

Energy Security Board
Email submission to: info@esb.org.au

22 November 2018

Dear Sir/Madam,

Re: National Electricity (South Australia) (Retailer Reliability Obligation) Amendment Bill 2018

Rio Tinto welcomes the opportunity to make a submission to the Energy Security Board (“the ESB”) on the draft legislation *National Electricity (South Australia) (Retailer Reliability Obligation) Amendment Bill* (the “Reliability Amendment Bill”) which sets out the changes to the *National Electricity Law* to give effect to the reliability obligation. Our responses in this submission are specific only to the Reliability Amendment Bill. These responses should be considered alongside the feedback on detailed design that we have already given to the ESB Secretariat.

As an inherently energy-intensive business, Rio Tinto seeks to produce minerals and metals in the most efficient way possible to both reduce its environmental impact and lower its operating costs. Rio Tinto has interests in three aluminium smelters and two alumina refineries that together use around 10 per cent of the electricity consumed in the National Electricity Market (“NEM”). We support an integrated approach to energy and climate change that delivers a sustainable and durable investment framework.

Rio Tinto sees the role of government, both Federal and State, as creating the right long-term targets and policy to ensure a functioning and effective NEM, one that secures reliable, predictable and internationally competitively-priced energy supplies consistent with Australia’s emissions obligations.

Rio Tinto has raised a number of concerns in our previous submissions and engagement with the ESB Secretariat in respect of the detailed design of the reliability obligation when it was part of the National Energy Guarantee (the “Guarantee”). Most recently we set out our concerns with the reliability obligation drafting in our submission dated on 18 September on the *National Electricity (South Australia) (National Energy Guarantee) Amendment Bill 2018*. While some of the concerns set out in this submission have been addressed in the Reliability Amendment Bill, a small number remain outstanding. These include:

- removing the ability to initiate the reliability obligations at T-1 without having first initiated the T-3 reliability obligation. This remains our primary concern with the reliability obligation – that there is effectively a process that occurs post consultation whereby the reliability obligation is always “on” rather than having a specific T-3 initiation.
- concerns about the disproportionate scale of penalties compared to those already in place in the National Electricity Law.
- technical drafting changes in respect of the reliability obligations including the opt-in provisions

Further to these issues, it is important to recognise that the Reliability Amendment Bill is only one part of reliability obligation with many elements of the design to be given effect in amendments yet to be made to the *National Electricity Rules* (“the Rules”). It is only possible to fully assess the Reliability Amendment Bill as part of an integrated package. Accordingly the issues raised in this submission should not be seen as a complete

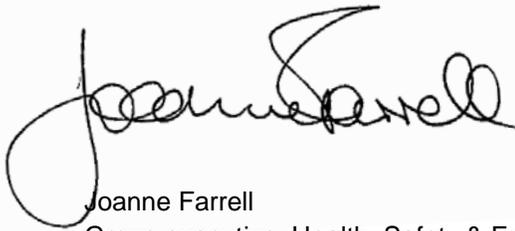
RioTinto

response to Reliability Amendment Bill, but as a preliminary set of issues, with a more complete response only possible to the complete legislative package including the amendments to the Rules. As part of informing the drafting of changes to the Rules our submission outlines some of the issues that need to be considered in drafting the grandfathering of pre-existing contracts into the Rules.

Attachment 1 sets out our technical comments on the above issues.

We would welcome the opportunity to discuss this submission or other design elements of the reliability obligation further with you. If you have any questions in the interim, please contact Daniel Woodfield (Daniel.Woodfield@riotinto.com).

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Joanne Farrell', is written over a light grey rectangular background.

Joanne Farrell
Group executive, Health, Safety & Environment; and
Managing Director Australia

Attachment 1: Detailed comments on the Reliability Amendment Bill

In this submission, unless otherwise noted, references to a section or paragraph within legislation should be taken to be references to that section or paragraph within the National Electricity Law, as amended by the Reliability Amendment Bill.

Consultation and Engagement

Limited timeframes bring with them the possibility of rapid changes with limited consultation and limited opportunity for business to consider the full impact of those changes on their operations. If the interactions in the complex system that is the NEM are not fully considered, there is a real risk of unintended consequences. Accordingly it is fundamental that consultation during this process is fulsome and well managed. In particular, given the complexity of long-term contractual arrangements which underpin our smelters and refineries, we are keen to participate in detailed engagement to ensure any adjustments can be made as necessary to minimise the risk of unintended consequences.

Compliance and Penalties

As a number of Rio Tinto entities are market customers, they will have direct obligations in respect of the reliability obligation. Our observation is that for entities that are large customers, the scale of the penalties seem disproportionately high as set out in paragraph (c) of the definition of *civil penalty* in Section 2(1). The civil penalty provisions for the reliability obligations extend to \$10,000,000 but Section 14T(4) makes provision for a cost recovery scheme to enable AEMO to recover up to \$100,000,000 of costs additional to any applicable civil penalty. The implication of these penalties is an expectation that the reliability obligation will prove to be exceptionally expensive in order to have such large penalties in place. This is particularly the case when considered in the context of current penalties set out in the National Electricity Law, where the penalty for a breach of a rebidding rules is 'an amount not exceeding \$1 000 000' (paragraph (b) of the definition of *civil penalty* in Section 2(1)).

