750,000 in Western Australia and across the National Electricity Market (NEM).

Whilst some aspects of the Issues Paper require further clarification, Alinta Energy welcomes the development of the EWP and suggests it will support market development and competition.

Policy Framework

Alinta Energy operates across the breadth of the NEM as well as the Western Australian energy market and as such is exposed to regulatory developments across all levels of government and is witness to various overlapping policy regulations which more often than not serve to act against the long-term interest of consumers.

It is Alinta Energy's view that the EWP should at a minimum:

- encourage the exploration and utilisation of Australia's natural resource endowment;
- support competitive markets that evolve to meet consumers' needs, free of undue regulatory intervention and distortion;
- resolve burdensome over-regulation and ongoing growth of regulatory bodies across all levels of government, in particularly in relation to project approvals;
- consider the consequences of consistent falling market demand and acknowledge that mandated demand response mechanisms and energy efficiency programs are not warranted in light of consumers' natural responses to rising prices;
- address the benefits of cost-reflective pricing, tariff reform and enabling metering upgrades in light of consumption patterns and network usage;
- consider the impacts of existing policies, such as the Renewable Energy Target, which act to change market and investment incentives;

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- consider the value of continuing to apply the energy efficiencies opportunities program, and any other peripheral schemes, to the energy sector;
- support active participation in energy financial markets to facilitate risk management through the use of a diverse range of financial products; and
- identify and assess the key reasons for the significant increases in the costs of delivered energy in recent years.

The EWP should support competitive markets that evolve to meet consumers' energy needs free of undue intervention and burdensome regulation. Such an approach will serve the market well in promoting market entry and exit and will maximise welfare, as demonstrated internationally and domestically.

A further EWP area of priority is the need to resolve the burdensome over-regulation and growth of regulatory bodies across all levels of government. The existence of large and sometimes duplicated bodies, directly acts to raise the cost of energy in Australia, which is inevitably passed on to consumers through higher prices. As documented below, the growth in size and scope of regulatory bodies has consistently outstripped economic growth, for little benefit to consumers.

It is important that the Government consider the strength of any new policy objectives proposed in the final EWP in the context of a market already crowded with regulations and regulatory bodies. Likewise, where state and federal policy overlaps there is a need for complementary measures.

Notably, since the commencement of the 2012 Energy White Paper process, the market has experienced consistent falling demand due to a variety of factors. The consequences of falling market demand should be a central consideration for the EWP, as it has wide ranging implications for tariff reform, market sustainability, and incentives for future investment.

The EWP should support the role of NEM financial markets in promoting market entry and delivery of cost-effective risk management solutions. Regulatory incursions into these markets could have significant and negative implications for participants and consumers.

Finally, the EWP needs to consider the imbalance between claimte and energy policies and give appropriate weighting to existing policies which have directly contributed to the current oversupply of capacity. The Renewable Energy Target (RET) and similar polices outlined below, have exacerbated the oversupply of capacity and increased retail power prices for consumers. The EWP should acknowledge that, such policies only act to distort and undermine investment in sunken assets whilst doing little to address the essential management of demand peaks.

In closing, it is important to note that the EWP is being framed in light of potential policy reform including: a review of RET; the repeal of the carbon pricing mechanism; and the introduction of an Emissions Reduction Fund.

Alinta Energy will continue to work with regulators and the Government to ensure a smooth transition through these significant reforms and where appropriate the implications of these policies will be clearly outlined within this submission.

Security of Energy Supply

<u>Gas Supply Issues</u>

With the establishment of LNG export facilities, Australia has a unique opportunity to exploit natural gas reserves and access foreign markets. Australia will undoubtedly benefit from export market development, although there is some genuine concern surrounding possible rapidly rising domestic gas prices.

Alinta Energy notes that whilst domestic gas price rises have been well-publicised, they are a natural consequence of Australia integrating into global energy markets. Alinta Energy remains concerned over the possibility of reactive policy making, such as gas reservation, in response to concerns from major gas users.

