3 May 2024

Mr Joe Dimasi
Regulator
Office of the Tasmanian Economic Regulator

Submitted via email to office@economicregulator.tas.gov.au

Dear Mr Dimasi,

Wholesale Contract Regulatory Instrument Pricing Investigation – Draft Report

Hydro Tasmania welcomes the opportunity to comment on the Tasmanian Economic Regulator's (the Regulator) Draft Report on the current Wholesale Contract Regulatory Instrument (WCRI or Instrument) Pricing Investigation.

This submission covers our feedback and proposed amendments regarding four key changes proposed in the Draft Report where we feel further consideration is warranted to ensure efficient price outcomes for Tasmanian electricity customers:

1. Calculating the Victorian peak swap by applying a quarterly multiplier to the weekly Victorian baseload price (section 4.2.1).

2. Removing from clause 8.3 of the Instrument the open interest limit requirement for Victorian peak futures contracts (section 4.2.2).

3. Setting the Tasmanian baseload cap price as the lesser of the Victorian baseload cap price and the price calculated using the current baseload cap price formula in clause 11.1 of the Instrument (section 4.2.4).

4. Extending the construction time of the gas peaker from 10 to 20 years in Schedule 1 of the WCRI, unless AEMO indicates a specific period by which additional capacity is required (section 4.2.6).

Our detailed comments and substantiation regarding the Draft Report's recommended changes are provided in **Attachment A**. If you have questions regarding this submission or any of the points raised, please contact Helen Gilmore at helen.gilmore@hydro.com.au or (03) 6240 4686.

Yours sincerely,

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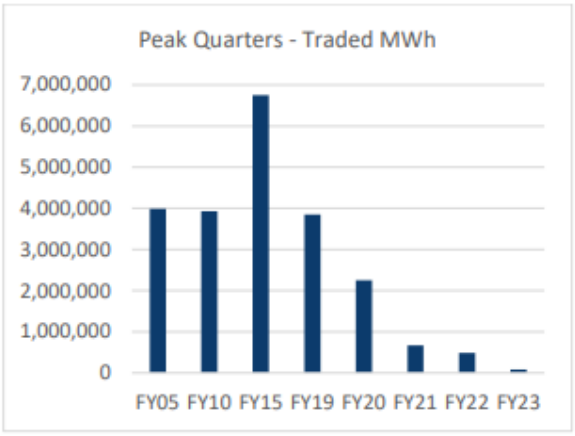
EGM Strategy

Attachment A – Hydro Tasmania's substantive comments on the Draft Report

1. During the period when there is no listed peak futures contract and in the period until there is 100 MW in open interest in the replacement product, the Regulator proposes calculating the Victorian peak swap by applying a quarterly multiplier to the weekly Victorian baseload price. Once the open interest in peak futures has reached 100 MW the Instrument will revert to using the Australian Securities Exchange (ASX) Energy peak futures value.

The increase in renewable energy, particularly solar generation, has resulted in a material change to the energy mix and demand profile in the National Electricity Market (NEM). As a result, the ASX's listed Peak Electricity Futures Contract, which is a key input to the TAS Regulated Peak Swap, has significantly reduced in both traded volumes and open interest (see Figure 1 below). Due to this reduction in liquidity the ASX is planning on changing the specification of the listed peak futures contract.[1] It is expected this new product specification will be implemented by the ASX sometime in 2024. As a result of these developments the Draft Report recommends that a 'proxy' approach is used when there is no listed peak futures contract (i.e. Baseload Reference Swap Value multiplied by the relevant Peak Multiplier).

Figure 1 – ASX Peak Load Futures Contract's traded volume and open interest



Use of the Peak Load Futures Contract has significantly declined, as shown above by the traded volume of the contract.

Open Interest in the contract has steeply declined over the last few years.

