

SUBMISSION

From

AUSTRALIAN BULK MINERALS

To

DEPARTMENT OF TREASURY AND FINANCE

Regarding

**RETAIL COMPETITION IN THE TASMANIAN
ELECTRICITY SUPPLY INDUSTRY
INFORMATION PAPER - MARCH 2004**

25 May 2004

SUMMARY

This submission is made by Australian Bulk Minerals (ABM) to the Department of Treasury and Finance in response to the proposals set out in its Information Paper on Retail Competition in the Tasmanian Electricity Supply Industry issued in March 2004.

The proposals for the introduction of retail competition into Tasmania contain at least seven detrimental restrictions. The reasons for most of these restrictions are not given in the information paper but all seem to benefit the incumbent dominant generator or retailer. If the proposals are introduced without modification they will act to slow or prevent the development of effective markets so allowing the incumbent dominant entities to maintain higher prices than would otherwise apply. In the short term this will maximise revenue to the Tasmanian Government but in the longer term higher prices and the vulnerability of contestable customers to further price increases from the dominant energy supplier will discourage investment in the state causing job losses.

In particular the proposals:

- a) Leave stranded non-contestable non-tariff customers (those below contestability limits but currently taking supply under a contract) when their existing contracts mature.
- b) Restrict the aggregation of multiple sites operated by a single customer so increasing billing costs. As well the restriction will significantly delay the introduction of effective competition by preventing such customers from negotiating contracts with new retailers.
- c) Do not deal with the situation of customers taking their supply from the transmission network through single user sub-stations owned by Aurora. As a result such customers may in future be required to pay a distribution network service charge for a network that they do not use.
- d) Enshrine the dominant market position of Hydro Tasmania during the periods when it controls the northbound capacity of BassLink and is in a position to manipulate the Tasmanian market energy price.
- e) Will not make the Deemed Fallback Contract available to all contestable customers leaving some subject to disconnection and uncontrolled price increases in an energy market that will (at least in the initial stages) be dominated by Hydro Tasmania.
- f) Result in an over-complex web of contractual obligations with many customers involved in three (possibly conflicting) contracts to obtain supply.
- g) Restrict supply at a connection point to a single retailer so preventing contestable customers from negotiating with alternative suppliers for additional load or for supply at different times of day.

To minimise the damage caused by the reforms the proposals should be changed to:

- a) Make all existing non-tariff ('contract') customers contestable immediately their existing contracts mature even if they are below the scheduled contestability limit at that time.
- b) Allow aggregation of multiple sites operated by a customer subject to the single customer accepting financial responsibility for the aggregated sites and providing metering information, to a standard approved by the Tasmanian Energy Regulator, to the retailer for billing purposes.
- c) Remove the responsibility of the distribution Network Service Provider (NSP) for interposed sole (or dominant) use sub-stations and either transfer responsibility to the customer or to the transmission NSP. Alternatively responsibility could be maintained by the distribution NSP as agent for the customer in return for a fixed maintenance fee approved by the Tasmanian Energy Regulator. It is critical that provision of and charges for sole use sub-stations are separated from the distribution network service charges paid by customers embedded in the distribution network.
- d) Mandate a Fallback Contract at the mainland market price during periods where Hydro Tasmania fully controls the northbound capacity of BassLink and as a result the Tasmanian energy price rises above the mainland price.
- e) Make the proposed Deemed Fallback Contract available to all contestable customers and link the price to the weighted average Tasmanian market energy price rather than exposing trapped customers to unhedgeable full market risk.
- f) Simplify the contractual arrangements from the customer's perspective to a single contract per retailer unless the customer decides to become a market participant.
- g) Allow supply by more than one retailer to a single connection point provided that the customer provides an effective metering system approved by the Tasmanian Energy Regulator that is capable of distinguishing supply from each retailer supplying that site

SUBMISSION

Introduction

Australian Bulk Minerals (ABM) operates the Savage River mine and the Port Latta pellet plant in NW Tasmania employing directly and through contractors over 400 people in a region with some of the highest unemployment in Australia. ABM is a substantial purchaser of electricity both under a Major Industrial Contract and various tariffs. The mining sector is a price taker and falls in metal prices in recent years have resulted in the closure of other Tasmanian mines. Any increase in energy costs has to be offset by other savings if an operation is to survive. Aurora has recently advised ABM that it will impose a backdated 47% increase in the Network Charge on ABM and the potential for further increases is of extreme concern to ABM and its owners.

For reference attached as Schedule 1 to this submission is a chart comparing for the last three years the sums received by ABM for its pellets with the cost of some of its major supplies including the Network Charge imposed by Aurora. Electricity energy prices in that period have risen faster than the Consumer Prices Index. It can be seen that Network Service Charges from the regulated monopoly NSP are unique in rising by over 100% in an era where ABM has been able to secure falling nominal prices from its other key suppliers. As energy is the most significant single input to ABM's cost structure such huge price increases impact on the viability of the operation. Electricity prices and their stability will be one of the factors considered in the current study being undertaken to extend Savage River Mine life (and the 400 jobs that go with it) beyond the current five year mine life.

