

**Submission to the
Australian Competition and Consumer
Commission**

**Regarding
Tasmanian Derogations and Vesting Contract - Tasmania's NEM entry
Draft Determination**

**By
AUSTRALIAN BULK MINERALS**

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14 September 2001

1. Submission

Australian Bulk Minerals (ABM) supports the main provisions of the Draft Determination by the Commission dated 18 July 2001 regarding the Tasmanian Derogations and Vesting Contract covering Tasmania's entry into the National Electricity Market (NEM). However ABM believes that prior to granting final approval the Commission should introduce conditions to minimise the potential for Hydro Tasmania to set the Tasmanian pool price in an anti-competitive manner resulting in detriment to Tasmania.

Hydro Tasmania should be required to submit its bids into the Tasmanian and Victorian pools in such a way that it does not utilise more than 80% of available Basslink capacity at any time and does not utilise more than 75% of available capacity over any 24 hour period

Hydro Tasmania should be required as a transitional measure to offer prices and terms equivalent to those incorporated in the vesting contract to customers and mainland generators when Hydro Tasmania is in a position to set the Tasmanian pool price

In addition ABM requests that the Commission re-consider the net public benefit of Basslink as the proposed Bell Bay power station may not be viable because of its uncompetitive fuel cost and marginal cost of generation.

2. Background

Australian Bulk Minerals (ABM) engages over 500 Tasmanian employees and contractors to operate an iron ore mine at Savage River and a pellet plant at Port Latta. ABM is a medium sized Major Industrial (MI) customer of Aurora with a contract to supply 22MW to Savage River and 12 MW to Port Latta. ABM's contract is currently being renegotiated and from 1 January 2002 ABM will be exposed either to a notional market price or the terms of a contract "negotiated" with a monopoly supply chain. It appears to ABM and other small and medium sized non-tariff non-contestable Tasmanian customers that Hydro Tasmania indirectly uses its dominant position to inflate electricity prices in Tasmania to an extent that they generate a monopoly rent for the generator and will become increasingly uncompetitive. This has the effect of producing an anti-competitive detriment to Tasmania in maintaining and attracting industry and jobs to the state.

3. Impact of Implementation of the Draft Determinations

The Commission expressed concern in the Draft Determination that the proposed Basslink contractual arrangements may result in an anti-competitive detriment

associated with Hydro Tasmania's ability at times to use its dominant position to set the Tasmanian pool prices. The Draft Determination balances this detriment against a greater benefit to the Australian economy but appears to underestimate the effect of the detriment on the Tasmanian economy. Several of the presentations at the draft determination conference point out that medium MI customers are particularly vulnerable as they rely on the effective operation of the market to ensure a competitively priced electricity supply. Under the proposed arrangements it is unlikely that an effective market will develop in Tasmania because:

- the vesting contract limits the market available to new entrants
- potential investors in additional on-island generation will perceive that carries a high risk factor as Hydro Tasmania effectively controls Basslink and has a near zero marginal cost of generation
- mainland generators are unlikely to bid into Tasmania because, in the circumstances outlined in the Draft Determination and various submissions to the Draft Determination conference, they will be unable to hedge their risk and may be forced to purchase electricity from a market dominant Hydro Tasmania at an unregulated price
- Hydro Tasmania's practice of requiring "commercial in confidence" clauses in all MI contracts will restrict the Tasmanian Government's ability to adjust their energy reform framework to minimise the detriment if/when anti-competitive detriments emerge
- Bell Bay will not be able to make unsubsidised competitive bids into the Tasmanian pool because its marginal cost of generation will be significantly in excess of that of Hydro Tasmania and mainland generators (see below).

In the probable event that an effective market does not emerge in Tasmania the dominant position of Hydro Tasmania, combined with the storage capacity of the Hydro system, will allow it to indirectly increase prices at all times to Hydro Tasmania's peak hour mainland bid price. The higher prices will apply both to new customers and existing M I customers as their contracts expire or are renegotiated.

In such circumstances Tasmania's contestable customers will be unable to plan on a continuing supply of competitive electricity. With the State's energy supply/demand in balance it is difficult to see any investor risking the future imposition of electricity prices significantly in excess of those available in competing jurisdictions. Even retaining our existing industrial base for the long-term will be difficult if Hydro Tasmania effectively controls Basslink.

