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Comalco Aluminium (Bell Bay) Limited

Submission to the
*Australian Competition and Consumer
Commission*

National Electricity Code Changes -
Tasmania's entry into the National Electricity
Market

January 2001

INTRODUCTION

Comalco Aluminium (Bell Bay) Limited is a major stakeholder both in Tasmania and the Tasmanian Electricity Market.

The Bell Bay aluminium smelter has a take or pay contract to 2014 for 256 Megawatts of electricity, and purchases additional energy periodically.

One of the State's largest employers, the Bell Bay smelter directly employs around 600 men and women with typically up to a further 100 contractors on the site at any one time. Independent studies have found that the smelter has a major and direct impact on the Tasmanian economy. In addition to its own employees, it creates employment for an additional 1800 Tasmanians who depend directly on the economic impact of the smelter. Last year Comalco spent more than \$120 million in Tasmania on goods and services, including wages.

In aluminium production, electricity is a major raw material. In most smelters it accounts for between 20% and 35% of the total cost of converting alumina to metal. Tasmania is considerably disadvantaged by its remote location with regard to the need to import raw materials and transport product to the mainland and to export markets in the Northern Hemisphere.

The availability of competitively priced electricity is therefore the prime reason Tasmania has an aluminium smelter and the associated development it brings to the State.

EXECUTIVE SUMMARY

It is our view that connecting Tasmania to the NEM is essential if Tasmania is to move from a monopoly electricity supply industry to a market that has the potential to deliver competitively priced electricity.

In principle, Comalco Aluminium (Bell Bay) Limited supports the Tasmanian Government's application to join the National Electricity Market (NEM). However, we are concerned that the proposed framework for NEM entry delivers significant market power to Hydro Tasmania in some situations.

We therefore ask that the ACCC assess the concerns raised in this submission, with a view to attaching certain conditions to authorisation, in order to reduce that market power.

In summary, Comalco urges the ACCC to consider the following conditions:

1. Requiring Bell Bay Power Station (BBPS) to be separated from Hydro Tasmania immediately. Hydro Tasmania to be required to withdraw from any contract negotiations on behalf of BBPS.
2. Requiring Hydro Tasmania to divest its interest in import rights and thus its ability to restrict competition in Tasmania. The ACCC to also direct Hydro Tasmania as to the appropriate timetable and process for the sale of import rights, and for the successful bid or bids to be subject to ACCC approval.
3. Hydro Tasmania to be required to ringfence the cost of wind power generation in order to eliminate any potential for cross subsidisation .
4. An investigation into the reasons for the stated 300 MW limit on the southbound flow of electricity at any given time, with full public disclosure. ACCC to redirect accountability for procuring reserve load from Basslink to NEMMCO.

EXECUTIVE SUMMARY (Continued)

5. **ACCC to also require Hydro Tasmania to:**
 - 5.1 **officially and publicly notify any hydro spills (as per the new requirement in the New Zealand Government Policy Statement)**
 - 5.2 **publish all of its NEM offers ex-post**
 - 5.3 **publish all storage levels on a regular basis**
 - 5.4 **publish aggregate hedge offers and uptakes**
 - 5.5 **to be held to public account each year on its market behaviour**

6. **ACCC to require BBPS to meet 5.2, 5.4 and 5.5 (above) while it remains a Government owned entity.**

THE SMELTING PROCESS - BACKGROUND INFORMATION

The Bell Bay aluminium smelter takes its electricity at 220 000 volts. We do our own distribution and transformation and have invested significant capital in our own Power Supply Infrastructure and Operations.

The process of smelting aluminium is a continuous one: operating 365 days a year, 24 hours a day, requiring a continuous supply of electricity. If the electricity ceases to pass through the electrolytic process and the cells in which the production of aluminium takes place, then the aluminium freezes solid. If an interruption in supply of electricity for greater than three to four hours were to occur, then a total restart of capacity would be required. Such a restart would take up to six months to complete and would cost in the order of hundreds of millions of dollars. Even interruptions of around one to two hours duration will result in substantial impact and cost in the order of several million dollars.