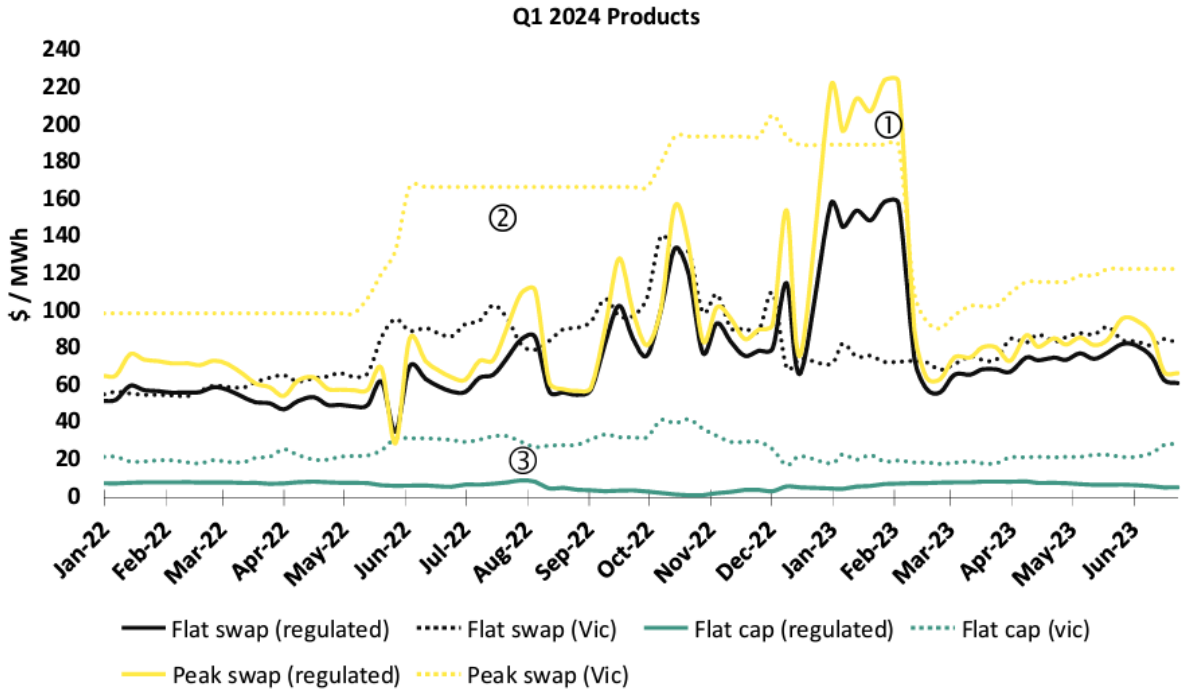
Source: ASX, ASX Australian Peak Load Electricity Futures Contract Changes Consultation Paper, 7 February 2024.

Overall, Hydro Tasmania is highly supportive of using the 'proxy' approach. However, Hydro Tasmania stresses the importance of implementing the proxy approach for the Regulated Peak Swap as soon as possible, rather than waiting for the ASX to change its peak product specification, due to the sustained lack of liquidity that exists now. The ongoing absence of liquidity in the ASX listed product is already creating some non-market reflective outcomes. As shown in Figure 2 below (annotated as 2), the Tasmanian regulated peak swap prices are highly unstable and do not follow

[1] https://asxonline.com/public/notices/2024/february/0108.24.02.html

any similar pattern to the Victorian peak pricing during the period shown. This is not market intuitive and is likely driven by the WCRI methodology, particularly the minimum open interest limit. If the open interest for the Victorian peak product in quarters 5 to 8, i.e. beyond the next 12 months, is less than the minimum open interest limit then the WCRI methodology uses the first prior corresponding quarter value. This means regulated peak pricing often represents the past, which is not always reflective of present market conditions.

Figure 2 - Comparison of Victorian and Tasmanian regulated flat swap, peak swap and flat cap pricing for Q1 2024, January 2022 – June 2023



Source: Seed Advisory, Wholesale Contract Regulatory Instrument Review – Report for Hydro Tasmania, 12 September 2023.

Hydro Tasmania also has some concern about reverting back to using the ASX peak futures product once there is 100 MW open interest in the replacement listed product. Based on the ASX's consultation[2], the replacement peak futures is expected to have a very different peak definition to the current Tas regulated peak product, and could even be multiple products (e.g. an evening peak product and a morning peak product). The replacement product is expected to cover a shorter time period e.g. 4, 5 or 6 hours, whereas the regulated peak product currently covers 15 hours. The two products are not like-for-like. Highly detailed changes would be needed to the regulated Tas contracts to be able to use the new listed peak product as an input.

Hydro Tasmania **proposes the proxy multiplier approach be used for the full term of the new WCRI (i.e. to 2029)**. When the Regulator conducts another investigation, major revisions to the WCRI could

[2] Ibid.

be undertaken to align the peak definitions. This approach would have the benefit that the Regulator and the market would have a better understanding of the function and liquidity of the new ASX peak product in 2029. At this stage, Hydro Tasmania is of the view it could take several years for the listed peak product to have enough liquidity to be a useful input for the WCRI.

