

Rio Tinto
GPO Box 153
Brisbane Queensland 4001
Australia

ACCC inquiry into retail electricity supply and pricing
Email submission to: retaillelectricityinquiry@accc.gov.au

30 June 2017

Dear Sir/Madam,

Re: ACCC inquiry into retail electricity supply and pricing

Rio Tinto welcomes the opportunity to make a submission to the Australian Competition and Consumer Commission (“ACCC”) on the *ACCC inquiry into retail electricity supply and pricing – Issues Paper* (“the Issues Paper”).

As an inherently energy-intensive business using significant quantities of electricity in its Australian operations, Rio Tinto seeks to produce minerals and metals in the most efficient way possible to both reduce its environmental impact and lower its operating costs.

The current challenges in the National Electricity Market (“NEM”) and the predicted future challenges are attributable to a range of issues including the nature and extent of competition in the wholesale electricity market. In line with the Terms of Reference and the request for feedback on the Issues Paper, Rio Tinto has confined its discussion in this submission to the operation of the wholesale market which it considers to be most relevant.

The NEM is not the competitive market it should be

In general, Rio Tinto believes free markets provide the best mechanism to respond to dynamic conditions that require the efficient allocation of resources. However markets can only deliver efficient solutions where they are competitive.

The extent to which the NEM is competitive varies by state¹. In general, the scale of generators’ portfolios in Australia means there is a significant concentration of market power with a small number of generators in several states (Figure 1). As a general rule, for markets to be effective where a supplier has the ability to exercise significant market power, there must be an effective regulatory framework that offers certainty of access and prevents excessive pricing and other predatory behaviour.

¹ A useful framework to define effective competition is set out in Section 18B of the National Electricity (South Australia) (Australian Energy Regulator—Wholesale Market Monitoring) Amendment Act 2016 which includes consideration of (a) whether there are active competitors in the market and whether those competitors hold a reasonably sustainable position in the market (or whether there is merely the threat of competition in the market); and (b) whether prices are determined on a long term basis by underlying costs rather than the existence of market power, even though a particular competitor may hold a substantial degree of market power from time to time; and (c) whether barriers to entry into the market are sufficiently low so that a substantial degree of market power may only be held by a particular competitor on a temporary basis; and (d) whether there is independent rivalry in all dimensions of the price, product or service offered in the market;

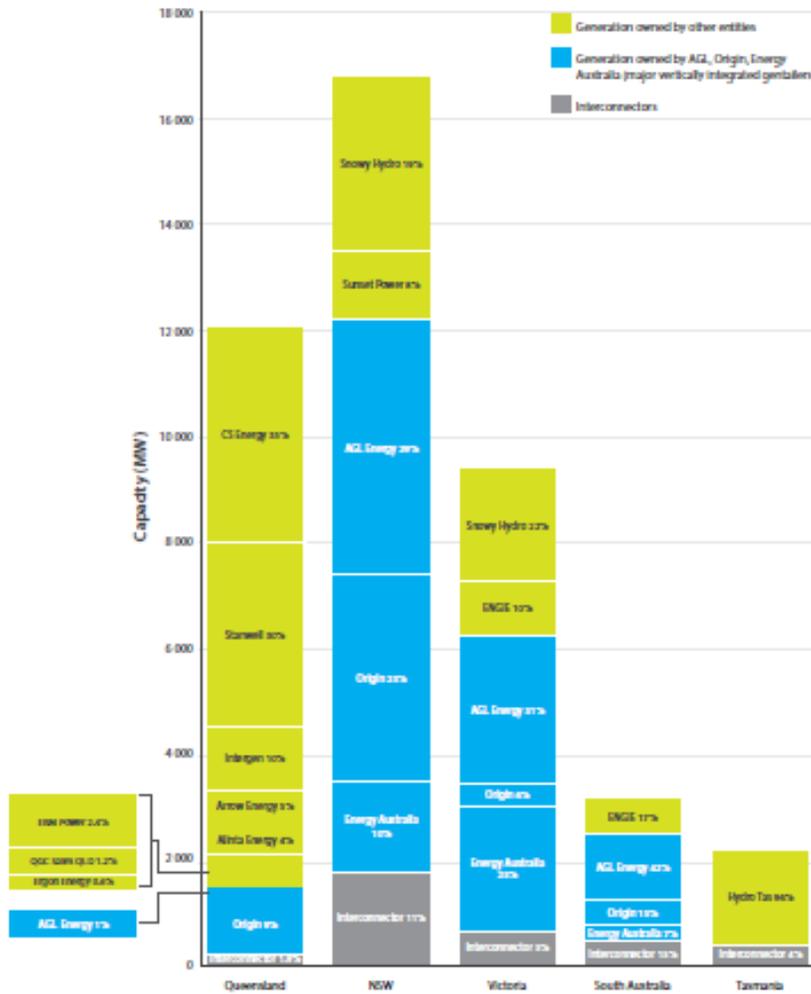


Figure 1 Generation Ownership by NEM Region 2017²

The current regulatory framework of the NEM appears unable to curb the clear exercises of market power which have become increasingly apparent with shifts in ownership, asset closure and in some cases, consolidation of generators whose behaviour is unconstrained by considerations of affordability of electricity. Generation companies are using their scale to engage in behaviours that seek to work to the boundaries and limits of the National Electricity Rules (“the Rules”) to maximise returns. As a result of changes over time, generation companies are now often in a position where they can make bidding choices that, in a more competitive market, would simply result in their generation not being dispatched. Rather, given the extent of generation under their control, these companies are able to propagate higher wholesale market prices and derive maximum advantage from additional volatility. This then has flow-through effects to the parallel contract market, allowing near-term high prices to set overall longer-term hedge contract prices and subsequent generation company portfolio gains. These higher prices are in many cases not acting as a price signal reflecting scarcity, but are instead reflecting the scale of the consolidated generation portfolios of individual companies.

