

Queensland Productivity Commission
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This submission is not confidential in any way

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Dear Commissioner

Pacific Aluminium welcomes the opportunity to make a submission to the Queensland Productivity Commission (QPC) on its draft report issued on 3 February 2016 as part of the Electricity Pricing Inquiry ('the Draft Report'). 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 for two reasons—GPS is the largest power station in Queensland (1680 MW) with approximately 13 per cent of the state's capacity and BSL is Queensland's largest single power consumer (~970 MW). BSL is a key contributor to the Gladstone region and the state. BSL has continued to invest in the smelter over the past 30 years, most recently completing a refurbishment at a cost of more than A\$720 million in 2012, including construction of a new bake furnace, the replacement of overhead cranes and improvements to the alumina transport system. This investment extends the technical life of the smelter, improves environmental and greenhouse performance and increases operational 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 the Gladstone area. The smelter directly employs around 1,000 people and helps create a further 6,700 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 services¹.

In responding to the Draft Report, Pacific Aluminium has provided comments on those draft recommendations most pertinent to BSL, as a major wholesale electricity consumer in the attachment to this letter. In addition, Pacific Aluminium has the following comments on the Draft Report:

1. Pacific Aluminium notes that the ACIL Allens electricity market forecast commissioned by the QPC projects that BSL and coal-fired generating capacity the size of GPS will close in 2029.

Global demand for aluminium is continuing to increase and, although the market is currently depressed due to an excess of supply, the future outlook for the industry remains strong. BSL is still a large smelter by global standards and is well-maintained and efficient. It is Pacific Aluminium's belief that, provided BSL can secure competitively priced electricity, there is every reason it could continue to compete internationally well beyond 2029.

Accordingly Pacific Aluminium is disappointed that the Draft Report contains no critical analysis to explain why Queensland, which once has a substantial competitive advantage in the production of electricity, no longer expects to maintain that competitive advantage into the future. Pacific Aluminium believes that it is critical for the Queensland Government to understand the drivers of

¹ Boyne Smelters 2011-2014 Sustainability Report, available from <http://www.boynesmelts.com.au/>

Queensland's loss of international competitiveness, in particular, the extent to which it is due to structural changes in the global, Australian and Queensland economies versus due to policy settings adopted by the Queensland and Australian governments. This knowledge would help to inform future policy decisions. 2. In the terms of reference for this inquiry, the Queensland Government sought advice on options that would "place downward pressure on electricity prices", yet ACIL Allens forecast that wholesale electricity prices will increase significantly to 2035. This forecast is against a backdrop of a global marketplace with excess supply of energy and falling prices. This provides a dismal outlook for Queensland electricity consumers in absolute and relative terms. It is unclear why the QPC has concluded that Queensland is moving against the trend.

3. Section 2.1.1 of the Draft Report states, "We note though that some of the most intensive electricity users have some degree of market power to allow them to generate their own power or negotiate their own long term contracts, placing downward pressure on prices." Pacific Aluminium's submission is cited to support this comment. However, we see nothing in our submission that supports the QPC's statement that most intensive electricity users have market power. Indeed, previously BSL has been unable to source competitively priced electricity for a substantial block of load from the market, and has been forced to reduce production in order to avoid excessively high electricity prices even at a time when low cost base load generation is idled. This is not evidence to support BSL having market power in the electricity sector. As stated in our submission of 16 November 2015, Pacific Aluminium is concerned that the high level of concentration in the generation sector is enabling the generators to use their market power to withhold cheaper coal-fired generation and drive unnecessarily high market prices. Figure 1 demonstrates the quantity of excess coal-fired generation available on 2 February 2016, when prices in Queensland spiked. This generation was withheld while much more expensive peaking plant operated.

