



Mr John Pearce
Chairmen
Australian Energy Market Commission
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28 October 2015

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Dear Commissioner

Pacific Aluminium welcomes the opportunity to make a submission to the Australian Energy Market Commission in relation to the second draft determination in regard to the proposed changes to the bidding in good faith provisions within the National Electricity Rules.

About Pacific Aluminium and Boyne Smelters Limited

Pacific Aluminium owns 59 per cent of Boyne Smelters Ltd (BSL) and 42 per cent of the Gladstone Power Station (GPS). These two assets hold a unique position in the Queensland electricity sector with GPS as the largest power station in Queensland (1680MW), with ~13% of the State's capacity and BSL as Queensland's largest single power consumer (up to ~995 MW).

BSL is a key contributor to the Gladstone region and the State. BSL has continued to invest in the smelter over the last 30 years, most recently completing a refurbishment at a cost of more than A\$720 million - including construction of a new bake furnace, the replacement of overhead cranes and improvements to the alumina transport system. This investment will extend the life of the smelter, improve environmental and greenhouse performance and increase efficiency. As Australia's largest aluminium smelter, BSL contributes more than \$1.4 Billion to the nation's GDP, more than half of which is Gross Regional Product (GRP) in Gladstone. The smelter directly employs around 1000 people and helps create a further 6700 jobs across other sectors of the Australian economy. Additionally, BSL contributes more than \$150 million each year to the local economy through salaries and spends a further \$100 million on local goods and services.

Pacific Aluminium also owns 100 per cent of the Bell Bay Aluminium Smelter in Tasmania and 51.55 per cent of the Tomago Aluminium Smelter in Newcastle.

Whilst generally concerned with the impact of late rebidding on the market as a whole, Pacific Aluminium are particularly concerned with the impacts of the behaviour in the Queensland market.

Pacific Aluminium's experience in the Queensland market

We note within the Information Paper released by the AEMC on 17 September 2015 that the AEMC is concerned that deliberate late rebidding may result in economic harm, and further, it may discourage industry from producing or even locating in regions that are subject to this behaviour.

Pacific Aluminium believes the electricity sector in Queensland is facing immediate challenges and this is already having material flow on impacts for the State's industry and manufacturing sector as the 50% increase in wholesale prices over the last 12 months flows through to all customers, including domestic and industrial. As a result of these significant price increases, BSL was recently unable to secure an affordable power arrangement for up to 185 MW of its electricity load (which is Queensland's largest single contestable load).

The key to any aluminium smelter, including BSL, remaining viable and being able to continue to attract sustaining capital investment is competitively priced energy. As part of the 1994 acquisition of the GPS; the owners of BSL made a \$1B commitment to expand the smelter and entered into long-term arrangements which provide for up to 810MW of load from GPS to BSL until 2029. BSL's load has grown over time and, since 1999, BSL has entered into separate contractual arrangements for the supply of its additional contestable load over and above the 810MW block (currently ~170MW or ~20% of BSL's total requirement). For reference, the BSL contestable load of up to 185 MW is greater in electricity demand terms than all household consumption on the Gold Coast.

Over the recent years, prices in the Queensland electricity market have substantially diverged from those in New South Wales and Victoria (Figure 1). It is difficult for Pacific Aluminium to understand why the cost of doing business is so much higher in Queensland when the cost of generation at most coal fired power stations in the State (including the idled¹ 350 MW Tarong capacity) is substantially below the levels shown for contracts being struck in NSW or Victoria.

¹ www.stanwell.com/energy-assets/. Stanwell expects the unit will come back into operation in 2016, subject to market conditions.

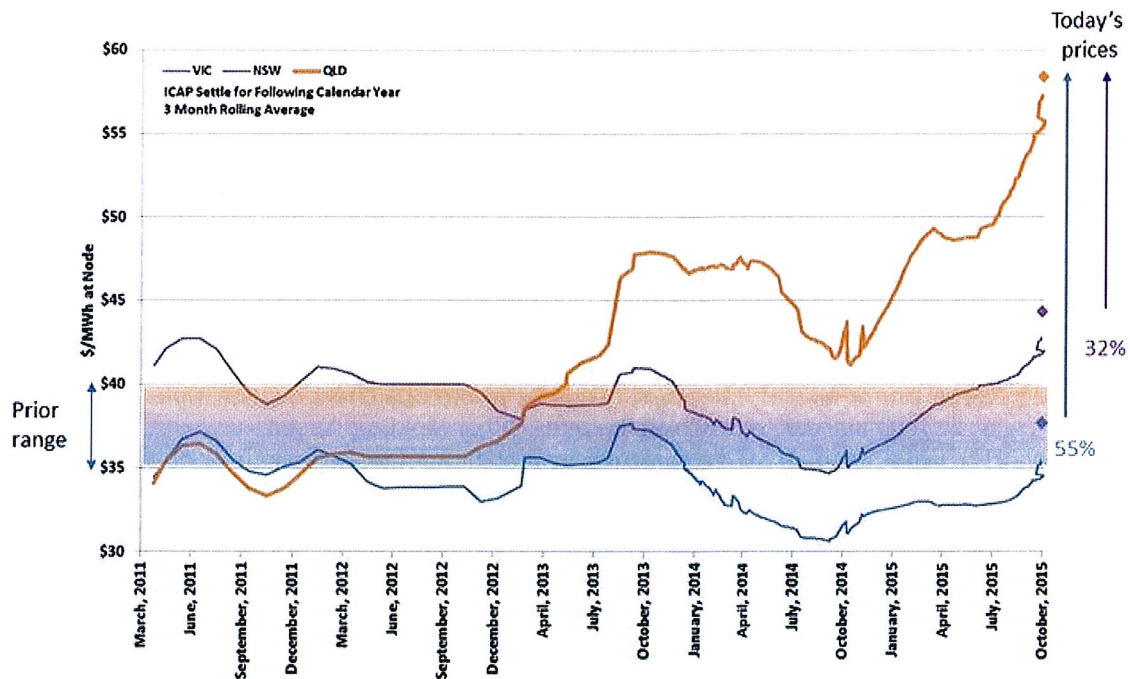


Figure 1. ICAP² Forwards Following Calendar Year (3 month rolling average)