Reliability Obligations

Triggering the Reliability Obligation

As noted in our recent submission in respect of the ESB consultation paper on options for the reliability obligation. Rio Tinto supports setting the Reliability Obligation to trigger at T-3, based on the publication on the annual ESOO or any within-year update to the ESOO triggered by a material change in circumstances. We do not support a reliability obligation that is always "on".

Accordingly we suggest the removal of Section 14H(2) (b), Section 14I (3)(b) and Section 14K(b) (ii) and any other sections of the Reliability Amendment Bill that allow for initiating the reliability obligations at T-1, without having first initiated the T-3 reliability obligation.

Process for non-liable customer to opt-in to the reliability obligations

Rio Tinto supports the ability for a non-liable customer to opt-in to reliability obligations. However the possibility of electricity being purchased through an intermediate step is not contemplated in Section 14E. We note also that “supply” of electricity may not be the appropriate term in all scenarios in the context of the NEM. Accordingly we would suggest amending the text as follows:

(a) the person ~~purchases~~ consumes electricity supplied in a region which forms part of the liable load for ~~from~~ a liable entity;

We support the inclusion of the ability to make specific provision in the Rules to cater for non-standard circumstances of non-liable customer opt-in.(Section 14E (1) (b))

Grandfathering of pre-existing contracts

For facilities with long term pre-existing contracts, it is fundamental that those pre-existing contracts (including retail contracts) are grandfathered so that they are qualifying contracts. This concern was acknowledged in the design of the reliability obligation presented to the Council of Australian Governments (“COAG”) Energy Council in the ESB Paper “*National Energy Guarantee Final Detailed Design*” dated 1 August 2018 (the ‘Final Guarantee Design’).. The Final Guarantee Design set out that these typically bespoke complex contracts will not require a firmness test. Rio Tinto supports this approach.

The Reliability Amendment Bill does not specifically engage with the grandfathering of qualifying contracts. Section 14O(1)(b) allows for the possibility of grandfathering by prescribing certain types of contracts as being qualifying within the Rules. Further paragraph 6K of Schedule 1 provides for ‘treatment of types of pre-existing contracts as qualifying contracts’ as subject matter for the National Electricity Rules. While this allows the possibility of grandfathering, it does not give effect to it. Accordingly, we are very keen to discuss the particular legislative drafting of the Rules that will record the grandfathering mechanisms in order that the policy intent is achieved and to minimise unintended consequences.

Some specific considerations arising out of the particular circumstances of different types of long term contracts are set out below to assist in drafting this provision in the Rules. In particular, it is important that the drafting will need to ensure that the grandfathering means large customers are fully able to satisfy all of their obligations in respect of fees, charges or costs associated with the reliability obligation for the volume and term of their applicable qualifying contracts, without the risk of additional cost-pass through.

Specific circumstances that need to be considered as part of grandfathering contracts

Situation 1: Large load with long term contract – liable entity that purchases electricity under contract is market customer contracted with a market generator.

The primary issue to manage is that while these contracts are qualifying contracts, the long term contracts may potentially be extended and/or expanded or assigned to third parties, whether by virtue of an option in the contract or by mutual agreement between the parties. Accordingly the

grandfathering will need to recognise the agreement, as amended and restated from time to time, without specifying particular volumes or terms and needs to accommodate “successors at law”.

Situation 2: Large load with long term contract – contracting entity is large customer with retailer who is market customer.

In the event that a large customer opts in under Section 14E to become the liable entity, long-term retail contracts (3+ years) must be a qualifying contract so that the large customer as the liable entity is able to meet their obligation under the reliability obligations by the existence of this contract.

Situation 3: Whole of the large load connected under complex historical arrangements to be grandfathered

Where a Registered participant is the liable customer for a liable load associated with complex historical arrangements between multiple counterparties (for example, exempt generation agreements) which provide for the connection of the whole of a large liable load, the grandfathering should apply to the whole of the large liable load at the relevant NMIs.

Other reliability obligations issues

1. Section 14O(2) uses the term, ‘*excluded contract*’ which does not have a definition. This term appears to be a technical one which should be defined.
2. Section 18ZI (1) requires the AER to make procedures and guidelines (the *Reliability Compliance Procedures and Guidelines*). These guidelines and procedures sit outside the National Electricity Law and the National Electricity Rules and are made “without limitation” (Section 18ZI (2)). However regulated entities must comply with them (see for example, section 18ZB (1) and 18ZB (2)). It is a concern that the checks, balances and process that apply to other elements of national electricity legislation and regulation are potentially missing from this process. We request that those matters which were to be included in the Reliability Compliance Procedures and Guidelines are instead included in the National Electricity Rules.