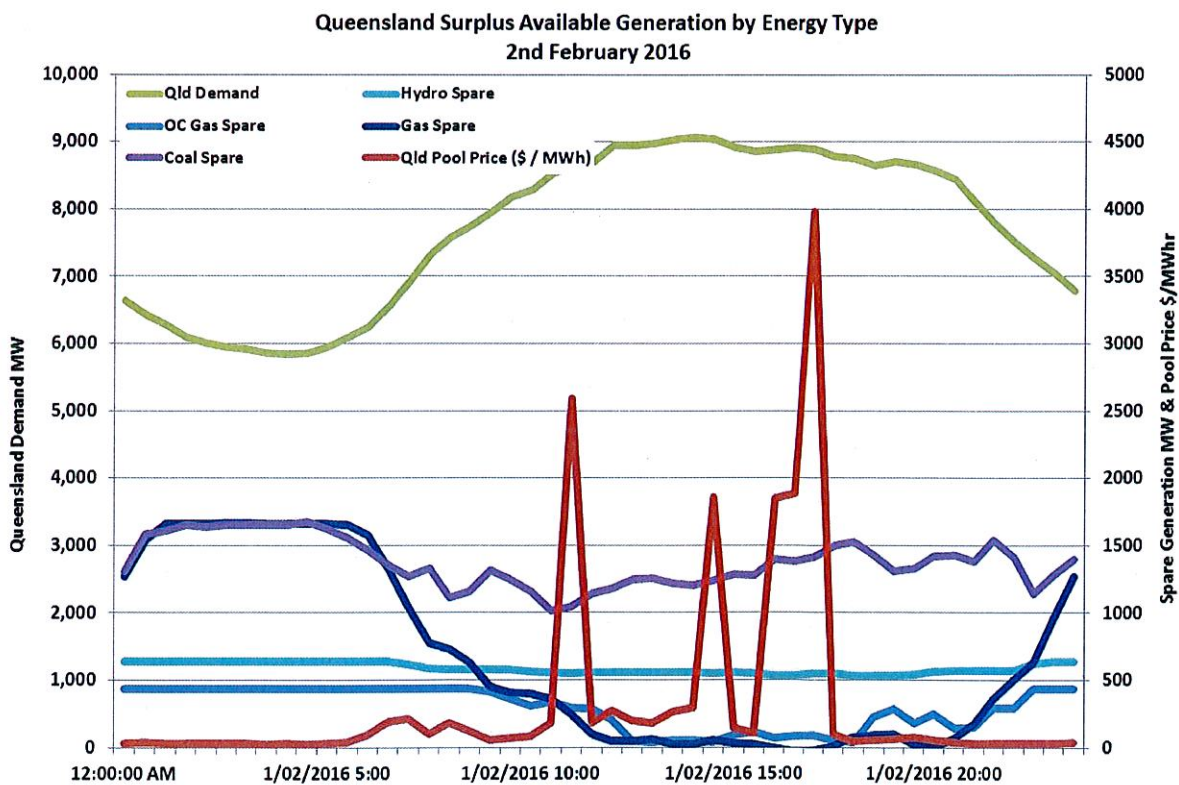
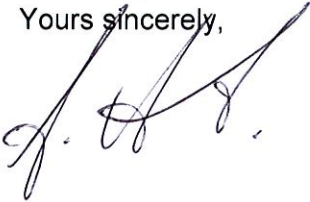


Figure 1 Queensland Surplus Generation by Energy Type (2 February 2016)

If you have any questions regarding this submission, please contact me on 07 3028 2090 or email me at Andrew.horvat@pacificaluminium.com.au.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'A. Horvat', written over the closing 'Yours sincerely,'.

Andrew Horvat
General Manager Energy

Comments on Draft Recommendations

	QPC's draft recommendation	Pacific aluminium's response
<i>Supply chain productivity - A sector in transformation</i>		
1	To ensure the development of an efficient electricity market, the Queensland Government should not favour any technology over another, and allow the market to evolve to meet consumer demand	<p>Pacific Aluminium supports the principle that a well-structured and highly competitive market should be left to determine which technologies should be adopted to create the product to be marketed. We also recognise that government intervention can have negative impacts on market confidence and efficient investment and is generally best avoided.</p> <p>That said, not all technologies for producing electricity are equal. Already concerns are being raised in South Australia, where it appears that intermittent wind generation that is subsidised through the Renewable Energy Target (RET) is crowding out base load thermal generation, without providing an equivalent replacement product. In addition, to the extent that network pricing rules do not send clear locational signals to generators, the increased demands new technologies are placing on network investment can lead to consumers facing higher costs.</p> <p>The electricity industry does not have a naturally occurring market and a significant portion of the industry is dominated by regulated monopolies. It is a very highly regulated market environment, and places a high reliance on the regulatory settings being just right in order to drive efficient market outcomes, which is not always the case.</p> <p>In these times of rapid technological change, the Queensland Government needs to be vigilant to ensure that the market rules do not promote inefficient technology choices to the detriment of the State's customers. This will enable the Queensland Government to support appropriate NEM market development through COAG.</p>