It is important to note that there are no significant identified gas market failures. Alinta Energy notes that resource markets face constantly changing dynamics and as such, Governments should be wary of intervention on behalf of businesses that make poor commercial decisions.

It is reassuring to see the Government's commitment to avoiding market intervention through prescriptive regulatory mechanisms such as domestic gas reservation policies and national interest tests. Interventionist policies (especially if applied retrospectively) only act to distort investment signals and discourage future investment decisions.

To the extent that the Government is concerned that rising gas prices will impact on certain sectors of industry, Alinta Energy would encourage the Government to provide assistance directly to those industries affected, where justified, rather than impose constraints on the broader market.

These concerns aside, Alinta Energy suggests there are several minor adjustments the EWP could consider to promote gas market development including:

- addressing impediments to the development of untapped coal seam gas reserves;
- reviewing arrangements surrounding the duplication of approvals which impact the cost of developing gas resources;
- encouraging greater price transparency;
- eliminating barriers to pipeline access including minimum haulage arrangements; and
- greater facilitation of capacity trading.

Many of the issues have been raised in the Eastern Australian Domestic Gas Market Study and may also be relevant to the EWP process.

<u>Electricity Network Reliability Standards</u>

Transmission and reliability standards currently remain an area of jurisdictional responsibility and current assessment methods differ between jurisdictions, making reform challenging.

In broad terms, Alinta Energy supports a national framework for distribution and transmission reliability targets and standards, such an arrangement will increase efficient investment and joint planning between transmission and distribution networks.

From Alinta Energy's perspective, some existing jurisdictions mandate reliability standards for network infrastructure which appear to be based on a high level of redundancy and exact duplication on certain parts of the network, potentially resulting in a low average level of network asset utilisation. Whilst such arrangements may help provide a high level of reliability, it is occurs at a material cost which is ultimately passed through the supply chain to end use consumers.

In general, Alinta Energy is supportive of jurisdictions moving away from prescriptive definitive transmission reliability standards towards a more realistic customer impact based standard as has effectively been used in Victoria. A logical first step in this regard is placing an accurate financial value on a customer's willingness to avoid a potential loss of supply event.

AEMO has recently been developing an updated Value of Customer Reliability (VCR) with the intention of encompassing nationwide customer reliability preferences. The VCR is a useful tool for assessing customer preferences when setting reliability targets.

It is important to note that transmission investment is paid for by network users providing network businesses (mostly state owned) with guaranteed financial returns, irrespective of the actual utilisation of the assets by the consumers. In direct contrast, new generation investment is funded by private enterprises that only recover their investment when their service is being used. In this context, the suggested alignment of VCR and NEM price settings is worthy of further consideration as are network investment incentives more generally.

Other Network Issues - Firm Access Arrangements

To underwrite a generation investment requires: (a) access to a quality fuel source; (b) a market for consumption of produced electricity; and (c) ability to deliver the converted energy to the market. A lack of certainty around the ability of generators to deliver energy through market, due to dispatch uncertainty, undermines existing businesses. A failure to achieve dispatch exposes a generator contract for difference payments and revenue uncertainty. This leads to a scenario where a physical asset may not be used to its full potential and acts to limit contracts offered in the market and attaches additional risk to future investments.

These issues have been assessed at great length by the Australian Energy Market Commission through the Transmission Framework Review yet largely remain unresolved. Optional firm access, or a similar scheme, will resolve dispatch uncertainty by providing firm access to the regional reference node, reducing risk exposure whilst ensuring a new generator has the ability to recover the fixed costs of investing in a long life generation asset where they are price competitive in the energy-only market.

Alinta Energy is supportive of the progression of the optional firm access reforms whilst existing access arrangements are grandfathered out. Alinta Energy would encourage the EWP to consider how firm access arrangements could be progressed and implemented in the immediate future.