² Sourced from Independent Review into the Future Security of the National Electricity Market (June 2017)p82

Generator exercise of market power has been identified in annual reports by AER over a number of years³. This exercise of a range of measures includes:

- (a) late rebidding for commercial gain,
- (b) changes in pricing and restrictive dispatch behaviour when interconnectors are constrained; and
- (c) in some cases the offering of very large amounts (>1500 MW) of coal-fired generation for extended periods at or near the market cap, effectively withholding low cost capacity, to drive up electricity prices,

all of which demonstrate the large concentration of market power in the hands of a small number of generators. Rio Tinto anticipates that specific examples of these practices are widely known and understood particularly by the Australian Energy Regulator (“AER”) and the Australian Energy Markets Commission (“AEMC”). Should the ACCC require further clarification on our comments, Rio Tinto would be happy to discuss these issues further with the ACCC.

A range of independent analysts and stakeholders has recently expressed concern about the behaviour of participants in the electricity market and their exercise of market power⁴. This behaviour has contributed materially to a sustained disconnect between short run marginal cost and typical pool prices over a number of years in some regions, as well as average wholesale spot prices and forward contract prices more than doubling in a number of States in the NEM in the last few years. This has left business consumers with the unenviable choice to either lock-in to uncompetitive contracts which weigh heavily on asset viability, or to remain exposed to the volatile wholesale spot market with the associated risk of exposure to high prices which may require shedding load and most seriously, urgent production curtailment and job losses.

Change is needed

It is fundamental that the operation of the NEM must be in the interests of consumers and that confidence in the operation of the market must be maintained in the context of this fundamental shift in market dynamics and concentration. Rio Tinto is open to a range of possible solutions to these structural issues including recommendations as to the scale and ownership of generation assets or alternatively recommendations regarding the role of the AER. While the AER has been recently given additional funding⁵ and a broader remit with regard to determining whether there is effective competition in the wholesale market⁶, it appears to be primarily a monitoring and reporting role (with long reporting timeframes) rather than one where there is power to act on the findings. One possible pathway that Rio Tinto would support is that maintaining confidence in the wholesale market becomes a core policy concern of the AER and that they be given the power to intervene in any behaviour that threatens, or may threaten, confidence in, or the integrity of, the wholesale market.

As an example, the Electricity Authority in New Zealand has powers to correct undesirable trading situations reflecting the following principle (as endorsed by the New Zealand High Court):

“It is in the public interest to have an electricity market in which all participants can be confident prices are competitively determined. If participants observe that prices are greatly divorced from supply-demand conditions and are excessively higher than underlying costs, they will lose confidence in the integrity of the

³ See for example AER reports State of the Energy Market 2013 p10, State of Energy Market 2014 p8, State of the Energy Market 2015 p9.

⁴ See for example <http://www.abc.net.au/radionational/programs/breakfast/new-report-finds-sa-energy-companies/7761754>. <http://www.abc.net.au/news/2016-09-08/sa-government-to-purchase-75pc-of-electricity-needs/7825852>; <http://www.premier.vic.gov.au/bipartisan-review-into-electricity-and-gas-retail-markets/>

⁵ <https://www.medianet.com.au/releases/135695/>

⁶ [https://www.legislation.sa.gov.au/LZ/V/A/2016/NATIONAL%20ELECTRICITY%20\(SOUTH%20AUSTRALIA\)%20\(AUSTRALIAN%20ENERGY%20REGULATOR%20-%20WHOLESALE%20MARKET%20MONITORING\)%20AMENDMENT%20ACT%202016_56/2016.56.UN.PDF](https://www.legislation.sa.gov.au/LZ/V/A/2016/NATIONAL%20ELECTRICITY%20(SOUTH%20AUSTRALIA)%20(AUSTRALIAN%20ENERGY%20REGULATOR%20-%20WHOLESALE%20MARKET%20MONITORING)%20AMENDMENT%20ACT%202016_56/2016.56.UN.PDF)

market arrangements and the incentive structures surrounding the wholesale market for electricity may be greatly damaged....⁷

We would welcome the opportunity to discuss this further with you. If you have any questions in the interim, please contact Daniel Woodfield (Daniel.Woodfield@riotinto.com).

Yours sincerely

A handwritten signature in blue ink, appearing to read 'B. Cox'.

Bruce Cox

Managing Director, Rio Tinto Aluminium – Pacific Operations

⁷ Final decision on the Undesirable Trading Situation of 26 March 2011, and Final decision on actions to correct the Undesirable Trading Situation of 26 March 2011, 4 July 2011 at <http://www.ea.govt.nz/code-and-compliance/uts/undesirable-trading-situations-decisions/uts-26-march-2011/final-undesirable-trading-situation-decision-and-proposed-actions/> and Bay of Plenty Energy Limited & Ors v the Electricity Authority [2012] NZHC 238