	QPC's draft recommendation	Pacific aluminium's response
2	To ensure the development of an efficient electricity market, government intervention should be limited to circumstances of clear market failure, and all government intervention should only occur after there is a clear demonstration that the benefits outweigh the costs.	<p>Pacific Aluminium supports the principle that government intervention is likely to have the effect of undermining the efficiency and development of a well-structured, competitive market.</p> <p>In the case of electricity, it needs to be recognised that</p> <ul style="list-style-type: none"> a) A substantial portion of the industry (networks) is not part of a competitive market as these services are provided by regulated monopolies, so the focus of government needs to be on ensuring the regulations drive efficient behaviour, and b) As the QPC has acknowledged, the highly concentrated structure of the Queensland generation sector has raised concerns about the impact on competition, and the Queensland Government has a direct role to play in ensuring its entities are appropriately structured. <p>Also, while Pacific Aluminium agrees that the government should be cautious about intervening in the market, the QPC's recommendation that it should not do so unless there is "clear market failure" may result in the stable door being closed only after the horse has bolted. Once a market has clearly failed, there is likely to be irreparable damage to the economy. The Queensland Government needs to be aware of trends and vigilant for signs of potential market failure.</p> <p>Given that a national governance framework exists for the NEM, the Queensland government should have a strong preference to seek change through that framework over unilateral action.</p> <p>Pacific Aluminium supports this draft recommendation. However, this draft recommendation appears to be inconsistent with the strong stance regarding government intervention taken by the QPC in draft recommendations 1 and 2, which Pacific Aluminium believes needs to be reviewed.</p>
3	The Government should implement an ongoing review program, in conjunction with the network businesses, to monitor the impacts of emerging technology, and to identify the potential need for an early response to be made, based on an assessment of the costs and benefits	
Generation		
4	The Queensland Government should not merge CS Energy and Stanwell, given the likely reduction in competition in Queensland's already concentrated wholesale electricity market and the likely consequence of higher wholesale electricity prices.	Pacific Aluminium does not support any changes which will likely lead to even higher wholesale electricity prices in Queensland than the current uncompetitive levels. Therefore, Pacific Aluminium supports the Queensland government's decision not to merge Stanwell and CS Energy.

	QPC's draft recommendation	Pacific aluminium's response
5	The Queensland Government requirement for CS Energy and Stanwell to achieve operating efficiencies should be complemented by a strengthening of the shareholder oversight role to ensure clear targets for improving performance are set and achieved.	Pacific Aluminium supports the draft recommendation to strengthen the financial governance of CS Energy and Stanwell.
6	To reduce the combined market concentration of CS Energy and Stanwell, the Queensland Government should confirm that it does not intend to increase the size of the existing Government owned corporation (GOC) generation capacity.	Pacific Aluminium believes that Stanwell and CS Energy should not increase the proportion of generation under their control, whether owned or not.
7	The Queensland Government should require CS Energy and Stanwell to develop and adhere to a common voluntary Code of Conduct (the Code) in respect of their rebidding behaviour. The Code should be developed as part of a public consultation process.	<p>Pacific Aluminium is pleased that the QPC has recognised that the GOC generators have been engaging in behaviour inconsistent with a well-functioning competitive market.</p> <p>The draft recommendation that Stanwell and CS Energy should develop a voluntary Code of Conduct with respect to rebidding is interesting and worthy of further consideration.</p> <p>The "good faith bidding" Rule change is scheduled to come into effect on 1 July 2016. This may be sufficient to ameliorate the behaviour it was intended to curb. However, Pacific Aluminium has reservations, particularly in the light of observations that generator behaviour has not yet changed, in spite of the focus on the negative consequences of late bidding during the period the Rule change was being considered.</p> <p>The process of developing and consulting on a code of conduct will focus the thinking of the GOCs on the rationale for their bidding behaviour and may clarify whether the Rule change is sufficient to protect consumers from inefficient pricing.</p> <p>If the conclusion of the QPC's final report is that the Queensland electricity market is too concentrated to be sufficiently competitive and the Queensland Government, as owner of the GOC generators, does not wish to change their structure, a code of conduct may be a useful alternative means of addressing the issue of market power.</p>