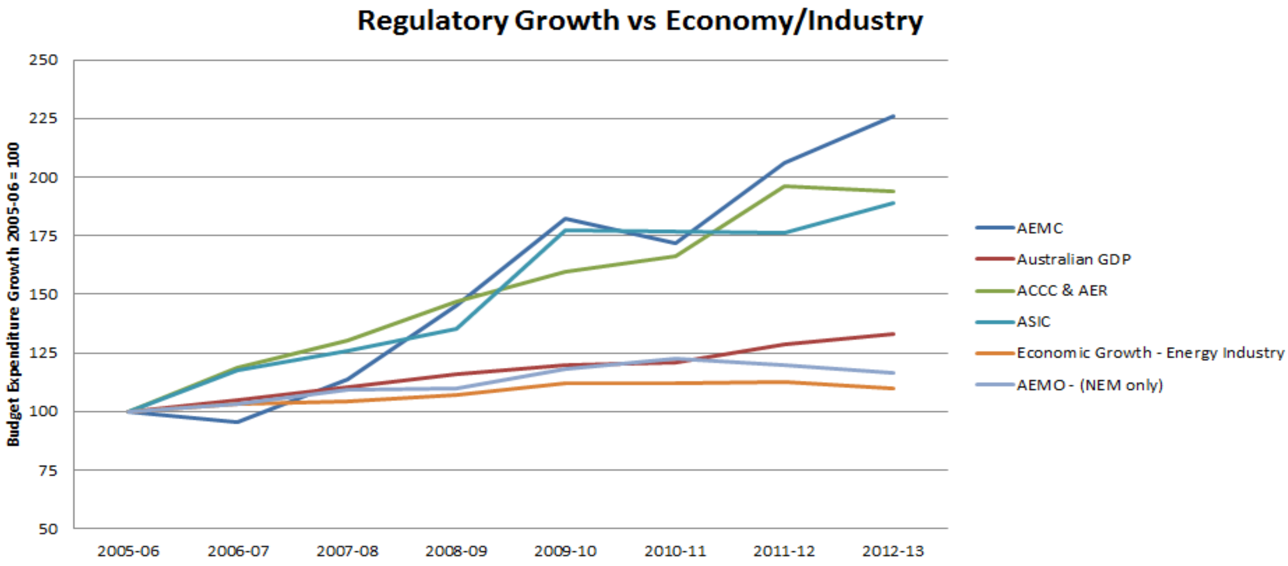
Regulatory Reform, Role of Government, Growth and Investment

Regulatory Best Practise and Efficiency

Alinta Energy notes the issue paper's commitment to developing a strong analytical base, which delivers a wide range of valuable information to policy makers, advisors and industry.

Such an analytical base would positively contrast with recent policy developments that seemingly have a preference for the creation of new regulatory bodies and compliance programs in the absence of proven failures. Such developments directly lead to higher retail costs for consumers, as businesses seek to recover their growing regulatory costs.

As demonstrated below, regulator revenue growth has significantly outpaced economic growth of the energy industry and Australia's gross domestic product for a substantial period of time and shows no sign of abatement. Interestingly, AEMO, whose ownership structure is 40 per cent industry held, parallels economic growth, suggesting industry ownership keeps costs down.



Alinta Energy analysis based on publicly released regulator budget reports. Data is accurate as of 30/1/14.

In addition to the sizeable revenue and staffing growth of existing regulatory bodies, in recent times several additional regulatory bodies have been created as part of the Clean Energy Future cohort of legislation. Two such bodies include the Energy Security Council and the Climate Change Authority. The move to disband these agencies is supported by Alinta Energy as a logical first step.

<u>Role of Government</u>

From Alinta Energy's perspective governments have a specific role in ensuring conditions which promote competition and an efficient market. The existence of price monitoring bodies during a transition to full retail competition is a good example of value adding regulation services.

Nonetheless, Alinta Energy considers several irregularities exist which currently distort market outcomes, primarily arising from the conflicted role of government in the energy sector. For example, in some state jurisdictions, government continues to have multiple roles including asset owner, merchant business, regulator and planner.