If industrial operations like ABM are to continue their operations in Tasmania it is critical that the delivered price of electricity is similar to that faced by equivalent operations on the mainland. Without significant changes to the proposals outlined in the Information Paper it is ABM's view that the dominant generator (despite their low marginal operating cost) will be able to manipulate the Tasmanian market to ensure that for considerable periods each day the Tasmanian market price is above the mainland price. For the remainder of the time the Tasmanian price will be the same as the mainland price. Tasmanian industry will face institutionalised higher average prices for one of their key inputs. Further the proposals do little to promote an effective electrical energy market as potential competitors to Hydro Tasmania will be faced with a dominant generator with a very low marginal cost of generation. Customers will thus be vulnerable to market manipulation or unwarranted contract price increases (like the recent 47% increase in Network Charges) imposed by the dominant suppliers.

a) Non-Contestable and Non-Tariff Black Hole

When the vertically integrated supply system was disaggregated in 1998 a number of customers took (and continue to take) electricity supply under a series of Non-Tariff Power Supply Agreements ('contracts'). Section 3.3.1 on page 8 of the Information Paper states that for non-contestable customers as these contracts expire "that

customers may again be supplied under a tariff.” Unfortunately for many of these contract customers no applicable tariff exists. That is the reason why they are supplied under a contract. Such customers will thus be forced to accept an inapplicable tariff (significantly more expensive) or “negotiate” only with Aurora who has every incentive to maximise the yield from that trapped customer by increasing prices. These customers are currently, in effect, contestable but will be forced by the proposals to take supply on a more expensive regulated tariff or cease operation in Tasmania. Clearly this is a perverse result of moves toward ‘Retail competition’. The perverse result can be simply avoided by slightly expanding the contestability criteria to include all existing contract customers as contestable from the date that their contract matures or otherwise provide that their energy price be related to that in the “Tasmanian Market” until they once again become contestable.

b) Aggregation of Sites

Section 3.2 on page 7 of the Information Paper notes that aggregation of sites will only be allowed where the “nature of the business undertaken requires several connection points at a single location.” The reason for this requirement is not stated in the Information Paper and it is not a requirement in the National Electricity Market. The only expressed reason for preventing aggregation is a supposed difficulty faced by a retailer in combining metering information from several disparate sites. Without aggregation of sites it is difficult to conceive how the number of available contestable customers in the state could build to a sufficient volume to enable other retailer(s) to enter the market. The National Electricity Market works best where customers can change their demand by short term moves of operation from one site to another in response to changes in the market energy price.

Subject to their combined demand meeting the overall contestability limits a maximum aggregation of say twenty individual sites is technically feasible. The aggregated customer should be required to provide metering giving a single signal or reading to their retailer from a metering system approved by the Tasmanian Energy Regulator.

Without aggregation development of an effective retail market will be delayed and contestable customers will not be able to negotiate with alternative retailers. Until an effective market emerges the blanket prohibition on aggregation of industrial sites will produce higher prices and restrict customers’ ability to compete with mainland operations.

c) Sole use Transmission Network Sub-stations

The proposals apply different rules to customers connected to the Transmission Network and those connected to the Distribution Network. Most Transmission Network connected customers pay for supply through distribution sub-stations owned by Aurora. Most of these sub-stations supply a single customer who may have made a substantial capital contribution to the construction or replacement of the sub-station.

The Information Paper is silent on their situation.

It is critical that responsibilities and the charging mechanism for sole or dominant use sub-stations be clarified. Such customers derive no benefit from the Distribution Network and when they become contestable should not be liable for the Distribution Network Service charge. The simplest solution is to transfer sole use sub-stations to the customer or for Aurora to make the sub-station available to the customer in return for a rent approved by the Tasmanian Energy Regulator. Any rent should take account of capital contributions made by the customer.

d) Restrictions on Market Entry

Well over half of the delivered price of electricity is a payment for energy. As Hydro Tasmania controls the Northward capacity of BassLink it is probable that it will be able to manipulate the Tasmanian energy market for some time. In the short term effective competition can only be provided by mainland generators.

Contestable customers will be forced to either accept (directly or indirectly) the Hydro Tasmania price or shut down their operations unless some Deemed Fallback Contract is made available in a similar way to that proposed for distribution customers on page 2 of Retail Competition Information Brief No.2. Such a Deemed Fallback Contract should be set at the average mainland market price for the time periods where the Tasmanian Market is separated from the mainland market due to Hydro Tasmania exercising its control over the northward capacity of BassLink. Such a fall back contract would enable mainland generators to hedge their exposure to the Tasmanian market price at times when they are unable to supply through BassLink. It will also ensure that Hydro Tasmania is unable to use its dominant position to manipulate the Tasmanian market.