	QPC's draft recommendation	Pacific aluminium's response
8	The Queensland Government should require CS Energy and Stanwell to report to the Government, on an annual basis, all late rebids submitted to the Australian Energy Market Operator. This report should be audited by an independent body, and the findings of the audit made available to the public.	This draft recommendation follows from the draft recommendation that there should be a Code of Conduct. Were such a Code to be developed then monitoring compliance with the code should be undertaken. If not, then additional monitoring of bidding activity by the Queensland government would not be efficient as AEMO already has responsibility for monitoring compliance with the Rules.
9	The Queensland Government's Renewable Energy Taskforce should consider: <ul style="list-style-type: none"> the cost and price impacts of a Queensland target; the merits of including small scale solar in a renewable energy target; and the benefits of an inter-jurisdictional approach to emissions reduction policy. 	As stated in our submission on the Issues Paper, Pacific Aluminium does not support additional state measures beyond federal government policy in respect to Renewable Energy. If the Queensland Government adopted draft recommendations 10, this draft recommendation 9 would not be required. Hence, these draft recommendations should be re-ordered and this draft recommendation made contingent on the Government rejecting what is currently draft recommendation 10.
10	In order to achieve least-cost carbon abatement, the Queensland Government should work with the COAG Energy Council to find opportunities for collaboration on carbon policy, as an alternative to pursuing independent action.	As stated in our submission on the Issues Paper, Pacific Aluminium does not support additional state measures beyond federal government policy in respect to Renewable Energy. Pacific Aluminium's view is that the Queensland government's collaboration within COAG on carbon policy should be with the objective of developing federal policy.
11	The Queensland Government should not intervene in the solar PV market to achieve a 3000 MW capacity target for solar PV uptake in Queensland by 2020.	As stated in our submission on the Issues Paper, Pacific Aluminium does not support additional state measures beyond federal government policy. Therefore we support this draft recommendation.
Networks		
12	The Queensland Government's planned merger of the network businesses to achieve efficiencies should be complemented by strengthening of the shareholder oversight role to ensure clear targets for improving performance are set and achieved.	Pacific Aluminium is of the view that this draft recommendation should be enhanced to ensure that there is no cross-subsidisation between the transmission and distribution regulated monopolies.

	QPC's draft recommendation	Pacific aluminium's response
14	<p>Where network businesses are engaged in potentially competitive functions, the holding company should:</p> <ul style="list-style-type: none"> • ensure priority is given to the core activities of the businesses being the provision of electricity network services; • ensure there is robust ring-fencing between the competitive and monopoly functions; • undertake market testing of any commercial interactions between the functions; and • consider a longer-term strategy of full structural separation of the energy services business and the natural monopoly distribution businesses 	<p>Pacific Aluminium supports this draft recommendation, but believes it should be more explicit that there should be no cross-subsidisation of commercial activities by customers to monopoly activities. We also support structural separation of regulated monopoly activities and competitive activities where possible to improve transparency and enable strong governance of those regulated monopoly activities.</p>
Shareholder interests		
21	<p>The Queensland Government should consider enhancing its shareholder performance monitoring role for electricity GOCs with a focus on achieving cost and performance efficiencies.</p>	<p>Pacific Aluminium supports this recommendation on the basis that the changes to governance would bring the GOCs more into line with their private sector competitors and provide a stronger proxy for share market discipline.</p>