

Energy Strategy Submissions  
Department of State Growth  
GPO Box 536  
Hobart TAS 7001  
[energystategy@stategrowth.tas.gov.au](mailto:energystategy@stategrowth.tas.gov.au)

10 September 2014

Dear Minister Groom,

Bell Bay Aluminum (BBA) welcomes the opportunity to make a submission on the Tasmanian Energy Strategy Issues Paper (the Paper). As Tasmania's largest electricity consumer for over 55 years and a major gas consumer, the structure of the State's energy systems is of paramount importance to the existence of BBA.

BBA directly and indirectly employs more than 1500 Tasmanians and contributes \$690M per annum to Tasmania's Gross State Product. It was the first aluminium smelter built in the Southern Hemisphere, commencing production in 1955 as a joint venture between the Commonwealth and Tasmanian Governments, attracted by the availability of electricity used in the smelting process.

The Australian aluminium industry is facing unprecedented challenges to its immediate viability from depressed aluminium prices and the continued strength of the Australian dollar. The aluminium price today in Australian dollar terms is more than 20 per cent lower than it was during the global financial crisis and 40 per cent lower than the long-term average. As noted in the Paper, the price of electricity in Tasmania has increased markedly over recent years – particularly transmission and the price of the Federal Renewable Energy Target (RET) both having increased by over 200% for BBA in the last 5 years.

Manufacturing aluminium is highly electricity intensive and, as such, is very exposed to the cost of the RET. Even after the current partial exemption the RET still costs BBA around \$8 million per annum. Aluminium is a globally traded commodity sold via the London Metals Exchange (LME) and as a result BBA has no ability to pass these costs through to its customers. Since the RET scheme commenced in 2001, it has cost BBA around \$48M of which \$35M has been allocated to the scheme in the last five years. Forecast RET costs for the next five years are a further \$42M. Put simply, BBA cannot afford to continue to pay this subsidy to renewable energy generators and is seeking a full exemption from the RET burden.

In addition, the 200% increase in Network charges over the last 5 years has crippled investment by major industrial users in Tasmania and undermined the system viability. Urgent and significant intervention is required to ensure the overall delivered energy cost is reduced which in return will restore BBA's confidence.

In response to the impacts of external forces including RET, transmission, freight costs and depressed market conditions, BBA employees have already delivered millions of dollars in cost savings and business improvements from across all parts of our business in areas such as capital expenditure, maintenance, raw materials and workforce productivity.

BBA has limited ways in which costs can be reduced and we have been actively reducing workforce numbers and reducing capital expenditure to remain viable. Continuing high costs for RET, transmission and freight can only be offset by further reducing the workforce and reducing capital expenditure.

The development of a Tasmanian Energy Strategy is a constructive means to leverage the State's existing (and future) energy assets to have the optimum impact on the Tasmanian economy. The Tasmanian Government is encouraged to ensure the Energy Strategy objectives are coherent, have clear links to economic performance indicators, and have an aligned support structure, consisting of State Departments, Government Business Enterprises (GBEs) and a regulatory framework to deliver on the Energy Strategy. There should be acknowledgement that this is the start of a process of significant change in approach to energy in Tasmania, which is evidenced in the decisions taken in recent months by both the State Government and the three electricity based GBEs – Aurora, Transend and Hydro Tasmania.

BBA believes the Energy Strategy should contain the following;

- Concise and measurable objectives expected from GBEs and how they contribute to the overall state economy,
- The GBEs understand the gaps and opportunities between their performance and globally competitive benchmarks for cost performance, cost to customer and service delivery and have strategic plans in place to close the gaps,
- There should be a clear means to ensure the energy businesses are aligned and making decisions in the best interests of Tasmania, as their shareholder, not just a narrowly defined version of their own interests;
- The Minister has access to independent advice re the merit of the content and basis of the individual GBE strategic plans including the rate of implementation.
- Arguably, the Tasmanian economy has the most to lose and the most to gain relative to other states from the structure and how it complies with the various regulations governing the interaction of the Tasmanian energy markets with national and interstate markets. Tasmania's Energy Strategy should include suitable resources and focus in the sphere of influencing the modification / development of the various regulations, in particular the treatment of transmission under the National Electricity Rules. Again, this needs to be tested against what is best for Tasmania.
- The Energy Strategy should establish clear milestones, both in time and benefits to be achieved for Tasmania, to maintain the necessary momentum and urgency in improvement.