Given the existence of multiple government roles, Alinta Energy urges the EWP to consider these conflicts. The market would be better served if governments consolidated their role to focus on oversight arrangements, rather than direct market participation.

Future energy market reform aimed at advancing customer interests cannot be assessed in isolation of the issue of government owned assets and price regulation. In South Australia and Victoria privatisation of government owned generation and network assets as well as retail price deregulation and monitoring have delivered significant competition and financial benefits to consumers.

More broadly, global experience suggests that privatised energy markets produce competitively priced, reliable electricity and are the most efficient way of guaranteeing energy market sustainability. Alinta Energy has previously considered entering regulated markets such as Queensland and Tasmania; however, industry structure remains a well identified barrier to entry.

Alinta Energy considers that in order to ensure effective and sustained downward pressure on electricity prices the EWP should consider the issue of full electricity privatisation and set out a framework to achieve this goal.

Transparency and Forecasts

Alinta Energy uses existing publications, modelling assumptions and data sets such as those produced by AEMO and the Bureau of Resources and Energy economics. Such publications and forecasts assist individual businesses' operating strategies in the market and improve transparency; as such, Alinta Energy appreciates attempts at improving these resources notably by the aforementioned entities.

Alinta Energy suggests several minor changes could improve transparency and forecasting arrangements in energy markets including:

- install key performance indicators for estimations which are then reported on a regular basis by the relevant government body;
- increasing engagement with Transmission Network Service Providers to better align forecasts;
- integrate local issues and demand trends into the modelling process;
- enhance gas load forecasting models (over the many different time horizons);
- improving links between connection points and regional forecasts; and
- Improve access to regional specific energy trends and demand.

The incorporation these changes could additionally add to the value of government publications and improve market transparency.

Price Deregulation and Monitoring

Price deregulation and monitoring is a pre-cursor to competition. Victoria and South Australia have demonstrated that retail price monitoring is effective and drives competition in the market place. Market based pricing and deregulation allows competition to flourish.

Whilst primarily a state issue, the continuance of regulated price setting, particularly where prices are not set at cost reflective levels will continue to stifle competition. This issue is exacerbated in light of falling market demand.

In this regard, Alinta Energy is supportive of the issues paper exploring the value of Government incentives to encourage states to deregulate and introduce full retail competition across the NEM. Additionally, Alinta Energy recognises the potential for additional customer protections where real concerns are identified; however, would point out that jurisdictional divergences add costs and decrease opportunities for efficiencies.

Emission Reduction Fund

The recently proposed Emission Reduction Fund (ERF) has the potential to be the most effective method of capturing domestic abatement opportunities at lowest cost in Australia.

Alinta Energy understands it is the Government's intention that the ERF will displace the previous carbon pricing mechanism as the primarily tool to meet Australia's abatement objectives. As such, the development of the ERF calls into question the need for state based duplicative schemes.

Currently several state based emission reductions schemes exist, including the New South Wales Energy Savings Certificate scheme and the Victorian Energy Efficiency Target. The benefits of eliminating these schemes are immediately apparent and desired by the majority of energy market participants.

These reforms will provide a clear benefit to participants seeking to participate in the ERF through reduced regulatory burden and compliance activities and should act to maximise the pool of participants seeking to compete for emissions abatement opportunities. Additionally, this will reduce reporting costs and administrative duties at the government level.

Importantly this reform would ensure the prevention of any possible “double dipping” from participant’s hoping to participate in both national and state schemes. This reform would be a practical way of ensuring the scheme’s integrity, whilst delivering lowest cost abatement. Alinta Energy suggests the EWP outline practical strategies to wind down duplicative abatement schemes in preparation for the development of the ERF.