Concerns about rebidding practises

- As detailed above, Pacific Aluminium has significant concerns about escalating contract prices in the Queensland electricity market impacting upon the State's industry and manufacturing sector. The price of electricity hedge contracts is influenced by electricity spot prices and Pacific Aluminium notes the views of others that late bidding practices are likely to have contributed to the high increase in Queensland electricity hedge contract prices: In its report dated 11 September 2015 to the AEMC 'Impact of late rebidding on the contract market', Ernst & Young notes 'that there has been historical price volatility that has been in part caused by strategic late rebidding, particularly in Queensland'. Further, where additional price volatility has occurred due to strategic late rebidding, it is probable that this has resulted in higher prices than would have otherwise occurred in the contract market;
- In its submission to the AEMC dated 12 February 2015, ERM Power contended that their analysis suggested that the impact of rebidding on the value of forward contracts curve could be \$400m in 2015 alone.

Comments about proposed ruled change

There are two key issues which Pacific Aluminium wishes to raise about the proposed rule change as follows:

² ICAP is a markets operating and provider of post trade information services.

1) *Whether the Rule change will prohibit the late bidding behaviour*

- The purpose of the Rule change is to prohibit market participants from engaging in the particular behaviour that has been deemed inappropriate. That is, making changes to bids in order to withdraw capacity as late as possible so as to prevent other market participants from responding and hence to drive up the spot price. Such behaviour is not conscionable conduct by generators that have ample spare capacity and yet use their market power to drive prices higher rather than competing to bring on more supply.
- We note the substantive effect of the changes in Rule 3.8.22A is to change the current obligation on market participants to make dispatch offers (bids and rebids) 'in good faith' to a requirement not to make a dispatch offer *that is false, misleading or likely to mislead*. Rule 3.8.22A (a1) then provides that the making of a dispatch offer is deemed to represent to the market that the dispatch offer will not be changed unless the Generator or Market Participant becomes aware of a change *in the material conditions and circumstances* upon which the offer, bid or rebid are based.
- The Rule change will be effective in prohibiting this behaviour in cases where the generator has already made the decision to change its bid, but delays taking action to do so. The question is whether the Rule change will be effective where a generator's decision to change its bid is contingent on circumstances existing in that late bidding period. If a generator can argue that this is the case, then it may still be able to exploit late bidding behaviour within the new Rule.
- For instance, ERM Power raised concerns about rebidding in Queensland in circumstances where such behaviour causes the QNI interconnector to bind which effectively separates the state from the rest of the NEM. It was suggested that this represented a 'concerted effort to drive up wholesale prices by generators'.
- If this bidding behaviour is occurring, Pacific Aluminium queries whether the amendments to Rule 3.8.22A are sufficient to capture such a scenario. In this regard, we are concerned that if bidding behaviour has caused the QNI to bind, then this may potentially allow rebids on the basis that there has been a change in the '*material conditions and circumstances*'. Our strong suggestion would be to add an addendum to 3.8.22A(a1) to exclude Generators or Market Participants from being able to rebid in circumstances where they have caused or contributed to the change in the material conditions and circumstances.
- In spite of this potential weakness (which we submit the AEMC should address as detailed above), Pacific Aluminium considers that putting the onus on the generator to ensure that its dispatch offers reflect its intentions at all times may act as a deterrent to late bidding and should be adopted.

2) *Whether the penalties are sufficient to discourage late bidding in breach of the Rules*

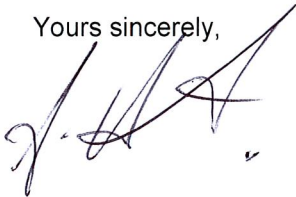
- We note the AEMC will be recommending to the COAG Energy Council that clause 3.8.22A continue to be classified as a rebidding civil penalty provision for the purposes of the National Electricity Law. The current penalties for a rebidding civil penalty provision are presently \$1,000,000 and \$50,000 for every day during which the breach continues.

We have concerns that this level of penalty is not sufficient to deter behaviour which contravenes the intent of the National Electricity Rules. For instance, ERM estimates the value of the current behaviour to be in the order of \$400M. As has been noted by both Ernst & Young and ERM Power, the benefits for engaging in this conduct are potentially lucrative and significantly above potential penalties faced. We would therefore propose that the AEMC consider raising the maximum penalty for rebidding civil penalty provisions to a more significant amount to provide a sufficient deterrent to these behaviours (such as \$10,000,000 for each event).

- We note that clause 85 of the National Electricity Law provides that if a corporation breaches a civil penalty provision, each officer of the corporation is to be taken to have contravened the offence provision or to have been in breach of the civil penalty provision if that officer knowingly authorises or permitted the contravention or breach. We consider this provision to also be a useful and significant deterrent available to the AEMC should a breach of the Rules in relation to late rebidding occur.

Nothing in this submission is confidential, however, we would seek a meeting with members of the Commission at your earliest convenience. If you have any questions, please contact Pacific Aluminium Manager Energy, Warren Saunders (3028 2092 or warren.saunders@pacificaluminum.com.au).

Yours sincerely,

A handwritten signature in black ink, appearing to be 'A. Horvat', written over a horizontal line.

Andrew Horvat,

General Manager Energy

