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Mr John Pierce
Chairman, Electricity Supply Industry Expert Panel
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Dear Mr Pierce

On behalf of Rio Tinto Alcan Bell Bay, thank you for the opportunity to comment on your Issues Paper on the Independent Review of the Tasmanian Electricity Sector.

Please find attached our responses to questions posed in the Issues Paper. We have responded to those questions we consider relevant to our business and where we believe we are well placed to respond.

We would be happy to discuss any aspect of our responses and look forward to the opportunity to comment on the Panel's recommendations from this important review.

Yours sincerely



Ray Mostogl
General manager, Operations

**We are Rio Tinto Alcan,
and our future is here.**



Rio Tinto Alcan Bell Bay responses to the Tasmania Expert Panel Issues Paper

1. Retail Sector

1. *For contestable customers, how has the move to contestability impacted on electricity purchasing decisions, for example:*
 - a. *Changes in pricing levels, and how each part of the supply change is*
 - b. *Contributing to those changes.*
 - c. *Pricing predictability.*
 - d. *Contract duration.*
 - e. *Spot market exposures.*

Rio Tinto Alcan Bell Bay has always had a negotiated contract for electricity and so was not impacted by contestability per se.

2. *What have been the implications of these changes for business decisions?*
3. *The importance of diversity in managing wholesale energy risk and the extent to which it drives competitive behaviour in the retail sector.*

Wholesale price risk is a function of any market and is enhanced in the National Electricity Market (NEM) by a market design (supported by the physical characteristics of electricity) that does not allow direct supply contracts between suppliers and customers. Our observation is that, to overcome this risk, energy companies have gravitated back towards vertical integration and concentration. We believe standalone retailers and generators have found it difficult to manage volatile pool price risk through financial transactions as successfully as through vertical integration, and businesses cannot afford to retain risks that the market will not reward them for bearing. Therefore, while economic theory would suggest pool price risk should be manageable through either companies hedging from a variety of diverse sources or shareholders diversifying their shareholdings, this does not appear to have proved practical in the NEM generally and is likely to be an even greater challenge in the small electricity marketplace of Tasmania.

4. *The ability of a retailer to contract with parties that have generation located in other NEM regions.*

Our experience is that, throughout the NEM, generators have a preference for hedge contracts referencing the NEM price in their own region, to avoid inter-regional basis risk. If such contracts cannot be sourced, generators have the choice to take pool exposure; that is, they do not need to have contracts in order to earn revenue. Therefore, the incentives for generators to contract inter-regionally are not high for the NEM generally. The size and structure of the Tasmanian electricity industry does not provide any improved incentive and indeed the converse is more likely.

5. *The effectiveness of retail participation and competition for larger commercial and industrial customers (Tranche 1 and 2) – what level of competition exists between the 5 licensed retailers and how has it changed since contestability has been introduced?*

From the perspective of our business, we consider that the benefit retail competition could bring

would be to compete down the cost of providing retailer-specific services (eg. customer service, billing, interfacing with the Australian Electricity Market Operator (AEMO)). As a major industrial customer, the majority of our costs relate to electricity and networks. Therefore, we do not see our business being materially impacted by the level of retail competition.

6. *The effectiveness of retail competition for smaller commercial, industrial and business customers with the two existing active retailers – have contestable customers observed strong competition on a consistent basis?*
7. *The potential barriers to effective retail competition in Tasmania, including:*
 - a. *The attractiveness of the retail market, particularly size and nature. When considering FRC, does the fact that over one-third of residences are concession customer impact on the attractiveness of entry?*
 - b. *The extent to which Aurora Energy, as the incumbent retailer, has superior market information on eligible customers as contestability rolls out?*
 - c. *The impact of the recent vertical integration of Aurora Energy as a ‘gentailer’ – has this had an impact on the perceptions of its competitive position in Tasmania?*
 - d. *The extent to which the commercial structure of Aurora Energy as an integrated retail and distribution entity is a material barrier to new entry, such as through access to information from its distribution business or its ability to absorb thinner retail margins supported by the cash generated by its distribution business.*
 - e. *Do all retailers face similar risks or does size pose a greater degree of transparency in the wholesale market?*
 - f. *Is there a difference in the cost to serve Tasmanian customers in relation to customers in other NEM jurisdictions?*
 - g. *What is the relative importance of wholesale market issues compared with other barriers to entry?*
8. *In what ways has the regulatory framework delivered retail costs that are higher than would be delivered by a fully competitive retail market in Tasmania?*
9. *The experience of contestable customers during the roll-out of retail contestability and outcomes of alternate retail options. What changes have customers observed?*
10. *What customer outcomes have influenced contestable customers switching retailers?*
11. *The experience of contestable customers during the roll out of retail contestability and outcomes of alternate retail options. What changes have customers observed?*
12. *What customer outcomes have influenced contestable customers switching retailers?*
13. *Stakeholders’ views on the proposition that weighting that should be placed on potential value implications on Aurora Energy’s retail business from the introduction of FRC, rather than on outcomes for customers.*

