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Supplementary submission in support of applications for authorisation

Rio Tinto Aluminium Limited (ACN 009 679 127)

Supplementary submission

1. Introduction

On 24 December 2009, Rio Tinto Aluminium Limited ACN 009 679 127 (**RTA**), the manager of the Gladstone Power Station Joint Venture, lodged three applications for authorisation on behalf of itself and the Gladstone Power Station Joint Venture Participants (the **JV Participants**)¹ (together, the **Applicant**). The applications concern amendments to agreements in relation to electricity generated by the Gladstone Power Station (the **GPS**) and supplied to the Boyne Island Aluminium Smelter (the **Smelter**) and the National Electricity Market (**NEM**).

The Australian Competition and Consumer Commission (**Commission**) may grant an authorisation expressed to be in force for a period specified in the authorisation.² The Commission has stated that it generally considers it appropriate to grant authorisation for a limited period of time, so as to allow an authorisation to be reviewed in the light of any changed circumstances.³

In its applications, the Applicant requests authorisation for the arrangements under the amended GPS Agreements for a period of:

- (a) 45 years; or
- (b) the term of the Interconnection and Power Pooling Agreement (**IPPA**) (which extends to 29 March 2029) and any extended term pursuant to the exercise of the option under the terms of the IPPA,

whichever is the earlier. The term of the IPPA, as executed in March 1994, was (and is) 35 years from 30 March 1994. The IPPA also included (and still includes) an option to extend the term. Consequently, the period of authorisation sought is consistent with the term of the IPPA as entered into in 1994 (including any extended term pursuant to the exercise of the option). The IPPA was authorised by the Commission in 1994 for no fixed period. Consequently, the authorisation was effectively granted for the term of the arrangements.

Attached as Annexure A is a confidential annexure identifying the term for each of the amended GPS Agreements.

The Applicant now provides a supplementary submission in support of the period for which authorisation is sought.

¹ GPS Energy Pty Limited ACN 063 207 456, GPS Power Pty. Limited ACN 009 103 422, Sunshine State Power B.V. ARBN 062 295 425, Sunshine State Power (No. 2) B.V. ABRN 063 382 829, SLMA. GPS Pty Ltd ACN 063 779 028, Ryowa II GPS Pty. Limited ACN 063 780 058 and YKK GPS (Queensland) Pty Limited ACN 062 905 275.

² *Trade Practices Act 1974 (Cth)*, section 91(1).

³ Australian Competition and Consumer Commission, *Final determination in relation to authorisation for application lodged by Hurstville City Council and Ors*, 6 November 2009, para 4.78.

2. History of the Arrangements

As stated in the submission lodged in support of the applications, the agreements relating to the GPS and the Smelter have been the subject of previous authorisations. In 1979 the consortium agreements relating to the construction and operation of the existing Smelter were granted authorisation⁴ and in 1994, authorisation was granted in relation to the contractual arrangements which supported the proposed expansion and operation of the Smelter and the proposed acquisition and operation of the GPS.⁵

The arrangements the subject of the 1994 authorisation were fundamental to the financial commitment for the expansion of the Smelter and the JV Participants' acquisition of the GPS. As recognised by the Commission in its 1994 determination:⁶

'Comalco advises that it and the other parties were not prepared to make the substantial investment in expansion of the Boyne smelter except on the basis of owning the Gladstone Power Station (which is currently owned and operated by the Queensland Electricity Commission ("QEC")). The Queensland Government is of the view that expansion of the Boyne smelter will have significant beneficial effects on the local, Queensland and Australian economies, and has advised that it is not prepared to allow the QEC to sell the Gladstone Power Station without a firm commitment that the Boyne smelter expansion will go ahead.'

The expansion of the Smelter and the acquisition and operation of the GPS were part of a successful strategy to increase the efficiency of both facilities, and provide a secure energy supply for the Smelter.

3. The Current Applications

The Applicant is seeking authorisation of arrangements under the amended GPS Agreements (as defined in the submission lodged in support of the applications) (the **amended GPS Agreements**). These agreements have been amended to accommodate certain changes to the commercial arrangements in consequence of the introduction and operation of the NEM.⁷

The Applicant submits that authorisation should be granted for the term sought in the applications, namely for a period of:

- (a) 45 years; or
- (b) the term of the IPPA (which extends to 29 March 2029) and any extended term pursuant to the exercise of the option under the terms of the IPPA,

whichever is the earlier. As indicated above, the period for which authorisation is sought is consistent with the term (including the option provision) in the IPPA as executed in 1994 and authorised by the Commission in 1994.

