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

5 April 2019

Dear Sir/Madam

Detailed Design of the Retailer Reliability Obligation

Rio Tinto welcomes the opportunity to make a submission to the Energy Security Board ("the ESB") on the Energy Security Board's Retailer Reliability Obligation ('the RRO') Draft Rule Changes ('the Draft RRO Rules') Our responses in this submission are specific only to the Draft RRO Rules. These responses should be considered alongside the feedback on detailed design that we have previously provided 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 supply consistent with Australia's emissions obligations.

Absent the proposed Retailer Reliability Obligation (RRO) being implemented, the expected consequences of the potential electricity reliability gaps will be either unplanned load shedding or AEMO incurring a large cost exercising its function as the Reliability and Reserve Trader (***RERT***) to procure reserve contracts to maintain system security which is then borne by all users in a region, regardless of their contribution to reliability issues Both outcomes are problematic for large industrial users with predictable loads, such as aluminium smelters and alumina refineries who seek to contract for long terms (5 years plus, and in many cases 20-30 years) in order to manage price risk and ensure reliable supply.

Unplanned load shedding fundamentally puts the business at risk as both aluminium smelters and alumina refineries suffer significant operational impacts if they are without power even for few hours, and similarly the requirement to pay additional amounts towards RERT, in addition to the cost they have already contracted to pay for firm electricity supply, places an undesirable impost on the business. Accordingly, Rio Tinto supports the implementation of an RRO to the National Electricity Market.

In this submission, we have sought to focus our comments on those matters directly relevant to large industrial customers with long term off-take contracts and have not sought to comment on every element of the Draft RRO Rules.

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Insufficient detail in the Draft RRO Rules to have certainty over the operation of arrangements

In our submission on the draft legislation *National Electricity (South Australia) (Retailer Reliability Obligation) Amendment Bill* (the "Reliability Amendment Bill"), we requested that those matters which were to be included in the Reliability Compliance Procedures and Guidelines to be drafted by the AER were instead included in the National Electricity Rules. We highlighted our concern that the checks and balances that apply to other elements of national electricity legislation and regulation are potentially missing from this process. Noting that for some of the Guidelines that it is required to make (e.g. the MLO Guidelines in Section 4A.G.25), the AER must make, publish and amend the guidelines in accordance with the *Rules consultation procedures*, we request that this be applied in respect of all guidelines made by the AER in respect of the RRO.

It continues to be the case that there is insufficient detail to establish exactly how existing contracts and other arrangements will be treated under the RRO absent procedures and guidelines yet to be formalised by the AER. This is of concern to Rio Tinto as we are currently unable to determine whether (in addition to the issues highlighted below) there are other issues that arise from the combination of the RRO Rules and the yet to be drafted procedures and guidelines. Our past experiences of dealing with regulatory change confirm the importance of getting the detail right given the large, long-term and bespoke nature of our electricity arrangements.

Qualifying Contracts and Grandfathering

Of primary interest to Rio Tinto when considering firmness principles is the treatment of existing contracts. This has two distinct elements – firstly that the contracts must be qualifying contracts and secondly establishing what firmness factor applies to those contracts.

Where long-term pre-existing contracts are in place to secure electricity arrangements for industrial facilities, it is fundamental that those pre-existing contracts are recognised as qualifying contracts for those facilities to be able to continue to rely on them, without needing to renegotiate them or duplicate them with alternative contracts in order to meet the requirements of the RRO definitions of 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') Further the Final Guarantee Design set out that these typically bespoke complex contracts will not require a firmness test which confirms that they must be qualifying contracts. Rio Tinto supports this approach but notes that the Draft RRO Rules do not adequately deal with this.

Rule 11.115.8 of the Draft RRO Rules sets out the proposed treatment of grandfathering. This section needs to be read in the context of Section 4.A.E.1 of the Draft RRO Rules and proposed Section 14O(1) of the National Electricity Law ("NEL").

Proposed Drafting – Grandfathering arrangements

Rio Tinto proposes the following changes to proposed Rule 11.115.8

11.115.8 Grandfathering arrangements
(a) In this clause, a "licensed retailer" means a person who holds a retailer authorisation under the *NERL* or an electricity retail licence under the *Electricity Industry Act 2000* (Vic).