Whatever policy decisions the Tasmanian Government makes with respect to Aurora Energy’s retail business, Government should ensure that it does not impose additional costs on the electricity consumers or taxpayers of Tasmania.

14. *How can the ability of customers to participate in the market be improved through the way information is provided?*

Rio Tinto Alcan Bell Bay does not perceive any shortage of relevant information or a role for the Tasmanian Government to provide our business with additional market information. We recognise that other customers with less experience in the NEM may have different needs.

15. Whether it is the role of the Government or the market to provide information for customers to make informed electricity purchasing decisions?

Consumers who perceive a need for more information are better placed to advise the Government on its role in providing the information. The cost of any such policy should be borne by its beneficiaries.

16. What forms of improved customer-related information could increase the overall effectiveness of retail contestability (e.g. Understanding of network prices, the ability to compare offers)?

2. Pricing

- 1. Whether it is the principle of a fixed daily charge or its level that is the major issue.*
- 2. The impact of the current tariff structure on demand management, energy efficiency and affordability.*
- 3. What examples of cross-subsidies do stakeholders think exist in the market and how do they arise?*

Rio Tinto Alcan Bell Bay does not believe there are any cross-subsidies in its purchase of electricity to the smelter.

3. Wholesale

1. What does the history of spot market prices demonstrate about the effectiveness of competition in the Tasmanian spot market?

Rio Tinto Alcan Bell Bay supports the Expert Panel investigating this question through rigorous analysis of market data.

2. What aspects of the Tasmanian market architecture and/or underlying features create sustained and transparent competitive influences in the wholesale market?

Relative to the rest of the NEM, we are not able to identify any features of the Tasmanian wholesale market architecture that create more sustained and transparent competitive influences. Given the highly concentrated nature of the Tasmanian market, we would suggest that transparency of Tasmanian spot prices relative to prices in the rest of the NEM may create a threat of regulatory intervention if Tasmanian prices are sustainably higher and the risk of customers leaving Tasmania (whether moving or closing) creates another pressure on Tasmanian suppliers to price competitively.

3. Are there material barriers to entry arising from the wholesale sector architecture of the Tasmanian generation sector?

Rio Tinto Alcan Bell Bay observes that no private sector generators have successfully entered the Tasmanian market and considers that the views of potential entrants would be valuable to this review.

4. *When contract levels are high, i.e. a large proportion of the total load is subject to wholesale contracts, what is the material impact of a high-priced event in the spot market?*

Any consumer or retailer that was uncontracted would be exposed to the high pool price. The extent of their exposure and their ability to respond would determine the materiality of the impact. Because maximum pool prices are extremely high relative to normal levels and because responding to individual half hourly prices is difficult for a party that is not a constantly active participant in the market (like generators and retailers are), there is potential for a material financial impact on anyone who has significant pool exposure.

5. *Does Hydro Tasmania have the capacity to raise or lower spot prices based on its knowledge of the contract positions of its counter-parties and is there evidence that such a capacity has been exercised?*
6. *How transparent is the underlying position of wholesale market participants in Tasmania, and does this pose a material barrier to entry in either generation or retailing?*

Rio Tinto Alcan Bell Bay is not in a position to comment as we have no information about contracts in the Tasmanian electricity market other than our own.

7. *How contestable, efficient and effective is the market for wholesale contracts in Tasmania?*

We have no evidence that there is a liquid market for wholesale contracts in Tasmania. Other regions of the NEM have futures contracts traded on the Australian Stock Exchange (ASX) and there are active brokers who are able to publish forward curves. Even in those regions, the number of trade occurring each day is relatively small and the market is not deep.

8. *How are wholesale contract prices, and other terms and conditions, struck?*

Rio Tinto Alcan agrees terms and conditions including pricing and other relevant commercial terms through a standard process of commercial negotiation with the relevant counter-parties.