The continuity of a reliable and secure supply of electricity is thus critical for our particular business.

HISTORIC OVERVIEW

The Bell Bay aluminium smelter was Australia's first. It began operating in 1955 as a joint venture between the Commonwealth and Tasmanian Governments. Comalco purchased the Commonwealth's majority interest in 1960. At that time the smelter produced just 12,000 tonnes per annum.

Under Comalco's ownership, Bell Bay's technology has been regularly updated and annual aluminium production capacity has increased to the current rate of 160,000 tonnes per annum. These increases in metal production, industrial development and employment in the region have been closely linked to the expansion of Tasmania's hydro electric system. The long term "take-or-pay" contracts between the HEC and the Bell Bay smelter went a considerable way to underwriting that expansion, including the development of the Derwent, Great Lake, Mersey Forth and to some extent the Gordon Schemes.

1. BELL BAY POWER STATION

The concept of the Bell Bay Power Station becoming a separate entity is welcome. However there can be no justification for Hydro Tasmania continuing to own BBPS.

It is our strong view that Hydro Tasmania should not be charged with managing BBPS until the commissioning of Basslink. How can BBPS compete fairly and effectively with Hydro Tasmania, when Hydro Tasmania will not only have a detailed knowledge of the power station's cost structure, including operating costs, depreciation costs and capital costs? Why should Hydro Tasmania be entitled to know at what price or tariff BBPS can offer contract customers, or bid into the market? Why should they have detailed knowledge of when BBPS would be making a profit or a loss? This point is exacerbated when it is realised that Hydro Tasmania is currently finalising long-term gas supply contracts for BBPS for its exclusive energy source, and in determining what contracts will be divested into the entity.

We are concerned that the continued involvement of Hydro Tasmania in determining (and perhaps limiting) its competitor's operation, provides Hydro Tasmania with unfair commercial advantage and strengthens its market dominance in Tasmania.

Comalco therefore requests that the ACCC grant authorisation, conditional on the BBPS being separated from Hydro Tasmania immediately. Hydro Tasmania to also be required to withdraw from any contract negotiations on behalf of BBPS, or any other decisions about the financial structure, technical and operational parameters of the entity.

2. IMPORT RIGHTS

We are advised that Hydro Tasmania propose to sell import rights on Basslink. However, we are concerned that there is no detail available in the Tasmanian Government application, about the procedure to be used for divesting these rights.

It is not clear to us whether or not Hydro Tasmania intends to participate in the bidding, or whether Hydro Tasmania reserves the right to retain the import rights if the bids are not deemed by them to be high enough to justify the sale proceedings.

The Tasmanian Government submission (page 89) to the ACCC also suggests that Basslink Pty Ltd is required to bid Basslink at a zero price *unless otherwise instructed by Hydro Tasmania*. While it can be presumed this scenario relates to export rights, it is not clear if it also applies to import rights.

Comalco believes it is appropriate that the ACCC, as a condition of granting authorisation, direct Hydro Tasmania on the appropriate sale process for import rights, and compel Hydro Tasmania to divest these rights following that process. Details of the sale process, including the timetable, should be publicly available.

The successful bids should also be subject to ACCC approval.

3. WINDPOWER

Hydro Tasmania will for the foreseeable future, continue to hold a dominant position in the Tasmanian market, even with the advent of natural gas and Basslink. Small-scale generation and higher priced alternatives such as wind and co-generation opportunities will be ineffective in curbing this dominance.

Hydro Tasmania has publicly outlined plans to invest in up to 1000 MW of wind energy to its generation capacity. The submission from the Tasmanian Government indicates wind generation to be at much greater volume.

Even with renewable credits (ultimately paid for by customers) the cost of producing wind generation is much greater than hydro generation. We are concerned that this could potentially lead to Tasmanian customers, with limited market access, paying for Hydro Tasmania's large-scale venture into renewable energy through cross subsidisation.