If, prior to 2029, there is sufficient understanding of the new peak product, including how it could be incorporated into the Instrument's methodologies, then another investigation could be conducted into the relevant peak methodologies earlier.

Hydro Tasmania's key recommendations

- The Regulator should implement the proxy multiplier approach for the Regulated Peak Swap from the beginning of the new WCRI approvals, rather than predicating its use on when the ASX changes the Victorian listed peak product, as there is already a lack of sufficient liquidity in the listed product resulting in non-market reflective pricing outcomes.
- The proxy multiplier approach be used for the full term of the new WCRI (i.e. till 2029). At the next WCRI investigation major revisions could be made to align the Tasmanian and Victorian peak definitions.

2. The Regulator proposes removing from clause 8.3 of the Instrument the open interest limit requirement for Victorian peak futures contracts.

Hydro Tasmania is strongly supportive of removing the open interest limit for the Victorian peak futures contracts. Due to the low liquidity in the listed peak contract the open interest limit has not been met since before 2021. If the open interest for the Victorian products in quarters 5 to 8, i.e. beyond the next 12 months, is less than the minimum open interest limit then the WCRI methodology uses the first prior corresponding quarter value. For example, if Q2-2026 (quarter 8) in Victorian peak swaps has an open interest of 90 MW, the methodology will use the preceding year's same price, i.e. Q2-2025 (quarter 4) Victorian peak swap prices. As discussed in section 1 above, this has resulted in non-market reflective peak pricing outcomes, with regulated peak swap prices being significantly and irrationally different to VIC peak swap prices. Hydro Tasmania considers removing the open interest limit as an integral element of implementing the proxy approach above. The two need to be implemented together to deal with the issues in the regulated peak swap.

Hydro Tasmania also queries how the reversion to using the listed ASX peak product (i.e. ending use of the proxy) when open interest in the new product reaches 100 MW would work if the WCRI has removed the open interest limit. **Again, we believe removing the open interest limit and implementing the proxy must be implemented together for the full term of the new approvals.**

Hydro Tasmania's key recommendations

- Removing the open interest limit and implementing the proxy multiplier approach must be implemented together for the full term of the new WCRI approvals.

3. The Regulator proposes that the Tasmanian baseload cap price equal the lesser of the Victorian baseload cap price and the price calculated using the current baseload cap price formula in clause 11.1 of the Instrument.

Hydro Tasmania notes that this is a significant change to the WCRI and has been proposed with limited time for stakeholders to consider before being implemented. We recommend the Regulator reconsider this decision and provide more time for analysis of different approaches to calculating the regulated cap price.

In principle, Hydro Tasmania disagrees with the proposed change to the calculation of the regulated cap price. The intention of the regulated cap price was to provide a market signal to capacity providers in the Tasmanian market, not the Victorian market. As such there is no logical basis for using the Victorian cap price (when lower) as it represents a capacity signal for a different NEM region.

Hydro Tasmania is also strongly concerned about the potential unintended distortionary consequences of this change. The Regulator is proposing to use the current cap price methodology *or* the Victorian listed cap price, selecting whichever is lower for the relevant quarter. Our preliminary analysis suggests that this will result in a much lower regulated cap price in Q2 and Q3 (see Figure 3 below). This is because Tasmanian cap prices have traditionally been higher than the Victorian price in these quarters due to Tasmanian market conditions. In Tasmania, Q2 and Q3 are generally characterised by higher demand and lower hydro storages (i.e. a winter peak), while Victoria's 'peaks' tend to occur more in Q1 and Q4. The proposed change will result in using the lower Victorian cap price in Q2 and Q3, essentially eliminating the consideration of Tasmanian market conditions in the regulated cap price.

Figure 3 – Price impact of using the VIC baseload cap price (or the current methodology if lower) as the Tas cap price on Tasmanian regulated prices

Delta in dollar terms ($/MWh)	Q324	Q424	Q125	Q225	Q325	Q425	Q126	Q226
Cap Prices	-$5.5	$0	$0	-$8.8	-$5.3	$0	$0	- $10.1
Swap Prices	-$5.5	$0	$0	-$8.8	-$5.3	$0	$0	- $10.1
Peak Swap Prices	-$12.3	$0	$0	-$21.0	-$11.9	$0	$0	- $23.6
Load Following Swap Prices	-$8.7	$0	$0	-$14.7	-$8.4	$0	$0	-$16.8

Delta in percentage terms ($/MWh)	Q324	Q424	Q125	Q225	Q325	Q425	Q126	Q226
Cap Prices	-41%	0%	0%	-65%	-39%	0%	0%	-74%
Swap Prices	-7%	0%	0%	-11%	-6%	0%	0%	-12%
Peak Swap Prices	-14%	0%	0%	-24%	-14%	0%	0%	-27%
Load Following Swap Prices	-9%	0%	0%	-16%	-9%	0%	0%	-18%

Note: the analysis presented is as at a point in time, assuming it is the regulated pricing week of 16 April 2024. Therefore, price impacts could change over time. This figure is presented for illustration purposes.

