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Senate Standing Committee on Environment, Communications and the Arts
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Dear Senator McEwen

Re: Inquiry into the Renewable Energy (Electricity) Amendment Bill 2010

Rio Tinto welcomes the opportunity to make a submission to the Senate Standing Committee on Environment, Communications and the Arts Inquiry into the Renewable Energy (Electricity) Amendment Bill 2010.

Rio Tinto understands the purpose of the Renewable Energy (Electricity) Amendment Bill 2010 (the Bill) is to separate the Renewable Energy Target (RET) scheme into two parts – the Large-scale Renewable Energy Target (LRET) and the Small-scale Renewable Energy Scheme (SRES). The changes are aimed at providing greater certainty for large-scale renewable energy projects whilst meeting the Government's commitment that at least 20 per cent of Australia's electricity will come from renewable sources by 2020.

However, as noted in the Explanatory Memoranda accompanying the Bill, while this division of the RET increases certainty for large-scale technology developers, it does so by shifting the risk associated with the open-ended commitment for small-scale generation to the liable entities and electricity end users. The only proposed mitigation against this risk is monitoring and reviews in 2012 and 2014. These will further increase uncertainty about the durability of scheme design. These risk mitigation measures will likely only lead to further changes, more uncertainty and increased cost for large electricity users.

The stated intent of the Bill is to preserve the effective rate of assistance for emissions-intensive, trade-exposed (EITE) activities. However, the Bill does not decouple EITE assistance from the now substantially delayed Carbon Pollution Reduction Scheme (CPRS) legislation, nor does it offer the EITE sector any relief from the increased risk and cost now borne by liable entities and electricity end users.

In summary, Rio Tinto does not support the *process*, which has led to these proposed changes (well before the REC market will have fully reached an equilibrium with the August 2009 legislation) nor *content* of the proposed changes. However, if the Government persists with them, the full additional and open-ended impact on electricity intensive and trade exposed activities need to be fully recognised. The proposed changes should be accompanied by a further change to ensure a true 90% exemption for electricity intense trade exposed activities.

Therefore, Rio Tinto looks forward to the Committee's critical appraisal of the legislation with a view to proposing amendments that enable the legislation to truly meet the government's objectives of efficiently encouraging renewables deployment in Australia and maintaining the competitiveness of Australia's value adding industries.

Rio Tinto's Aluminium Smelters in Australia

Rio Tinto has interests in three facilities which will be severely impacted by the current form of the RET legislation – each are aluminium smelters which are highly important regional employers, earners of export income and contributors to the local economy (Table 1).

Table 1. Rio Tinto Electricity Intensive Trade Exposed aluminium smelting businesses in Australia

Rio Tinto Electricity Intensive Trade Exposed Facilities	Rio Tinto Ownership (per cent)	Region	2009 Production (Saleable '000 tonnes)	2009 Employees and Contractors	Total Salaries Paid	Payments to Local Suppliers
Boyne Smelters ¹	59.4	Gladstone	556	1339	\$180M	\$500 M
Tomago Aluminium	51.6	Hunter Valley	552	1335	\$110 M	\$450 M
Bell Bay ²	100	Tamar Valley	177	586	\$50 M	\$175 M

As aluminium is internationally priced and new operational costs cannot be passed through to customers, most aluminium smelters have limited options in the way in which the additional impost of the RET can be addressed. Options include reducing workforce and winding back capital expenditure. Rio Tinto's Australian aluminium smelters spend tens of millions of dollars annually on sustaining capital. Much of this spend is done locally - paying for regional employment, equipment and supplies. Faced with additional costs from RET, cuts in sustaining capital allocations will inevitably be made. These cuts, if they continue over the medium term, will progressively impact the ability of Australian smelters to successfully compete within international companies and attract ongoing sustaining capital.

The problem for large electricity users

Legislation to expand the RET passed on 20 August 2009. This followed lengthy debate and consideration by Government of a range of concerns raised by interested parties. As internationally competitive electricity prices are extremely important to many of Rio Tinto's operations across Australia, particularly the electricity intensive aluminium smelters, Rio Tinto was extensively involved in consultation leading up to the passage of this Bill.

