

Mr John Pearce
Chairmen
Australian Energy Market Commission
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Dear Commissioner

Pacific Aluminium welcomes the opportunity to make a submission to the Australian Energy Market Commission (AEMC) in relation to the proposed rule change "*Demand side obligations to bid into central dispatch*".

About Pacific Aluminium

In Australia, Pacific Aluminium owns 59 per cent of Boyne Smelters Ltd (BSL), 42 per cent of the Gladstone Power Station (GPS), 100 per cent of the Bell Bay Aluminium Smelter in Tasmania and 51.55 per cent of the Tomago Aluminium Smelter in Newcastle. These assets hold unique positions in the Queensland, Tasmanian and NSW electricity sectors consuming between 10 -30 per cent of each State's power (355-995 MW) and with GPS as the largest power station in Queensland (1680MW). Pacific Aluminium also owns 79 per cent of New Zealand Aluminium Smelter.

Each asset is a key contributor the region in which they operate collectively Pacific Aluminium generates revenues of approximately \$2.7 billion, production in excess of 1.1 million tonnes of aluminium and directly employs close to 3,500 people in the region. Sales are primarily shipped to export markets in Asia.

The Proposed Rule Change

Snowy Hydro Ltd (Snowy) has submitted a rule change request to the AEMC which proposes that all market customers with market loads of 30 MW or greater that are, or intend to be, responsive to spot price would be required to become scheduled loads. Currently, under the rules this is not a requirement, and it is up to the market customer to decide if they would like to be classified as a scheduled load or not.

Snowy suggests that the proposed rule change would improve transparency in the National Electricity Market (NEM) resulting in more confidence that the price signals from Australian Energy Market Operator's (AEMO) central pre-dispatch process reflect the actual underlying supply and demand conditions.

Pacific Aluminium Response

Pacific Aluminium opposes the proposed rule change on the grounds that the perceived problems non-scheduled demand management creates have not been proven and the proposed rule change would have adverse impacts on large industrial electricity users with no proven benefit to other market participants. We set out our reasons below for your consideration.

Please also note Pacific Aluminium's submission of 28 October 2015 to the AEMC on the proposed rule changes to the bidding in good faith provisions as this provides additional context for some responses, particularly around rebidding behaviour in by generators in Queensland.

A narrow view on efficiency from an industrial producer's perspective

Snowy presents a number of arguments to support its assertion that the proposed rule change would be beneficial with their central argument being that, if AEMO had prior knowledge of the demand management intentions of large industrial loads, it would lead to increased efficiency in the operation of the electricity market.

This electricity market centric view of economic efficiency reflects a business whose core activities are to produce and sell electricity in the electricity market. Large industrial electricity users are also primarily focussed on the product they produce and sell, but this is not electricity. For instance, electricity is one of the two most significant inputs for aluminium smelting, so Pacific Aluminium has a strong interest in the electricity market, but it is not our core business. For other large industrial producers, electricity would be an even smaller proportion of their overall inputs. This is an important consideration because requiring industrial producers to focus more of their limited resources and time on operation in and compliance with the electricity market rules is an added burden that distracts management and operations from their core business. If industrial producers saw a benefit from scheduling their loads, they already have the freedom to do so under the current Rules.

Industrial producers vary electricity consumption for a range of reasons. Sometimes this may be to avoid a large electricity spot price, but it may also likely to be for reasons unrelated to the electricity spot price. Therefore, forcing scheduled loads to signal their electricity consumption decisions through bids would be cumbersome and introduce additional risks and costs to their operations. In addition the requirement to bid a scheduled load may be in conflict with pre-existing contractual arrangements, which could put those arrangements at risk.

Electricity market rules should not dictate how industrial producers operate their production processes as this "tail wagging the dog" approach can only lead to economic inefficiency.

Materiality of improvements in confidence in pre-dispatch prices

Snowy's argument that the proposed rule change would increase confidence in pre-dispatch prices is unproven. There is evidence that the effects of demand response on price outcomes is relatively small in the context of the market, for example, Snowy quotes that on 2 July 2012 there was a 70MW change in demand in Victoria however, at that time, the total Victorian demand was approximately 7000MW: the demand change was only 1%. Furthermore, demand response effects are dwarfed by re-bidding behaviour of generators, particularly as experienced in Queensland and South Australia.

Despite being scheduled, it is not uncommon for generators to re-bid volume into significantly higher priced bands at short notice, materially affecting price, and with no practical notice to the market to allow peaking generators or demand to respond. Pacific Aluminium believes this issue is an order of magnitude more relevant to the issue of confidence in pre-dispatch prices, and may also be a driver of some of the demand management currently occurring in the electricity market, as businesses interrupt their production processes to avoid artificially high electricity prices.

For example, in Queensland (BSL's market of interest) during the summer period (1/12/14 – 30/3/15) the 5 minute price increased by >\$300 with no warning in pre-dispatch forecasts on 105 instances (30% of all

>\$300 events) when actual demand was relatively unchanged (<+50MW above forecast). When considering only cases of demand where the 5 minute change was equal to or less than forecast, there were still 38 instances of >\$300 price spikes (11% of total >\$300).

Pacific Aluminium considers that the impact of demand response on confidence in pre-dispatch prices is not material in comparison to other issues with late re-bidding. The recent rule change request "Bidding in good faith" aims to attempt to address some of the issues around late re-bidding and Pacific Aluminium believes it would be necessary to await the implementation of that proposed rule change to gather reliable evidence about any impact of non-scheduled demand management on market efficiency.

Reserve forecasting and AEMO's ability to manage the central dispatch process

Snowy's argument that non-scheduled loads may impact AEMO's function of ensuring adequate reserves for the reliable supply of electricity is counter to AEMO's objectives for the reliable supply of electricity. Un-scheduled demand response only provides an up-side to ensuring adequate supplies of electricity as it is essentially additional reserve which can relieve tight supply conditions and is currently acting as additional redundancy. Taking this demand-response load into consideration for reserve forecasting would only increase risk to the network if this redundancy is removed, as the system would become more reliant on demand management to maintain security.

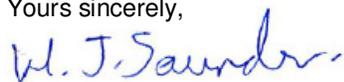
Pricing of financial contracts

Snowy argues that another impact of non-scheduled loads is incorrect pricing of financial contracts in the short term and the long term, as contract prices don't reflect underlying supply and demand. Pacific Aluminium does not agree that market participants rely on pre-dispatch pricing to price electricity hedges. We believe that historical data on actual electricity prices, supply and demand data would be far more influential, as would expectations for future market outcomes. The far larger issue remains the actual impact of late rebidding by generators on inflating actual spot electricity prices and hence electricity hedge prices.

Conclusion

For the reasons stated above, Pacific Aluminium does not consider that the proposed rule change to require large industrial electricity users to schedule their loads would improve the efficiency of the electricity market and, moreover, that it would be an unnecessary burden on those producers. Large electricity users want the electricity market to be efficient to drive competitive prices so that they can compete globally. Those industrial producers that see benefit, already have the freedom to choose to schedule their loads. Pacific Aluminium believes that the real problem for the electricity market is the lack of competitive pricing, as is observed through late-rebidding practices. Nothing in this submission is confidential. If you have any questions, please contact Pacific Aluminium Manager Energy, Warren Saunders (3028 2092 or warren.saunders@pacificaluminum.com.au).

Yours sincerely,



For Andrew Horvat,
General Manager Energy