With the exception of the Natural Gas Pipeline, Tasmania has recently secured few major new industrial projects. Tasmania is seen nationally and internationally as a remote and difficult location for investment. When securing finance for projects a reliable long-term supply of energy at a competitive price is high on the list of matters

considered by potential investors. Prices quoted for additional electricity supplies are already higher than the published prices in the NEM. The perception of a high energy cost state subject to extreme sovereign risk will be reinforced if the government owned Tasmanian monopoly generator is allowed to maintain exclusive use of Basslink.

If the Draft Determination is implemented in these circumstances without the proposed conditions Tasmania will suffer:

- Reduced inwards investment
- Loss of existing industrial plants as electricity prices increase
- A significant reduction in employment as the industrial sector contracts
- Lower taxation revenues as employment, profits and population decline

Basslink has the potential to deliver significant benefits to the other NEM states including the displacement of coal-fired generation and a reduction peak prices but these benefits should not result in higher electricity prices to Tasmanian industrial customers and the exporting of Tasmanian jobs.

4. Proposed conditions to be incorporated in the Draft Determination

ABM suggest that one or both of the conditions below will promote the effective development of a Tasmanian electricity market despite the initial dominance of Hydro Tasmania.

Restricting Hydro Tasmania's bidding strategy

Limiting Hydro Tasmania's ability to submit its bids into the Tasmanian and Victorian pools in such a way that it does not utilise more than 80% of the available Basslink capacity at any time and does not utilise more than 75% of the available capacity over any 24 hour period.

Such a restriction will ensure that capacity is available to mainland generators and enable them to make bids into the Tasmanian market confident in their ability to deliver without an unacceptable risk of having to purchase electricity from a dominant supplier at a price determined by a dominant supplier

Ensure the availability of competitively priced electricity at all times

Require Hydro Tasmania to offer equivalent prices and terms to those incorporated in the vesting contract to following circumstances:

- *non-tariff, non-contestable customers on expiry of their existing supply contracts*
- *existing M I customers seeking new or additional load during the currency of their existing supply contracts or on expiry of their existing supply contracts*
- *New contestable and non-contestable non-tariff customers*
- *Mainland generators for load supplied during periods when Hydro Tasmania is able to set the Tasmanian pool price*

Such a requirement will provide a hedge for existing and potential customers against uncompetitive Tasmanian pool prices resulting from an abuse of a dominant market position in Tasmania. The condition should be transitional and expire at the same time as the vesting contract. It will provide certainty as to the maximum price at which electricity is supplied until an effective Tasmanian market is established. In other states extra high voltage tariffs or the establishment of a portfolio of vesting contracts has provided certainty.

5. Viability of proposed Bell Bay Generator

The Application incorporates a proposal to create an independent competing government owned generator by converting the existing Bell Bay power station

(BBPS) to gas. The existing two 114 MW generators at BBPS were designed as a low capital cost fuel inefficient back up to the Hydro network. The full details of the proposed conversion are not available but ABM remain unconvinced that it can ever be competitive because

a major capital injection will be required to convert the power station if its fuel conversion efficiency is to match its competitors

even if substantial capital is invested the generator will continue to be an inefficient as base load generator when compared to mainland generators because of its size

gas used by BBPS will be more expensive than that used by competing generators because of the toll payable to fund the gas pipeline from Longford in Victoria

for most of the time when the Tasmanian and Victorian pool prices coincide the marginal cost of generation of BBPS will be higher than the pool price so the station is unlikely to be dispatched

ABM understands that Hydro Tasmania is committed to purchase from Duke Energy International a significant quantity of either gas or electricity. In such circumstances either the electricity price for contestable customers will have to rise substantially above the Victorian pool price or the owner (Tasmanian government) must provide a subsidy or the station will revert to its design purpose of operating only to provide emergency relief in the event of drought. ABM believes that a substantial price increase is most likely outcome in a market dominated by a single generator.

ABM asks the commission to reconsider the net public benefit of Basslink in circumstances where Tasmanian industry contracts because it faces an electricity cost substantially in excess of its competitors or a government subsidy is required for a generator supplying about 20% of the Tasmanian market.