The final scheme design adopted in August 2009 was a consolidated package covering many areas including the treatment of EITE exemption. The proposed changes to the scheme as set out in the legislation are oriented to increasing the cost and risk to liable entities and end users of electricity, to the benefit of renewable generators. From the perspective of liable entities and end users the changes:

- increase the volume of renewable energy above the 45 000 GWh target including introducing an open-ended liability through SRES, with an uncapped volume. This, when combined with other policy instruments, such as feed-in tariffs and deeming multipliers, will likely grow to very significant levels;
- increase the cost of Renewable Energy Certificates (REC) over the lifetime of the scheme in order to incentivise investment decision-making in Large Scale Renewables;
- reduce the liquidity of the near term REC market;
- increase the complexity of the scheme;

¹ BSL data taken from 2009 Sustainable Development Review, available from www.riotinto.com

² Bell Bay data taken from 2009 Sustainable Development Review, available from www.riotinto.com

- foreshadow further changes to the scheme design (e.g. 2012 Review of SRES, Council of Australian Governments [COAG] decisions); and
- increase regulatory uncertainty and demonstrate a lack of commitment by Government to a legislated policy by changing the design a few months into a twenty year scheme. This will likely increase the required hurdles for investment decision-making in the face of uncertainty and therefore increase the long term REC price.

For the electricity intensive industries, such as aluminium smelting, where internationally competitive electricity prices are vital, the proposed EITE partial exemption will become even more inadequate. The pre-condition of passage of the CPRS legislation before activities become eligible for partial exemption should be removed given the announcement on 27 April 2010 of the delay of the CPRS until *“after the end of the current commitment period of the Kyoto Protocol and only when there is greater clarity on the actions of major economies including the US, China and India.”* In the absence of a CPRS, the REC price will rise to compensate for the lower electricity price available to REC generators (Figure 1, Figure 2).

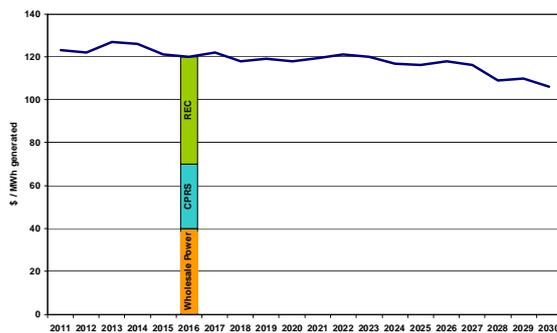


Figure 1. Example Cost of Renewable Power³ (with CPRS)

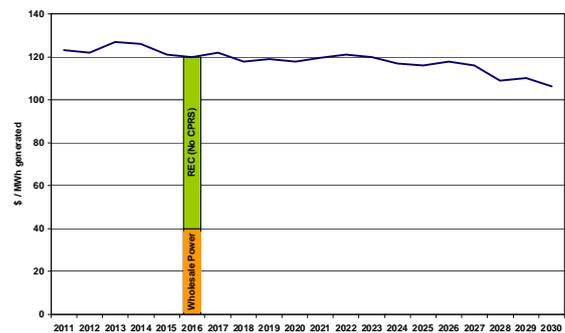


Figure 2. Example Cost of Renewable Power (No CPRS)

All of these changes will have a disproportionate effect on the competitiveness of electricity intensive and trade exposed industries especially aluminium smelting activities⁴.

The cost of the proposed scheme to Rio Tinto

As no modelling has been released to support the decision to split the RET into LRET and SRES or the potential cost impact on electricity users, Rio Tinto has used the 2009 MMA⁵ modelled REC prices to model the LRET price. This probably provides a conservative (low) estimate of impact as the renewable industry has widely reported that the proposed changes to the scheme will up to double REC prices.