Without such protection an effective energy market cannot develop and contestable customers will be vulnerable to price increases such as the recent backdated 47% Network Charge increase imposed by the monopoly retailer. Such exposure will have a detrimental effect on investment (jobs) and in the case of ABM, on its ability to continue operations beyond the present 5-year mine life.

e) Deemed Fallback Contract

The proposals include a Deemed Fallback Contract (where no other contractual arrangements are in place) for contestable customers connected to the Distribution Network but not for contestable customers connected to the Transmission Network. There seems little logic in the limitation of the Deemed Fallback Contract to distribution connected customers. Certainly no justification is provided in the Information Paper. Given the dominant market positions of Hydro Tasmania and Aurora it is unlikely that effective competition in either of these “markets” will emerge before full contestability in 2010. It is therefore quite likely that in the first few years some alternative will be required for customers unable to reach agreement with the dominant supplier. The physical arrangement of connections does not determine a customer’s requirement for an alternative and customers connected to the Transmission Network are just as vulnerable to market manipulation as customers connected to the Distribution Network.

The Information Paper seeks comment on the retail host for the Deemed Fallback Contract. ABM is of the opinion that the Deemed Fallback Contract should be with the retailer of last resort. If the Deemed Fallback Contract is with the incumbent retailer or the last retailer to have supplied then neither have any incentive to provide a price other than that determined under the Deemed Fallback Contract. Further as the reason for utilising the Deemed Fallback Contract may be a commercial dispute (or a bad debt) with the last retailer to have supplied, a requirement for that retailer to operate the Deemed Fallback Contract is likely to exacerbate the situation.

The proposed pricing structure for the Deemed Fallback Contract is not explicit but it is based on the Tasmanian spot market price. Such a price will be difficult to administer as it changes every half hour and will expose both the nominated retailer and the customer to market risk. As contestability limits fall exposure to the huge market price spikes experienced to date could prove catastrophic for smaller customers limiting the effectiveness of the Deemed Fallback Contract.

Given the likely initial limited market development and the consequent vulnerability of customers to the dominant Tasmanian generator ABM believes that the Deemed Fallback Contract should be available to all contestable customers. Its pricing should be based on the weighted average Tasmanian market price for each day of supply under the Deemed Fallback Contract.

f) **Complex mesh of Contracts**

Contestable Customers taking supply from a retailer do so, amongst other reasons, to avoid the complex arrangements required of Participants in the National Market. As proposed in the Information Paper contestable customers taking supply from a retailer will be involved in three contracts;

- A connection agreement with the monopoly transmission NSP
- A deemed contract with the distribution NSP and
- An agreement with the retailer

Each of these contracts will require separate formation and billing resulting in substantial cost and possible delay to both retailer and customer. Given that two of these contracts are with statutory monopoly NSPs it is unlikely that their terms will vary between customers or that they will be subject to market forces. Customers will have no real negotiating position thus there seems little point in setting up such a complex, time consuming procedure.

It will be a lot simpler if the retailer(s) incorporate the required NSP provisions in their contracts with customers. Further it may be possible for retailers to set up balancing internal risk hedges between different customers should their customers wish to have arrangements differing from those mandated by the monopoly NSP. Such alternatives are not available to an individual customer but could prove to be a market opportunity available to prospective retail market entrants.

ABM believes that contestable customers should be required only to enter into a single contract with their selected retailer which should incorporate terms specified by the NSPs and approved by the Tasmanian Energy Regulator.

g) **Additional supply to contestable customer**

In the National Electricity Market it is possible for customers to “stack” contracts from different retailers. The facility is attractive to customers changing their demand pattern as they can negotiate with a new supplier for additional supply. The facility prevents an incumbent retailer using its position to manipulate prices for additional supply. The proposals in the Information Paper prohibit such a facility with only one Tasmanian retailer allowed to supply each connection point. Such restrictions are said to be due to metering limitations. Given that meters are now available to cope with multiple suppliers it is difficult to justify such a restriction. Provided that the customer is responsible for providing any required metering to a standard approved by the Tasmanian Energy Regulator contestable customers should be able take supply from multiple retailers and (an unlikely situation) act as Market Participant for part of their load. Further given the likely continuing dominant position of Hydro Tasmania at certain times of day it should be possible for customers to negotiate with multiple suppliers for different supply times on the same site.

Without the ability to negotiate with alternative or multiple suppliers any expansion of operations (and the jobs that go with them) in Tasmania will encounter a premium electricity price not encountered by operations on the mainland putting Tasmanian operations at a considerable disadvantage. ABM believes that (subject to provision by the customer of metering approved by the Tasmanian Energy Regulator) contestable customers should be able to negotiate with multiple retailers for blocks of base or additional load.

Conclusion

The proposed model for the introduction of retail competition into Tasmania contains at least seven detrimental restrictions. The reasons for most of these restrictions are not given in the information paper but all seem to benefit the incumbent generator and/or the incumbent retailer. If the proposals are introduced without modification the restrictions will act to slow or prevent the development of effective retail and energy markets so allowing the incumbents to manipulate prices. Whilst such price manipulation may maximise revenue to the Tasmania State government in the short term it will, in the longer term, divert development from Tasmania, reduce employment and so overall have a detrimental effect on the state.

Schedule 1
Comparison of various nominal prices with Network Charges
Common base April 2002