Streamlining Government Approvals

Participating in regulatory approval processes across all levels of government is becoming an overly burdensome compliance cost on participants. In many cases, similar or exactly the same information regarding specific projects is being provided to government bodies several times over (often in different formats). This is an unnecessary cost for both businesses and governments and only acts to delay or stop investment opportunities.

Driving Energy Productivity

The Issues Paper explores the possibility of expanding demand side participation and demand response management options within energy markets. This issue has been extensively explored with no evidence of market failure.

In the absence of intervention competitive markets are shown to evolve to capture innovation as retailers provide the products and benefits most valued by consumers. Over time, competitive markets will uncover the value of energy efficiency, if such a value exists.

Whilst establishing a demand management and energy efficiency strategy is a well-intentioned policy development, the theoretical benefits of further incentives for demand management are difficult to quantify, whereas compliance and regulatory costs in developing demand management strategies are real and significant. In short, despite a policy fixation on this topic over the past decade, there has been a failure to demonstrate that the benefits of intervention to encourage demand management outweigh the costs.

Alinta Energy suggests that energy efficiency and demand side response mechanisms do not require further detailed consideration. The current market design incentivises demand management through existing price signals. It should be clearly noted that on the back of price rises and existing efficiency measures energy demand has consistently fallen and shows no sign of reversing. This shows the market is functioning and there is no need for intervention.

Several demand management products are currently in existence with many businesses and consumers taking advantage of these. Where there are significant benefits available from such arrangements, the competitive market will seek to identify and capture such benefits. There is no evidence that further government mandated demand management products are needed at this time or would produce a better outcome that those already available to the market.

An alternative approach in this area would be to remove existing regulatory barriers that prevent customers from engaging with the market through diverse products and contractual arrangements. Alinta Energy has long held the view that consumers themselves are best placed to make choices that best suit their needs free of any government direction.

To summarise, demand response mechanisms and efficiency programs present an uncertain business case at best, and should not proceed absent a comprehensive and independent cost benefit analysis given that policy bodies and reviews in this area continually underestimate the value consumers place on the option to consumer in the manner which best meets their needs.

Declining Market Demand

Notably, since the commencement of the 2012 Energy White Paper process, the market has experienced consistent falling market demand due to a variety of factors. Falling market demand has wide ranging implications for tariff reform, market sustainability and incentives for future investment. Whilst some short term benefits may accrue to consumers through lower wholesale prices, these are unlikely to last as the market consolidates and participants exit.

The consequences of falling market demand should be assessed in conjunction with the policies such as the RET. Generation capacity being legislatively forced into the market only acts to exacerbate market conditions which penalise existing generators and jeopardise market sustainability. Considering the implications of falling market demand should become a primary concern for the EWP.

Energy Efficiencies Opportunities Program

The Issues Paper states the following about energy efficiency regulation:

> "*The challenge is how to best facilitate industrial energy efficiency outcomes in a manner consistent with the needs of business, and in a manner that minimises unnecessary regulatory, reporting and compliance obligations. Government effort may be best directed at those businesses that still need assistance in identifying ways to reduce energy costs*."

Alinta Energy considers that the electricity generation sector does not require regulation targeted at identifying ways to reduce energy consumption and costs, because converting fuel energy into electricity is the core business for thermal power stations. As a result, high energy input costs and drivers from the emission reduction programs should provide a significant incentive for these facilities to improve their energy efficiency that is far greater than any mandated federal government energy efficiency program.

Alinta Energy recommends that the energy efficiencies opportunities program be discarded from 30 June 2014 (after which Alinta Energy understands there are no funds currently allocated in the budget to administer the program). Should the government revisit the issue of energy efficiency in the future then polices should only be considered where there is demonstrated market failure, which is unlikely to be the case for commercial businesses.

Alternate and Emerging Energy sources and Technology

Participants operating in the NEM are protected by the principle of technology neutrality through Clause 3.1.4 of the National Electricity Rules which states "*avoidance of any special treatment in respect of different technologies used by market participants*".