The exemption provided to Rio Tinto’s aluminium smelting assets is equivalent to only a 55 per cent exemption over the first decade of the scheme, unless the coupling to the passage of the CPRS is removed. Rio Tinto’s smelters will be required to pay around \$500 million dollars in REC costs over the first decade of the modified scheme. This could increase to around \$800 million if LREC prices reached the shortfall charge. These additional costs have flow-on implications for employment and expenditure in the Gladstone (Queensland), Tamar (Tasmania) and Hunter Valley (NSW) regions.

³ Cost of renewable generation required to meet 20% target by 2020 taken from McLennan Magasanik Associates, Report to Department of Climate Change, Benefits and Costs of the Expanded Renewable Energy Target, January 2009. For the purposes of illustration, consistent with McLennan Magasanik Associates modelling for the Australian Treasury a wholesale power cost without carbon of \$40/MWh is shown. The REC cost increases to meet the cost of creating the renewables if there is no CPRS.

⁴ Identified in the COAG Working Group on Climate Change and Water Discussion Paper on the Treatment of electricity-intensive, trade-exposed industries under the expanded national Renewable Energy Target scheme (January 2009) as the most electricity intensive activity.

⁵ McLennan Magasanik Associates, Report to Department of Climate Change, Benefits and Costs of the Expanded Renewable Energy Target, January 2009

The solution - a true 90% exemption for electricity intense trade exposed

The Bill does not expressly deal with the partial exemptions for the emissions intense trade exposed industries and the Explanatory Memorandum states only that the regulations relating to partial exemptions will be updated to ensure that the effective assistance rates are consistent with the policy intent. Rio Tinto therefore refers to the proposed partial exemption combination set out in the Department of Climate Change Discussion Paper (March 2010) and the existing regulations. For highly emissions intensive industries, this consists of a 90% exemption for the portion of the combined target above 9500 GWh and, if the CPRS passes, a partial exemption for 90% of the REC price above \$40. This will not achieve the stated policy aim of preserving the effective rate of assistance, and it will impact upon the competitiveness of aluminium smelting.

To recognise this, as an activity which is both highly electricity and highly emissions intensive, for aluminium smelting a true 90 per cent exemption for both LRET and SRES should apply to the full volume of purchased electricity that is a relevant acquisition under the *Renewable Energy (Electricity) Act 2000*. A true 90 per cent exemption would mitigate most of the impacts of the proposed changes to EITE activities and would put in place a policy approach that would be robust and sufficient for future scheme changes that are already foreshadowed in the Discussion Paper. The Government may consider extending this treatment to other EITE activities.

Rio Tinto also seeks that the RET exemption package be fully decoupled from the passage of the delayed CPRS. Electricity users should not have to have such a large line item of their costs tied to a separate piece of legislation, one where a delay of more than two years has already been announced. The linkage is bad legislation and bad policy.

Appendix 1 proposes legislative changes which could be made to address these concerns.

Market Uncertainty

Rio Tinto has serious concerns with the underlying process associated with the proposed changes and associated consultation. The proposed changes, for example the division into LRET and the fixed price uncapped SRES, represent radical changes to RET scheme design. It is unfortunate that the Departmental Consultation process did not seek stakeholder comment on these important issues that are central to the proposed changes to the scheme.

To support the Government's proposed changes there is no thorough analysis of the historic and anticipated performance of the REC market that separate out longer term trends from short term fluctuations, or that considers market certificate liquidity issues. Also no modelling is available to describe the anticipated impact of the changes to the scheme to allow affected parties to form a view as to the impact on their business. The changes appear to be driven by a desire to achieve a technological outcome rather than to deliver a set quantity of allowable renewables to the grid over a specified period of time. The COAG process has been sidelined and there appears to be no attempt to frame the policy proposals in terms of the COAG Best Practice Guidelines.