9. *What is the relative negotiating position of the parties and do contract terms broadly reflect contract terms, such as premiums relative to the spot market, available in other NEM regions?*

Rio Tinto Alcan's contract terms reflect the outcome of standard commercial negotiations. As smelter contracts tailored to the characteristics of the load, we cannot compare them to standard contracts available in other NEM regions.

10. *What is nature and extent of differences in wholesale contract in Tasmania, and what drives those differences?*
11. *Does a high level of contract cover represent an optimal risk management position for market participants, and what is the impact of higher insurance levels on end customer prices, noting that insurance is not costless?*

Rio Tinto Alcan Bell Bay does not consider that there should be any reason for customers (or

retailers) to be uncontracted in a market where supply must always equal demand.

12. The validity and usefulness of a new entrant LRMC pricing indicator as a measure of the effectiveness of the wholesale energy market in Tasmania.

The LRMC of new entrant supply is only one measure of the marginal cost of supply, and lacks credibility in a region that does not require new investment for many years. Another approach is to consider the marginal value of the last MW supplied, rather than the next MW that would have been supplied if demand were there. This could be considered as the price that would cause a customer to reduce demand.

13. How have the application of the NEM rules in Tasmanian created value opportunities? For example:

- a. In shaping the bid stack – where along the supply curve is competition strongest and weakest?*
- b. How can non-scheduled generation materially shift supply and demand balance and therefore move prices?*

Rio Tinto Alcan Bell Bay supports the Expert Panel investigating this question through rigorous market analysis of the data.

14. Are there other aspects of the ‘standard’ NEM model that appear inconsistent with the underlying market architecture in the Tasmanian region and evidence to support this view?

A market with very few sellers is not conducive to producing the highly competitive electricity market contemplated by the NEM. However, Rio Tinto Alcan Bell Bay considers that a key question for the Expert Panel to consider is whether Tasmania has the market size for a fully functioning competitive market in electricity? Before recommending any restructuring of the industry in Tasmania, Rio Tinto Alcan Bell Bay strongly suggests the Expert Panel should investigate what evidence there is that such a small population can develop a competitive electricity market. Any proposed restructuring should be designed to bring tangible benefits to customers and should not be costly and complicated to implement.

15. Is there a need for something to support the standard NEM arrangements to deal with specific Tasmanian circumstances?

It is important for Government to maintain keen regulatory oversight, particularly in markets where competition is limited to a few.

16. Is there any evidence of latent market power in the Tasmanian wholesale market, and what are its consequences?

Any market that has only a few sellers, particularly one where one seller has a significant share of the market, will create a perception of dominance that may influence the market behaviour of others. The consequences of latent market power are difficult to determine, as it is not possible to observe how behaviour would differ in different circumstances.

17. Stakeholder views on whether latent market power may be exercised at some point in the future.

In any market where there is competition amongst a few, there is the potential for market power to be exercised, which emphasises the importance of effective regulatory oversight and governance in

such a market if increasing the level of competition is not practical.

4. Wholesale Pricing for Non-Contestable Customers

1. *How prescriptive should the regulatory arrangements for determining prices be?*
2. *What is the appropriate role of Government in establishing the framework for the regulator, given its multiple interests in the sector?*
3. *The use and application of the existing form of LRMC methodology in determining the wholesale energy allowance for non-contestable customers.*
4. *How efficient and effective are the current regulatory arrangements in determining efficient energy price outcomes for non-contestable customers?*
5. *What alternative arrangements for setting the energy supply cost allowance might be more appropriate than those currently specified in the current Price Control Regulations?*

While non-contestable customers are better placed to respond to these questions in detail, Rio Tinto Alcan Bell Bay's comment is that the pricing arrangements for non-contestable customers should not distort the competitive sector of the electricity market.

5. Network Issues

1. *The experiences of customers regarding the efficiency and effectiveness of Tasmania's network businesses in the delivery of capital programs.*

Rio Tinto Alcan Bell Bay believes it is important that there should be transparency about the efficiency and effectiveness of network investment, given the regulated monopoly nature of this business. We would welcome disclosure of the findings of the operational efficiency effectiveness review.

2. *What can be done to reduce network costs to customers while maintaining appropriate reliability and safety standards?*

It is important to ensure that regulated network businesses face the same incentives to improve performance as competitive businesses in the private sector. Failure to achieve this creates a transfer of value to the network companies at the expense of the competitiveness of other businesses and higher cost of living for households.