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(b) This clause applies to:

(1) a Market Customer; or

(2) an opt-in customer,

who is not a licensed retailer ("**Transitional Customer**").

(c) If:

(1) a Transitional Customer is a party to a qualifying contract which reduces the Transitional Customer's exposure to the volatility of the *spot price* in a relevant *region* during the gap trading intervals for the *load* for which it is a liable entity; and

(2) that qualifying contract, as amended and restated from time to time, was in effect as at 10 August 2018,

("**transitional contract**") then for the purposes of clauses 4A.E.2 and 4A.E.3, that qualifying contract is taken to have a firmness factor of 1.

(d) For the purposes of paragraph (c), an electricity retail supply agreement between the Transitional Customer and a licensed retailer for a *connection point* for which it is a liable entity is taken to be a qualifying contract.

(e) A contract for the supply of electricity (as amended and restated from time to time) in effect as at 13 December 1998 under which a Transitional Customer is supplied the *load* at the *connection point,* is taken to be a qualifying contract under section 14O(1)(b).

(~~e~~f) Paragraph (c) applies until the later of:

(1) the end of the term of the transitional contract, specified in that transitional contract as at 10 August 2018, excluding any extension or renewal of such term even if the right to extend or renew existed as at 10 August 2018; and

(2) if paragraph (a) does not apply, 1 July 2023.

The above changes are in response to issues that are of importance to Rio Tinto:

Historical Agreements that predate the National Electricity Market as qualifying contracts

As Rio Tinto has previously outlined in detail to the ESB, Rio Tinto has in place long term agreements that were in effect prior to start of the National Electricity Market ("NEM"). In reviewing the drafting of section 14O(1) of the Reliability Amendment Bill, Rio Tinto noted the importance of Section 14O(1)(b) allowing for the possibility of grandfathering by prescribing certain types of contracts as being qualifying within the Rules as provided for in section 14O(1)(b).

Given the current drafting in 4A.E.1(a)(2) specifically prohibits the AER from prescribing other types of contracts or arrangements as qualifying contracts in the Contracts and Firmness Guidelines under section 14O(1)(b), it is important that the Rules specifically prescribe other forms of qualifying contracts as are necessary to give effect to the intent of COAG as set out in the Final Guarantee Design.

As the definition of a qualifying contract in section 14O(1)(a) of the NEL is entirely framed in the context of the operation of the existing NEM, it is important to provide clarity in respect of the operation of historical agreements that were in effect prior to start of the National Electricity Market ("NEM") in December 1998.

Rio Tinto proposes that a new Rule 11.115.8(e) be added to the Draft RRO Rules, and the current Rule 11.115.8(e) be renumbered as Rule 11.115.8(f). This new provision would establish that physical electricity

supply agreements that were in force prior to 13 December 1998, the commencement of the National Electricity Market, would be qualifying contracts. The effect of this change would mean that these very historical agreements would be qualifying contracts with a firmness factor of 1 until the end of the term of the transitional contract as specified in that qualifying contract as at 10 August 2018. After the end of the existing term, should the exempt generation agreement be extended or renewed according to its terms, it would be remain a qualifying contract under section 14O(1) of the *NEL*, but would be subject to audit or review with regard to the firmness factor that should apply in respect of the contract.

Expiry of Grandfathering

As discussed with the ESB, Rio Tinto continues to see as onerous the requirement to establish a firmness factor for the period beyond the initial termination or review date for complex, bespoke long term arrangements that are able to be extended or renewed where these contracts are used to underpin the operation of very large loads such as smelters and refineries and where these contracts were not drafted in contemplation of the specific requirements of the RRO. Our concern about this may be addressed once we have the opportunity to consider the AER's Contracts and Firmness Guidelines. However what is especially important is ensuring these arrangements are in fact and remain qualifying contracts for their full term including any renewals or extensions, that they are given a firmness factor of 1 for at least their current contract term as specified as at 10 August 2018 and that the parties to the arrangements are not prevented from opting in by the structure of these arrangements.