While there have been recent fluctuations in the spot market price, which has been discussed within the renewable energy industry, the radical changes proposed to the scheme to manage the current price fluctuations will undermine the confidence of energy users in both the management of the RECs market and more broadly in climate policy design. This policy shift may also have the perverse consequence of increasing the caution of potential renewable energy suppliers to invest, particularly given that the discussion paper foreshadows further changes through both the COAG process and proposed SRES reviews.

Given the clear lack of anticipation of how the RET market would respond to the August 2009 legislation, it is possible this new intervention could overshoot the Government's desired outcome. As a result the price of RECs for the LRET may rise to the shortfall charge and cause significant financial impacts on electricity users and further damage confidence in the operation of the scheme.

No part of this submission is confidential. Should you wish to follow up on any matter raised in this submission, please contact Neil Marshman Rio Tinto would appreciate the opportunity to appear before the Committee as part of the Australian Aluminium Council.

Yours faithfully

David Peever
Managing Director
Rio Tinto Australia

APPENDIX 1 – PROPOSED AMENDMENTS

These amendments have been designed to achieve three things:

1. A 90% exemption from the full RET for activities that are both highly emissions-intensive and also electricity-intensive.
2. Reducing the reliance of the RET exemptions on passage of the CPRS legislation. This has meant changing the start date (that was linked to CPRS), changing the definition of EITE (that was also linked to CPRS) and changing references to the “Authority” (established under the CPRS) to the “Regulator” (that already exists for the current RET).
3. Bringing in some of the detail of the EITE program into the legislation.

Renewable Energy (electricity)

Amendment Bill 2010

No. , 2010

(Climate Change and Water)

- 1) Clause 2, page 2 (table item 3), omit the table item, substitute:

3. Schedule 2 A single day fixed by proclamation.
However, if the provision(s) do not commence before 1 July 2010, they commence on that day.

- 2) Schedule 2 , item 2, page 7 (lines 14 to 16), omit the definition of **emissions-intensive trade-exposed activity**, substitute:

emissions-intensive trade-exposed activity - See section 38D.

- 3) Schedule 2, item 2, page 7 (lines 17 to 21), **remove item**.

- 4) Schedule 2, item 8, page 9, after Section 38C, insert:

38D Regulations

- (1) The Governor-General may make regulations for the purposes of:
 - (a) identifying emissions-intensive trade-exposed activities; and
 - (b) classifying such activities as:
 - (1) both highly emissions-intensive (>2000 t CO₂-e / \$million revenue) and electricity intensive (>4000 MWh / \$million revenue); or
 - (2) highly emissions-intensive (>2000 t CO₂-e / \$million revenue); or
 - (3) moderately emissions-intensive (1000-2000 t CO₂-e / \$million revenue); and
 - (c) prescribing all matters necessary or convenient to be prescribed for carrying out or giving effect to the matters in paragraphs (a) and (b).
- (2) The regulations are to ensure that the activity consisting of the physical and chemical transformation of alumina (aluminium oxide, Al₂O₃) into saleable aluminium metal (Al) is classified as an activity which is both emissions-intensive and electricity intensive.
- (3) The regulations are to provide that the amount of the partial exemption stated in a partial exemption certificate is as follows:
 - (a) for an activity which is both highly emissions intensive and electricity intensive—90% of the total liability;
 - (b) for a highly emissions-intensive activity—90% of the expanded liability;
 - (c) for a moderately emissions-intensive activity—60% of the expanded liability.
- (4) The Minister must take all reasonable steps to ensure that regulations are made for the purposes of subsection (1) before 1 July 2010.

(5) In this section:

expanded liability means, in relation to an activity, a liable entity's additional liability for the renewable energy shortfall charge that would be incurred as a result of the enactment of the *Renewable Energy (Electricity) Amendment Act 2009*, including the entity's entire liability for the renewable energy shortfall charge in respect of the period commencing on 1 January 2021, but for the liable entity's partial exemption.

total liability means, in relation to an activity, a liable entity's liability for the renewable energy shortfall charge that would be incurred but for the liable entity's partial exemption.

5) Omit references to "**Authority**" (wherever occurring), substitute "**Regulator**".