⁴Applications A90265-A90271

⁵ Applications A40062-A40070. See *Comalco Limited and Comalco Aluminium Limited* (1994) ATPR 50-142 at 55,101.

⁶ at 55,102.

⁷ The amended GPS Agreements have been executed by the parties but the amendments will not take effect unless and until those amendments are authorised by the Commission and approved by the Australian Energy Regulator.

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The need for authorisation of the amended GPS Agreements arises because of the need to accommodate certain changes to the commercial arrangements in consequence of the introduction and operation of the NEM. However, it should be noted that there has been no amendment by the parties to the term of the IPPA (including the option provision) as authorised in 1994. All of the GPS Agreements (including the provisions relating to the term of those Agreements) were authorised in 1994 without any limit as to the period of authorisation.

4. Submission

As with the previous authorisation by the Commission of the GPS agreements, the Commission has previously and indeed recently granted authorisations for a period of 10 years or more in appropriate circumstances.⁸ In the Applicant's submission, appropriate circumstances exist in this case for the reasons set out below.

- (a) *History of the GPS agreements and the arrangements in relation to those agreements*
- (i) The consortium agreements relating to the construction and operation of the existing Smelter were first authorised in 1979.
 - (ii) The GPS agreements were entered into and authorised in 1994. The authorisation related to the arrangements supporting the proposed expansion and operation of the Smelter and the proposed acquisition and operation of the GPS. The determination did not specify the period for which the authorisation would remain in force. Rather, in light of the circumstances giving rise to the GPS agreements, the Commission granted the authorisation for a period which was effectively the whole of the term of the GPS agreements.

⁸ See for example, Australian Competition and Consumer Commission, *Final determination in relation to authorisation for application lodged by Hurstville City Council and Ors*, 6 November 2009 (authorisation granted for 20 years); Australian Competition and Consumer Commission, *Final determination in relation to authorisation for application lodged by Inner Sydney Waste Management Group of Councils*, 29 October 2008 (authorisation granted for 10 years); Australian Competition and Consumer Commission, *Final determination in relation to authorisation for application lodged by Council of Camden, Campbelltown City Council, Wollondilly Shire Council and Wingecarribee Shire Council*, 16 December 2004 (authorisation granted for 15 years).

- (iii) In order to make a case for the sustainable economic expansion of the Smelter, it was necessary to obtain competitive, secure, long term power purchase arrangements for the supply of electricity to the Smelter. In order to achieve this it was essential to acquire the GPS (see Paragraph 2 above).
- (iv) Under the arrangements that were agreed, GPS assumes primary responsibility for the supply of electricity to the Smelter, and the majority interests in the GPS were acquired by persons who held equity interests in the Smelter. However, interests associated with the operator of the GPS, NRG, also acquired a 37.5% interest in the GPS. So it was necessary to enter into long term contractual arrangements for the supply of electricity from the owners of GPS to the Smelter. Those arrangements are contained in the Master Power Purchase Agreement and the Block A and Block B Power Purchase Agreements. Those arrangements have a term which, coupled with options to renew, reflects the expectation of the Smelter owners as to the operating life of the Smelter.
- (v)

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Accordingly the parties entered into the IPPA and CPAs.

- (vi) The Applicant is now seeking authorisation for amendments to some of the GPS Agreements which were the subject of the 1993 authorisation application. These amendments are required to accommodate changes to the commercial arrangements including those which have occurred in consequence of the introduction and operation of the NEM. However, there has been no change to the original term of the IPPA (including the option provision), reflecting the continued need for certainty under the arrangements for both the GPS and the Smelter, in light of the economic reasons outlined above.
- (b) *Term/s of the amended GPS Agreements for which authorisation is sought*
- (i) As with the 1994 authorisation, the period for which authorisation is now sought by the Applicant corresponds to the term of the IPPA (which is 35 years, commencing 30 March 1994) and any extended term pursuant to the exercise of the option under the terms of the IPPA.
- (ii) The term of the following amended GPS Agreements continue to be aligned with the term of the IPPA:
- (A) Joint Venture Agreement;
- (B) Capacity Purchase Agreements;

- (C) Master Power Purchase Agreement; and
- (D) Block A and Block B Power Purchase Agreements.

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(c) *Security of supply to the Smelter*

- (i) The parties to the amended GPS Agreements and the agreements in relation to the Smelter continue to require certainty for the sale and purchase of electricity and delivery of services under those agreements for the term of those agreements.
- (ii) The expansion of the Smelter and the acquisition and operation of the GPS by the JV Participants have, in the Applicant's submission, resulted, and continue to result, in substantial public benefits to Queensland and Australia.
- (iii) Further authorisation granted for the period sought will continue to ensure security of supply of electricity for the expanded Smelter and provide certainty for the parties to the amended GPS Agreements in relation to the arrangements under which the GPS will be operated.