Amendment and Restatement of Contracts

The large long term electricity contracts that underpin smelters and refineries may be subject to amendment and restatement from time to time. For example, significant changes in the operation of the National Electricity Market (such as the change to 5 minute trading intervals) may require amendments to some or all of the long term contracts in place for these facilities. To ensure that there is no confusion in respect of Rule 11.115.8(c)(2) that an amended and restated contract is still the contract that 'was in effect as at 10 August 2018', Rio Tinto proposes that there is a clear explanatory statement as to the operation of this clause and that the clause is amended so that it refers to qualifying contracts, as amended and restated from time to time.

Liable Entity and Opt-in

The existing drafting of Rule 4A.D.5 has the potential to cater for entities with more complex arrangements than those contemplated for in Rule 4A.D.4(a)(2). However, the qualifier in Rule 4A.D.5(a)(3) that this should be 'in accordance with the AER Opt-In Guidelines' creates an unnecessary level of doubt regarding the status of entities who are financially exposed to the cost of some or all of the *load* at the *connection point.* This is particularly so in the context of Rules 4A.D.5(a)(6) and 4A.D.5(b), and with the constraints regarding thresholds set out in Rule 4A.D.6. Accordingly, we suggest that Rule 4A.D.5(a)(3) be modified as follows:

> (3) the person is~~, in accordance with the AER Opt-In Guidelines,~~ financially exposed to the cost of some or all of the *load* at the *connection point*

Demand Management and Self Generation

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Attachment 1 sets out some specific confidential concerns we have regarding the treatment of self-generation. In addition, exactly how demand management arrangements that facilities self-provide will be treated, is unclear absent the publication of the relevant guidelines and details of the 'certain specified circumstances' that are not yet defined.

Market Liquidity Obligation as it applies to large electricity users who self-generate

The current circumstances for Rio Tinto's portfolio of assets and commercial arrangements mean that we do not meet the requirement for an MLO group set out in Rule 4A.G.10, in particular 15% of average aggregate trading group capacity of all trading groups in the relevant *region*. However, it is important to recognise that Rio Tinto's owned or managed assets have total load that exceeds 15% of the load for several regions in the NEM. Further, a significant proportion of the electricity supplied globally to Rio Tinto smelters and refineries is from self-generation. Should Rio Tinto at some future point set out to self-generate to manage price risk for our portfolio of smelters and refineries in Australia, the scale of our demand (and therefore of the required generation to back that demand) may mean that we inadvertently meet the requirements of an MLO group, as that term is defined in Rule 4A.G.10. Accordingly, we suggest that the definition of MLO Group in Rule 4A.G.10 exempt entities in circumstances where one or more of the end users of more than 50 per cent of the electricity generated by a trading group are related bodies corporate of the MLO generator.

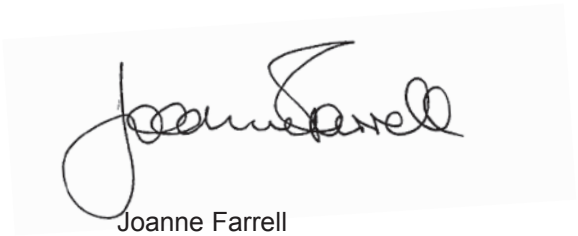
Proposed drafting

4A.G.10 MLO group

MLO group means, for a *region* in a quarter, a trading group in relation to which its trading group capacity at the end of the two preceding quarters exceeds on average, 15% of the average aggregate trading group capacity of all trading groups in the relevant *region*, at the end of the two preceding quarters <u>but does not include a trading group in which any trading right holder has a related body corporate[1] that is a *large customer* with *peak demand* for the two preceding quarters of more than 300MW.</u>

We would welcome the opportunity to discuss this submission or other design elements of the reliability obligation further with you, and look forward to the opportunity to work with you in the future as the overall structure of the RRO develops. If you have any questions in the interim, please contact Daniel Woodfield (Daniel.Woodfield@riotinto.com).

Yours sincerely



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[1] "**related body corporate**" has the meaning given in the *Corporations Act 2001* (Cth)