Rio Tinto is a member of the Network Rules Change Committee, formed under the governance of the EUAA by a group of leading Australian companies, who have grown increasingly concerned about the recent escalation of network prices. The Committee has funded work to develop Rule Change proposals to improve the effectiveness and fairness of network pricing. If successful, this work will be of benefit to all electricity consumers in the NEM.

Rio Tinto's participation in this Committee emphasises our genuine concern about the current regulatory framework for electricity networks. Rio Tinto Alcan Bell Bay would be pleased to facilitate providing the Expert Panel with further information about the work of the Committee.

3. *The extent to which the NEM arrangements and/or jurisdictional changes have required additional network investment and/or direct customer costs to increase?*

Rio Tinto Alcan Bell Bay understands that network companies have increased their revenue requests in recent determinations to fund additional investment, in part to replace aged assets and deal with

growth. Rio Tinto Alcan Bell Bay is of the view that revenue requirements could be lower, without the need to compromise system security.

4. *The consequences, including costs, for the transmission network arising from physical interconnection and how these costs are distributed to customers?*

The network businesses and Hydro Tasmania are best placed to provide the Expert Panel with detailed, accurate information about these costs.

5. *How are customers benefitting through the current NEM arrangements by comparison with previous arrangements?*

This is a very broad question. In general, Rio Tinto Alcan Bell Bay recognises that access to the Victorian market provides an opportunity to source power from Victoria to mitigate the impacts of drought. However, we are concerned about the extent to which electricity supply costs have risen under the NEM.

6. *When reliability standards are being proposed, how are pricing consequences considered?*

Security of supply is very important to an aluminium smelter as loss of supply can quickly result in metal “freezing” resulting in significant financial loss. Rio Tinto Alcan Bell Bay takes account of this in the management of our own operations as well as in our assessment of the cost of electricity supply.

7. *Do customers recognise changes in service quality have pricing implications and how could the link between prices and standards be made more transparent?*

Rio Tinto Alcan Bell Bay does not consider that the relationship between quality of supply and price is a simple one.

Rio Tinto Alcan Bell Bay operates in a highly competitive global market and is familiar with the cost pressures that such competition imposes. Our business is always seeking ways to improve our operations to increase supply or minimise the cost of production without compromising the quality of supply, which our customers would not tolerate.

Rio Tinto Alcan Bell Bay is concerned that regulated network businesses do not face this competitive pressure, which places more importance on effective regulatory oversight. We consider that network regulation could be improved through increased use of benchmarking to ensure that network companies have clear incentives to adopt best practices and continuously improve the efficiency and effectiveness of their operations.

8. *The affordability for Tasmanian customers of the improved reliability standards imposed by the ‘101 communities’ policy.*

6. Value Considerations of Major Investments

1. *The extent to which the anticipated benefits of Basslink to Tasmanian electricity customers are being delivered and the value placed on those benefits by customers.*

An undertaking was given to the ACCC by Basslink Pty Ltd which stated in summary, “Basslink will assist in meeting Tasmania’s growing demand for electricity and will help facilitate the State’s participation in the NEM, resulting in benefits both for Tasmanian and other NEM customers. In

particular, Basslink will enable the trading in electricity between Tasmania and other NEM jurisdictions, capturing the economic benefits of exchange between an energy constrained Tasmanian hydro power system and the mainly capacity constrained thermal power systems of other NEM jurisdictions.”

It is Rio Tinto Alcan Bell Bay’s view that Basslink has added to the supply of electricity into Tasmania and it has enabled Hydro Tasmania to capture benefits from trading across the NEM. We are not in a position to quantify what value this has provided to customers within the NEM.

2. If a primary role of the TVPS is hydrological risk management, how should the full costs of the TVPS should be funded over time?

Rio Tinto Alcan Bell Bay queries the basis of the assumption that TVPS has the primary role of “hydrological risk management”. The TVPS development was originally a private sector project. We understand Aurora contracted to take the output, but Aurora does not own any hydro generation and we have no knowledge of any exposure Aurora may otherwise have to hydrological risk, say through its contracts with Hydro Tasmania.

In the NEM, the way in which a power station is bid and the competitive dynamics of the spot and contract markets determine the revenue it earns, and no guarantee is provided that a power station investment will recover its full costs. Any alternative arrangements to provide additional revenue to the TVPS would be a departure from the NEM.

3. Stakeholder views on the trade off between the preservation of value of the TVPS asset and non-contestable customer prices.