In the event the milestones are not achieved, the Energy Strategy should outline what actions it will consider in order to get back to the planned improvement targets – including consideration of the structure of the Board and Governance processes for the GBEs

The remainder of this submission contains answers to specific questions raised in the Paper that are relevant to BBA. No part of this submission is confidential. BBA looks forward to continuing dialogue with the Tasmanian Government and other stakeholders in the development of this Energy Strategy.

Kind regards

A handwritten signature in black ink, appearing to read 'Ray Mostogl', with a large, sweeping flourish at the end.

Ray Mostogl,  
General Manager  
Bell Bay Aluminium

***Question 1 - What enhancements could be made to regulatory frameworks to ensure the right incentives for businesses and consumers are in place?***

The regulatory framework applicable to Tasmania and the National Electricity Market (NEM) more broadly, has seen businesses and consumers face year on year cost increases in Tasmania which have been in the order of 200% over the last five years. These cost increases provide a negative incentive for businesses and consumers in Tasmania, at a time when business in particular, can least afford it.

In this context, material changes to the regulatory frameworks need serious consideration, however given the overall complexity of the framework under the National Electricity Rules (Rules) and the number of NEM jurisdictions involved, we expect any such change will take considerable time to be developed, agreed and implemented, a process which is misaligned with the more immediate needs and interests of Tasmania's businesses and consumers. As such, it is important to note that while the regulatory frameworks applicable to regulated transmission and distribution businesses in the NEM set the maximum revenues those businesses are entitled to recover from their customers, there is no regulatory impediment to those businesses electing to recover less than the maximum approved revenues. Given the owner of the transmission and distribution business in Tasmania is the Government, we consider there is scope for the Government to ensure the right incentives for businesses and consumers are in place at least until such time as broader NEM based regulatory change can be achieved.

Leveraging the opportunity to provide regulatory cost relief noted in the paragraph above, the Tasmanian Government should, in the first instance, satisfy itself of the appropriate level of cost reduction to be provided to businesses and consumers to achieve the best overall outcome for the economy. It should be seeking this commitment from the existing GBE Boards, and where appropriate obtain independent advice to demonstrate proper alignment between the State's objectives and the inherent capability within the existing energy GBEs.

The next step would be to understand where the state economy sensitivities are within the existing regulatory framework and establish a plan to challenge the regulations for immediate and broader change. It is important to note, the Tasmanian economy is potentially the most exposed economy in Australia to energy policy and NEM regulatory frameworks, with large cost sensitive industries consuming ~60% of the State's energy.

***Question 2 - Given both the State and Commonwealth Government are committed to reducing red and green tape, and that the electricity market is highly regulated and complex, what opportunities are there to reduce or remove regulation?***

The response to the first question partially answers this by identifying the linkage between regulatory requirements and cost burden that places on the energy entity, which is ultimately passed onto consumers, and where there is an option to pass through less than the maximum charge.

Specifically within the Networks Regulations, the meteoric rise in transmission charges has been largely attributed to overspending leading to the expansion of the Regulated Asset Base (RAB) and then the Weighted Average Cost of Capital (WACC) over-compensating the State owned providers of monopoly network services for the risk they are genuinely taking. Changes to regulations which address the over investment (including recognition of stranded assets and associated impairments) and the inappropriate treatment of the investment risk would go a long way to reversing the increased network charges which has been borne by consumers. Arguably, it has also penalised the

electricity industry by effectively incentivising consumers to avoid the high prices by switching to other forms of generation, thereby affecting the capability of the network. The current regulations and the way in which TasNetworks chooses to operate within them, if unchanged, will potentially lead to a “death spiral” as lost charges are recouped by charging existing consumers more, making more businesses unviable and driving further switching to reduce network use thereby increasing the death spiral, and so on.

