

19 November 2010

Ms. Elisabeth Ross
Senior Advisor
Australian Energy Market Commission
PO Box A2449
SOUTH SYDNEY. NSW. 1235.



Dear Ms. Ross

SUBJECT: NYRSTAR SUBMISSION TO SENE RULE CHANGE PROPOSAL (ERC0100)

By way of background Nyrstar in Australia operates large trade-exposed businesses in regional areas of South Australia (the Port Pirie multi-metal recycling facility) and Tasmania (the Hobart zinc refinery). These businesses operate in international commodity markets where prices can be volatile due to industry dynamics and international economics. These markets are by nature highly competitive. Consequently, Nyrstar cannot pass-through increases in input costs into its final product pricing and costs must be absorbed. Increases in input costs directly affect the cost competitiveness particularly if competing economies do not have similar cost drivers. Typically with smelting processes electricity costs make up a large proportion of direct operating costs. Current policy settings do not provide these industries with assistance or exemptions for climate change-induced network cost increases. Many large end users like Nyrstar have experienced significant cost increases in relation to network pricing already. For instance, Nyrstar's Hobart smelter will see a doubling in transmission capacity costs over the current regulatory period. This is occurring now without a mechanism for pricing carbon.

Whilst Nyrstar understands the logic behind the intent of the proposed Rule change (efficient investment) Nyrstar's primary concern is that the costs and risks borne by end-users could outweigh any scale benefits that may arise from SENEs. The options as outlined by the AEMC are not supported by detailed and rigorous quantitative analysis and are presented as a series of concepts so it is difficult to fully ascertain the impacts/ risks. There is an inherent danger that an option will be chosen that drives unintended consequences and distortions in the market.

Nyrstar contends it is questionable that a Rule change is needed given there is evidence that indicates that the uptake of renewable generation is already being stimulated without the need to modify the Rules to cater for SENEs, suggesting the existing Rules are sufficient to support connection of remote generation. The existing Rules already have a RIT-T test to ensure that there is a net benefit whilst meeting the National Electricity Objective (NEO). Against this context further modifications to the Rules to specifically accommodate SENEs would be deemed unnecessary.

The options as presented in the paper are questionable whether they meet the long-term interests of consumers particularly if renewable generation arrives later or not at all. There is no certainty whether generation will enter a renewable zone. Whilst a threshold for capacity is one potential solution it doesn't provide the necessary comfort unless the threshold level approaches 100%. This uncertainty in generation entry is heightened even further with the debate on a carbon price in Australia. There is a strong argument that any modification to a Rule in relation to SENEs should at least be synchronised to the policy surrounding a carbon price. Furthermore, as an example when Nyrstar invests in productive capacity and it for whatever reason does not use those assets it is unable to pass-through the costs/ risks of the stranded assets to its customers. If the purpose of regulation is to impose a "competitive market" onto market participants in the NEM then a market-based approach must be adopted for SENEs, as the market should determine the least cost solution for connection of remote generation.

NYRSTAR
HOBART PTY LTD
ABN 49 124 818 113

RISDON ROAD
LUTANA
TAS 7009
AUSTRALIA

T +61 3 6278 4444
F +61 3 6278 4608

info@nyrstar.com
www.nyrstar.com

GPO BOX 377
HOBART
TAS 7001
AUSTRALIA

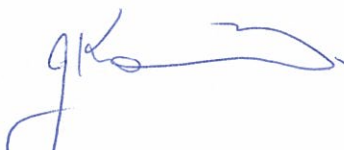
The options in the AEMC paper are based on a 'causer pays' principle. It is recognised that consumers are not the causers for a SENE to be built - it is the proponents for the renewable generator. Consumers cannot diversify away this risk as they are not party to the proponent's connection agreement or negotiations with the TNSP nor do they have any credible options to mitigate this risk. The generator and TNSP are best placed to manage and/ or diversify this risk as they have commercial incentives based on risk/ return. Furthermore, the renewable energy generator is rewarded through the energy price, revenue from renewable energy certificates and in the future a possible carbon price. Consumers do not receive these rewards to trade-off the risks of asset stranding. The options as presented by the AEMC contain significant latent costs and risks and are heavily biased by the notion of efficient investment. As previously stated there is no 'hard' evidence that proves or otherwise that the advantages from scale efficiencies are > the costs and risks to consumers like Nyrstar. Also, the options are such that they also do not accommodate major shifts in climate change policy (such as direct action initiatives rather than a carbon pricing mechanism). The AEMC has stated at page ii of the Options Paper

"While there is still some support for change, this has been tempered by the complex nature of the proposed Rule and the implementation difficulties that it poses. In particular, some stakeholders consider:

- *the proposed Rule requires customers to bear significant risks that they are not best placed to manage;*
- *competitive neutrality between generators that connect to the SENE and those that connect directly to the network has been questioned; and*
- *certain characteristics of SENEs do not fit naturally into the existing framework which creates an additional layer of complexity, such as the nature of the service that the SENE provides and compensation arrangements where generators are constrained off the SENE."*

The proposed SENE options do not resolve the above issues. On the basis of the above arguments Nyrstar strongly recommends that the existing Rules are unchanged as they are already robust enough to manage this problem. There is a further argument that the Federal Government through vehicles like Infrastructure Australia or other climate change based programs should either fully or partially fund the costs and underwrite the risks for SENE proposals through direct subsidies or renewable loans and other incentives. The Federal Government has already publicly signalled this intent previously. This is exactly what the US administration has done in the United States to support their renewable energy ambitions. We would welcome further discussions with you on the above issues.

Yours faithfully
NYRSTAR HOBART



Jeremy Kouw
GENERAL MANAGER.

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