This question presumes that the market will not provide an adequate return to the TVPS without Government intervention to provide a cross-subsidy from non-contestable customers. Rio Tinto Alcan Bell Bay suggests that first the case should be established that the Tasmanian electricity market has failed (not that the price paid for TVPS was too high) and Government intervention is necessary to provide a fair return to the TVPS.

4. In the event that a carbon pricing mechanism delivers significant increase in the value of Hydro Tasmania, how ought that additional value be utilised?

Once the carbon price has been introduced, it will be one of the many factors that now drive electricity prices in Tasmania and the NEM generally. It will not be possible to unambiguously separate out the price impact of carbon versus other factors, such as latent market power. Therefore, under a carbon pricing scheme, it will be even more important to ensure that the Tasmanian electricity market operates efficiently and effectively with the right level of regulatory oversight.

With respect to the value Hydro Tasmania expects to accrue from the introduction of a carbon price, Rio Tinto Alcan Bell Bay notes that the people and businesses of Tasmania have provided the funding for investment in Hydro Tasmania’s renewable assets over many decades, and it is the public ownership structure that allows the benefits of a carbon price to flow to the Tasmanian Government. Government needs to determine the policy for distributing that benefit, and Rio Tinto Alcan Bell Bay would welcome an approach that sees the benefits equitably shared amongst those that have funded the assets over the years.

7. Governance

1. *What could be done to improve transparency and accountability of decision making in the future, while recognising the need for appropriate protection of commercial interests?*
2. *What application of private sector continuous disclosure arrangements could be applied to the SOEBs, given community ownership of the businesses?*

Rio Tinto Alcan Bell Bay supports the suggestion of referencing the ASX continuous disclosure obligations as a benchmark for disclosure by the SOEBs.

3. *How stakeholders view the competing objectives commercial and broader Government policy objectives of SOEBs.*

Rio Tinto Alcan Bell Bay considers that there should be transparency about what are considered to be the “broader Government policy objectives of the SOEBs”. It is only with this explicit context that views can be formed about whether those objectives are consistent or competing with the commercial objectives of the businesses and, if they are found to be competing, form judgements about how they should be reconciled.

4. *How stakeholders view the impact of competing objectives on SOEB performance and electricity market outcomes.*

In a competitive market, competitive forces would drive efficient market outcomes that were consistent with the electricity businesses deriving an acceptable return.

A conflict between the objectives of SOEB performance and efficient market outcomes arises either as a result of inefficient investment decisions by individual businesses or a failure of the market. Before any solutions to the issue are contemplated, more consideration should be given to the causes of the issue, to give confidence that any solution will be effective.

5. *Comments on the Panel’s view that compromising efficient electricity sector outcomes to achieve financial outcomes for the SOEBs or the taxpayers would not be in the community’s best long-term interest.*

In principle, an efficient electricity sector should not be compromised by intervention to support an under-performing business. However, Rio Tinto Alcan Bell Bay notes that the form of this question presumes that the starting point is indeed an “efficient electricity sector”. Rio Tinto Alcan Bell Bay has noted in earlier responses that the Tasmanian market is small and there is competition amongst a few only. Therefore, a determination needs to be made on that point first, followed by an assessment of the underlying causes and potential remedies of any existing inefficiency.

6. *The role of Shareholder Ministers in driving business performance – both financial and operational.*
7. *The role of Shareholder Ministers in driving business efficiencies to improve electricity prices for Tasmanian customers.*
8. *How the Tasmanian community, as the ultimate owner of the SOEBs:*
 - a. *Views the additional risk associated with SOEBs expansion into non core activities and/or operations outside Tasmania.*
 - b. *Views the trade-off between capital growth and the SOEBs and the return of dividends.*

9. *The broad financial performance of the SOEB portfolio – does the community receive a reasonable return for its investment in the portfolio, and what could be done to improve it?*

Constraining SOEBs to operate within limited parameters not faced by the private sector may be seen as reducing their risk exposure, but it can introduce long-term risk by rendering them unable to adapt to changing market circumstances through the inability to develop, acquire and dispose of assets and businesses. On the other hand, non-traded businesses lack the share market feedback that disciplines their publicly listed counterparts.

The Tasmanian Government should consider the long-term objectives of the SOEBs. For instance, some State Government's have decided that their SOEBs are transitional organisations that will manage their existing assets until they are replaced by private sector investment, in which case the focus should be on optimising the operational performance of those businesses while fostering private investment. On the other hand, some overseas Governments view their ownership of businesses as strategic investments and encourage them to compete at all levels.