(d) *Return on investment in relation to the GPS and the Smelter*

- (i) The commercial arrangements the subject of the amended GPS Agreements formed part of the basis for the substantial investment made by the JV Participants and BSL (and related parties) in the expansion of the Smelter and the acquisition and refurbishment of the GPS.
- (ii) Furthermore, the amended GPS Agreements contain provisions for the supply of electricity and services involving significant payments of money over the terms of those agreements.
- (iii) The terms of the amended GPS Agreements remain consistent with the life of the underlying assets. Power is a significant cost input to BSL.

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Accordingly, the IPPA and associated documents are necessary to support the Smelter Power Purchase arrangements.

- (iv) Aluminium smelters are capital intensive and stable long term power arrangements are required in order to attract funding. In its applications for authorisation in 1993, Comalco estimated the total capital expenditure on the expansion of the Smelter during the construction phase would be \$930 million. (In fact, the actual expenditure during the 1995-97 construction phase was over \$1.13 billion.)
 - (v) In February 2008, RTA announced that BSL would be investing A\$670 million in modernising the Smelter.⁹ Underpinning this investment decision was the view that electricity would continue to be supplied in accordance with the terms of the Master Power Purchase Agreement, until at least 2029.
 - (vi) As stated in the submission lodged in support of the applications, the JV Participants have spent a substantial amount on capital works at the GPS (\$170 million to 1999) to ensure the continuing reliable operation of the GPS over its 35 year plus life. This is in addition to the purchase price of the GPS of \$750 million. As recognised in the 1994 Determination, the sale of the GPS to the JV Participants in 1994 was conditional upon and proceeded only as a result of the commitment by BSL to the expansion of the Smelter.¹⁰
 - (vii) The period for which authorisation is sought by the Applicant will continue to ensure that the JV Participants and BSL (and related parties) recoup their investment and achieve an appropriate commercial return on the substantial investments made in the expansion and, subsequent ongoing modernisation of the Smelter and the acquisition and operation of the GPS.
- (e) *Appropriate circumstances for the grant of authorisation for lengthy period*
- (i) The Commission has previously granted authorisations for lengthy periods in appropriate circumstances. The Applicant submits that the circumstances of the GPS arrangements and the amended GPS Agreements are such appropriate circumstances. The long term of the agreements in question continue to be necessary to maintain the viability of the Smelter and to provide an appropriate return on the ongoing investment in the GPS and BSL.

⁹ Rio Tinto Aluminium, 'Rio Tinto to invest in future of Boyne Smelters', URL: http://www.riotinto.com/media/18435_media_releases_7077.asp (accessed 2 February 2010).

¹⁰ Applications A40062-A40070. See *Comalco Limited and Comalco Aluminium Limited* (1994) ATPR 50-142 at 55,124.

- (ii) The Applicant's applications can be distinguished from applications in which there are technological or other changes which are constantly having an effect on aspects of the relevant market/s which make it appropriate for the Commission to have the opportunity to review the authorisation within a short timeframe.¹¹
- (iii) In its submission in support of its applications for authorisation, the Applicant identified that the amended GPS Agreements may have an impact on three relevant markets:
 - (A) the NEM for the supply and acquisition of electricity;
 - (B) the domestic market for the supply and acquisition of aluminium; and
 - (C) the market for the supply and acquisition of Nominated Generator services.
- (iv) The Applicant submits that none of these markets are of a character which would require the Commission to review the authorisation of arrangements existing within those markets in the short to medium term. In any event, to the extent that any such changes brought about changes to the IPPA, it would be necessary to seek the approval of the AER under the NER and the AER is in turn obliged to have regard to the competition law concerns of the Commission.
- (v) The NEM is a relatively mature market and the generation of electricity by coal fired generators is a mature technology.
- (vi) Long term contracts for the supply and acquisition of electricity are a feature of the NEM for large users of electricity such as smelters, refineries, fertiliser plants and other large manufacturers.
- (vii) Similarly, the smelting of aluminium undertaken by BSL at the Smelter is based on broadly mature technology with incremental efficiency improvements derived from ongoing investment in BSL.

Consequently there is no real requirement for review of any authorisation granted by the Commission of the amended GPS Agreements in the short to medium term because of technological or other changes which are constantly having an effect on the relevant markets.

¹¹ See for example, *Australian Performing Rights Association* (1999) ATPR 41-701 at 42,997.