In many ways, the greatest threat to the energy intensive industries in Tasmania comes entirely from the practices of Tasmania’s own GBE’s.

***Question 3 - Is retail competition important because of price, choice or for other reasons?***

*No comment*

***Question 4 - What enhancements or additional information could increase the reporting transparency of the Government’s electricity businesses and contribute to improved efficiency?***

Much of what is measured within GBEs is publically available, either through the entity or via end of year reports, such as that from the Office of the Tasmanian Energy Regulator. The GBEs have a plethora of measures some of which are very technical and difficult to interpret for both businesses and the average person in the community. BBA believes an improved sense of transparency could be achieved via the establishment of a “Consumer Challenge Panel”. The Consumer Challenge Panel, with appointments determined by the respective Minister, should be used to provide advice to the Minister on appropriate plans, requests and reports. The purpose fo the Panel would be to enhance the community’s view that their interests are in fact being represented in what can be a very technical area. The Consumer Challenge Panel could also be utilised to provide briefings to the Legislative Council, again to provide further transparency to both houses of Government.

***Question 5 - Do energy intensive and trade exposed businesses require greater future price certainty to maintain and/or grow their operations?***

For capital intensive industries such as BBA, investment decision making requires as clear an understanding as possible of future costs over the time horizon of the investment. Operating in a capital intensive commodity business where revenues can be cyclical and at times volatile, businesses like BBA have to take a long term view, but also have the ability to quickly and effectively respond to global market and national regulatory changes which result in a material change to the businesses viability. BBA as an industrial consumer, who is fully exposed to global pricing, and therefore global economic factors, to ensure continued business viability, has sought both certainty and customised solutions to deal with revenue volatility where possible with suppliers. BBA would welcome a willingness to consider such solutions with all of the suppliers of energy services to the smelter.

***Question 6 - Would you consider accepting slightly lower levels of reliability if this resulted in materially lower prices?***

There is no debate that aluminium smelting is highly reliant on a dependable supply of energy. Debate occurs when proposals to increase reliability are implemented which the consumer did not ask for and to manage risks in a “gold plated” manner. The case is even more questionable when system reliability has been shown to deteriorate after five years of “investment to improve reliability”. Reliability is a cost and risk proposition. The optimum is for the service provider and the consumer to agree on the business case, for the reliability improvement to be delivered in an

efficient manner and finally for the predicted improvement to be demonstrated via system performance data. BBA welcomes all opportunities to consider trading cost for reliability but would prefer a mindset which says how can we achieve reliability for the lowest possible cost?

Reliability of supply has two classes, human generated faults and asset related faults. The former should be actively scrutinised and consumers made aware of measures taken to prevent a reoccurrence.

A key consideration in the area of reliability investment is who pays for what. While reliability of a central asset may be warranted for one consumer class (or location), should the cost of the improvement be levied across all consumers?

***Question 7 - Would a review of tariff structures be desirable, in terms of minimising total network costs and allocating costs fairly?***

A review of tariff structures would be desirable; however this may have a negative impact for some consumers, including major industrials.

***Question 8 - What approach, including non-regulatory ones, should Government consider for improving the thermal efficiency of our buildings?***

*No comment.*

***Question 9 - What approach to energy efficiency should Government use to help improve productivity for small to medium businesses, and to reduce energy bills for households?***

The best interests of all consumers needs to be represented in the Energy Strategy. The opportunities to value add to Tasmania's natural resources to generate employment and economic activity should be core business for the Tasmanian Government. One pathway to consider is to give the right mandate to GBEs and their Boards so that this is an active part of their mandate.