It is recognised that Hydro Tasmania considers wind generation to be commercially viable, but no detail has been made available.

Comalco urges the ACCC to consider granting authorisation on the condition that Hydro Tasmania's wind generation is ringfenced to eliminate the potential for cross subsidisation.

4. 300 MW IMPORT CONSTRAINT

Hydro Tasmania, Basslink and the Tasmanian Government submission to the ACCC all state that the Tasmanian Electricity Supply Industry can only support 300 MW import across Basslink. The Basslink undersea cable is not the limitation, but rather the amount of available reserve in Tasmania in the event of the link failing temporarily. This limit appears to have been set by Hydro Tasmania based on current reserve supplied by their own plant and "indications" of available load shedding from an unknown source.

While the retailer Aurora, on behalf of the Basslink Development Board made preliminary investigations about the amount of available reserve from customers some time ago, it was well before the successful proponent was selected. We understand that a minimum of 480MW of interruptible load was identified as potentially available, but that no work was done as to what the commercial terms would be. There has been no follow-up since that time with any customers, and no discussion on price.

Comalco questions why accountability for determining the actual limit rests with Hydro Tasmania together with Basslink? We believe these parties should be completely removed from setting this limit, as they have an incentive to keep the limit low. Comalco believes this should be a System Control (or NEMMCO) accountability, based on commercial available reserve from a variety of sources, as is the case in the NEM. Hydro Tasmania should also be prevented from withholding reserve capacity (or in any other way exercising dominance) to force an import constraint.

We therefore ask the ACCC to investigate and report on whether the limit on the southbound flow of electricity at any given time is arbitrary, or arises from any sound technical or system security constraint.

It is our view that as a condition of granting authorisation, the ACCC direct that accountability for procuring spinning reserve/interruptible load should rest with System Control - i.e NEMMCO.

5. OTHER

Control of market power in the Tasmanian Electricity Supply Industry is a critical issue for Comalco and indeed all customers.

If Natural Gas is landed in Tasmania and Basslink is commissioned, there will be two potential new generation sources available to Tasmania customers. However, Tasmania will still be well short of a competitive market, as the issues of the market power of Hydro Tasmania will remain.

As the ACCC is only too aware, there has been significant market power research performed over the years by the likes of Cournot, Bertand, Nash and Hirschmann and Herfindahl. The Hirshmann Herfindahl Index (HHI) is commonly used to determine market power in commodity markets (including displacement commodities such as electricity). In the United States, the Department of Justice applies three regions in the determination of market power:

- (a) where the HHI is <1000 the market is said to be unconcentrated
- (b) where the HHI is between 1000 and 1800 the market is moderately concentrated
- (c) where the HHI is >1800 the market is highly concentrated

Even with the separation of BBPS as a gas fired power station and the commissioning of a 300MW import Basslink cable, the HHI for Tasmania would be in excess of 6000.

The need for some control of market power in Tasmania therefore requires additional measures not required in other NEM jurisdictions. It is our view that these measures could include the requirement, as a condition of granting authorisation, for Hydro Tasmania to:

- 5.1 officially and publicly notify any hydro spills (as per the new requirement in the New Zealand Government Policy Statement - see website www.med.govt.nz/ers/electric/package2000/gps/index.html)
- 5.2 publish all of its NEM offers (ex- post) in Tasmania
- 5.3 publish all storage levels on a regular basis
- 5.4 publish aggregate hedge offers and uptakes
- 5.5 to be held to public account each year on its market behaviour

5. OTHER (Continued)

In addition, if BBPS is to remain a government owned entity, then we would also suggest that BBPS be held accountable for 5.2, 5.3 and 5.4 above.

SUMMARY

Comalco is a major stakeholder both in Tasmania and the Tasmanian Electricity Market.

In principle we support the Tasmanian Government's application to join the National Electricity Market, but request that the ACCC only grant authorisation subject to the conditions outlined in this submission, in order to reduce the market power of Hydro Tasmania.

We would welcome the opportunity to discuss this submission in more detail, and to participating in the pre-decision conference