5. Conclusion

The Applicant submits that authorisation should be granted for the term sought in the applications, namely for a period of:

- (a) 45 years; or
- (b) the term of the IPPA (which extends to 29 March 2029) and any extended term pursuant to the exercise of the option under the terms of the IPPA,

whichever is the earlier. The period for which authorisation is sought is consistent with the term (including the option provision) of the IPPA as executed in 1994 and authorised by the Commission in 1994.

The Applicant submits that the period for which this further authorisation is sought is appropriate given the history of the GPS agreements and the arrangements in relation to those agreements and in circumstances where the period for which authorisation is sought:

- corresponds to the original term (including any option) of the IPPA and the majority of the other amended GPS Agreements;
- ensures security of supply of electricity to the Smelter; and
- ensures that the JV Participants and BSL (and related parties) will recoup their investment and achieve an appropriate commercial return on the substantial investments made in the expansion and any subsequent modernisation of the Smelter and the acquisition and operation of the GPS.

Further, there are no technological or other changes which are constantly having an effect on the relevant markets which would make it appropriate for the Commission to review the authorisation within the short to medium term.

3 February 2010

ANNEXURE A
The term of each of the amended GPS Agreements

Contract	Parties	Initial Term	Extension of Term
Joint Venture Agreement (JVA)	GPS Power Pty. Limited GPS Energy Pty. Limited Sunshine State Power B.V. Sunshine State Power (No.2) B.V. SLMA. GPS Pty Ltd Ryowa II GPS Pty. Limited YKK GPS (Queensland) Pty. Limited Rio Tinto Aluminium Limited		
Interconnection and Power Pooling Agreement (IPPA)	Stanwell Corporation Limited GPS Energy Pty Limited GPS Power Pty. Limited Sunshine State Power B.V. Sunshine State Power (No.2) B.V. SLMA. GPS Pty Ltd Ryowa II GPS Pty. Limited YKK GPS (Queensland) Pty. Limited		EXCLUDED FROM PUBLIC REGISTER

Contract	Parties	Initial Term	Extension of Term
Capacity Purchase Agreement (CPA)	Stanwell Corporation Limited GPS Energy Pty Limited GPS Power Pty. Limited Sunshine State Power B.V. Sunshine State Power (No.2) B.V. SLMA. GPS Pty Ltd Ryowa II GPS Pty. Limited YKK GPS (Queensland) Pty. Limited (GPS Participants)		
	(Note: there are seven separate Capacity Purchase Agreements between Stanwell Corporation Limited and each of the GPS Participants)		
Master Power Purchase Agreement (MPPA)	Boyne Smelters Limited GPS Energy Pty Limited GPS Power Pty. Limited Sunshine State Power B.V. Sunshine State Power (No.2) B.V. SLMA. GPS Pty Ltd Ryowa II GPS Pty. Limited YKK GPS (Queensland) Pty. Limited		
Block A Power Purchase Agreement	Boyne Smelters Limited GPS Energy Pty Limited GPS Power Pty. Limited Sunshine State Power B.V. Sunshine State Power (No.2) B.V. SLMA. GPS Pty Ltd Ryowa II GPS Pty. Limited YKK GPS (Queensland) Pty. Limited		

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Contract	Parties	Initial Term	Extension of Term
Block B Power Purchase Agreement	Boyne Smelters Limited GPS Energy Pty Limited GPS Power Pty. Limited Sunshine State Power B.V. Sunshine State Power (No.2) B.V. SLMA. GPS Pty Ltd Ryowa II GPS Pty. Limited YKK GPS (Queensland) Pty. Limited		
Operation and Maintenance Agreement (OMA)	GPS Energy Pty Limited GPS Power Pty. Limited Sunshine State Power B.V. Sunshine State Power (No.2) B.V. SLMA. GPS Pty Ltd Ryowa II GPS Pty. Limited YKK GPS (Queensland) Pty. Limited Rio Tinto Aluminium Limited NRG Gladstone Operating Services Pty Ltd		EXCLUDED FROM PUBLIC REGISTER

Contract	Parties	Initial Term	Extension of Term
Power Sales Administration Agreement (PSAA)	<p>Rio Tinto Aluminium Limited NRG Gladstone Operating Services Pty Ltd</p> <p>GPS Energy Pty Limited GPS Power Pty. Limited Sunshine State Power B.V. Sunshine State Power (No.2) B.V. SLMA. GPS Pty Ltd Ryowa II GPS Pty. Limited YKK GPS (Queensland) Pty. Limited (GPS Participants)</p> <p>(Note: there are seven separate Power Sales Administration Agreements between Rio Tinto Aluminium, NRG Gladstone Operating Services and each of the GPS Participants)</p>		

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