Nonetheless, recent renewable energy and climate change policies across all levels of government have directly challenged this cornerstone principle, penalising investors in long lived generation assets.

This market intervention is distorting outcomes for participants and contributing to higher retail energy costs for consumers. Given Australia's energy markets are oversupplied with generation capacity, Alinta Energy would welcome a review of existing policy mechanisms, federal and state, that act to pick technology winners and as well as methods of managing the oversupply of capacity that has resulted.

Such distortions should be addressed in the EWP to ensure Australia's energy market remains sustainable, underpins investments and allows the market to function in the manner in which it was designed.

Whilst arguments exist to retain interventionist policies which support the entry of renewable generation and promote "investor certainty", in Alinta Energy's view, it is conflicted to suggest that certainty is needed to financially support renewable generation investment that has not, and need not occur.

Notably, the retention of the RET will lead to increased costs for consumers as the existing bank of renewable energy certificates are used. Whereas the removal of the RET will have little impact on the builders of existing assets but will mostly impact the companies that underwrite power purchase agreements, being existing energy retailers.

Energy market participants have suffered loss of asset value as a consequence of policies such as the RET and the carbon pricing mechanism. In the context of falling demand, generation overcapacity and rising retail energy costs the EWP must address these policy anomalies and the level of assistance provided to select technologies which only act to undermine the long term viability and pool of investment capital available to the energy market.

Going forward, Alinta Energy suggests at a minimum climate policies at the federal level should be subject to a cost benefit analysis which demonstrates consumers will not be adversely affected by policies which may impose material costs for no discernible benefit.

Emission Abatement Programs

Alinta Energy notes the desire from market participants for a smooth transition from the carbon tax to the ERF. The following high level principles are endorsed by Alinta Energy:

- the role of duplicative abatement schemes should be assessed;
- a commitment to domestic abatement from the outset of the program will allow the ERF to be tailored appropriately;
- multiple measurement approaches to increase flexibility and lowest cost abatement should be considered;
- secondary trading is possible without the need for a corresponding penalty regime;
- baselines should be set in accordance with industry consultation;
- contractual certainty should be established over the life of the project; and
- past policies have placed a heavy burden on reductions from energy businesses, the ERF should move away from the expectation that limitless low cost abatement is available in the energy sector.

These principles require detailed consideration through the ERF consultation process and the EWP in the context of the role of wider market developments such as falling market demand.

Conclusion

Alinta Energy believes the issues paper provides a strong platform for policy development and investment in Australian energy. As explored in our discussion above, the EWP should focus on the following key areas:

- encourage the exploration and utilisation of Australia's natural resource endowment;
- support competitive markets that evolve to meet consumers' needs, free of undue regulatory intervention and distortion;
- resolve burdensome over-regulation and ongoing growth of regulatory bodies across all levels of government, in particularly in relation to project approvals;
- consider the consequences of consistent falling market demand and acknowledge that mandated demand response mechanisms and energy efficiency programs are not warranted in light of consumers' natural responses to rising prices;

- address the benefits of cost-reflective pricing, tariff reform and enabling metering upgrades in light of consumption patterns and network usage;
- consider the impacts of existing policies, such as the Renewable Energy Target, which act to change market and investment incentives;
- consider the value of continuing to apply the energy efficiencies opportunities program, and any other peripheral schemes, to the energy sector;
- support active participation in energy financial markets to facilitate risk management through the use of a diverse range of financial products; and
- identify and assess the key reasons for the significant increases in the costs of delivered energy in recent years.

These principles provide a foundation for a EWP framework which supports investor certainty and provides a clear identification of energy cost drivers. Whilst some outstanding issues remain, Alinta Energy believes they have been well identified and the Government is well equipped to address these matters.

Alinta Energy looks forward to participating in the ongoing Energy White Paper process.

Should you have any queries in relation to this submission, please do not hesitate to contact me on, telephone, 02 9372 2633, or Mr Anders Sangkuhl on, telephone, 02 9375 0962.

Yours sincerely,

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