***Question 10 - What role should Government play in attempting to retain and increase load growth in Tasmania and how should it do it?***

With 60% of Tasmania's electricity being utilised by a small number of industrial customers the proposition to retain load is relatively simple. Clearly all of the major industrials are subject to national and international market forces, which typically lie outside of what the State Government should take into account with its own policies and strategies.

The Tasmanian State Government should satisfy itself that its delivered energy costs are internationally competitive. If a business's viability is still threatened, despite having access to internationally competitive delivered energy, then neither the Tasmanian Government, nor its taxpayers should be expected to see delivered energy costs lowered further to offset other factors.

The Tasmanian Government should have a strategy which ensures its world class renewable assets are delivering world class pricing, via highly efficient, customer focussed GBE's. This is its obligation to put its best case forward to retain existing businesses.

Globally competitive delivery of renewable energy is the "carrot" which Tasmania can make available to national and international energy consumers. Achieving this result and advertising this competitive advantage should be a key plank in the strategy to retain existing businesses and to grow the load of energy used on the island.

***Question 11 - What further potential is there to develop renewable energy in Tasmania, including wind energy, given there is no unmet Tasmanian demand requiring additional generation for the foreseeable future?***

Additional investment in electricity generation should only occur on the back of a business case. The challenge for investment decisions is ensuring the capacity can be utilised to provide a return on investment. Given there are some projections Tasmania has sufficient capacity to meet its own needs until 2035, the business case for additional generation will either be in expanding industry in Tasmania or exporting electricity to the NEM. The Tasmanian economy does not have the depth for one sector to subsidise another, therefore any growth of the Renewable Energy Sector should be entirely self-sufficient.

One consideration will be in the focus of the GBE. As is expected from all private enterprises, maximising the productive capacity from existing assets should be a core priority for any operator of an asset. If the focus of the business is in installing new generation, they may not be as focussed on maximising their existing assets. The Tasmanian Government should have an asset utilisation target, and the energy GBEs should be refining their operating strategies to reflect optimum productive capacity. Taking opportunities to increase efficiency in parallel with carrying out necessary maintenance of assets may be prudent, but again the additional upfront investment needs to be substantiated by the additional return.

A further consideration is that investing early may mean that Tasmania misses out on the innovation which is occurring in the Renewable Energy Industry. The innovation may appear as more efficient generation equipment or lower cost generation equipment, or both. Investing too early can bring with it a liability which exceeds the return.

***Question 12 - Is there a further facilitation role for Government in gas roll-out, or should Government focus its efforts on examining the costs and benefits of improving minimum protections for gas customers?***

The more gas is utilised in Tasmania, the more the fixed costs are reduced for individual users, as well as creating more competition to reduce the size of any price differential between electricity and gas. As a significant gas user in the Tasmanian context, BBA encourages the Government to consider pathways to increase gas utilisation within Tasmania.

***Question 13 - What are considered to be the key opportunities, and the key issues, associated with possible energy futures?***

No comment



***Question 14 - What could be some outcomes for the Tasmanian Energy Strategy, and what actions can government, or energy providers and consumers take to achieve them? How could success/performance be measured?***

The Energy Strategy is founded on the view that competitively priced electricity will enhance Tasmania's socio economic performance.

Globally competitive energy pricing will be delivered by exacting and unrelenting State Government expectations requiring highly efficient generation, transmission and distribution enterprises to perform at benchmark levels.

This globally competitive resource will be leveraged for every residential connection in Tasmania to have the lowest energy rates in Australia, and for businesses to have energy pricing which supports growth rather than threatening viability.

Tasmania's energy cost and fit for purpose reliability will be a draw card for interstate and overseas businesses to consider relocation to Tasmania, thereby boosting employment opportunities, and adding further benefits to Tasmania's socio economic performance.