This change could also be open to opportunistic buying behaviour. Retailers, aware that Q2 and Q3 caps will be under-valued, could buy up the regulated volumes, meaning volume for retailers who are legitimately attempting to hedge their Tasmanian load may not be available when they need it. This potential oversubscription could be highly distortionary to Tasmanian contract market.

Hydro Tasmania is of the view that the Regulator needs to spend more time considering approaches to setting the regulated cap price. There could be various approaches to dealing with the fact that the gas peaker new entrant input is now potentially unsuitable.

If the Regulator views that a change to the Tasmanian baseload cap methodology needs to be made now, Hydro Tasmania strongly suggests the Regulator consider using the average annual VIC cap price to set the regulated cap price. An annual average of all four quarters would reduce some of the Q2/Q3 price distortions from the current proposed approach.

Hydro Tasmania's key recommendations

- The Regulator should reconsider this change due to its significant impact on regulated prices. More time is needed to fully consider alternative approaches to setting the regulated cap price. Stakeholder feedback will be critical to this analysis.

4. Schedule 1 updates

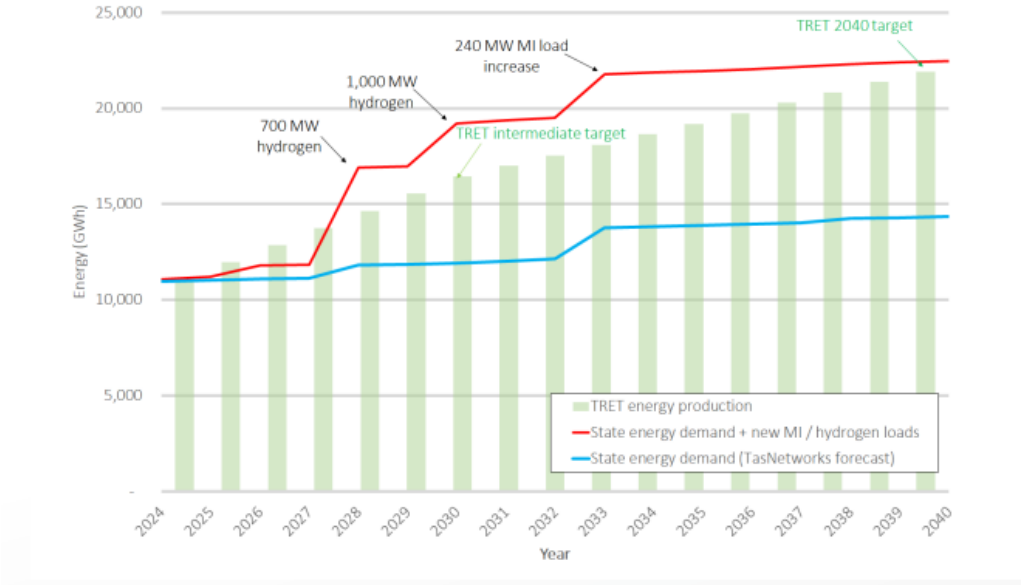
The Regulator proposes:

- extending the construction period of new capacity to 20 years in the future, unless AEMO indicates a specific period by which additional capacity is required.

Hydro Tasmania believes the construction time for additional capacity should remain set at ten years in the future within the WCRI. The Draft Report assumes that because the Electricity Statement Of Opportunities (ESOO) has never forecast a capacity shortfall in Tasmania, that the construction time should therefore be extended to 20 years in the future. While we continue to think the ESOO is the correct source to reference in the Instrument for a capacity shortfall, we do not think it is the only source to consider when setting the alternative construction time (i.e. if no shortfall is expected). The ESOO only includes generation and demand projects where these meet AEMO's definition of 'committed'. It therefore disregards a large number of proposed and known projects within Tasmania.

Several forecasts suggest Tasmania will require new energy generation much sooner than 2044. AEMO's Draft 2024 Integrated System Plan's Step Change scenario forecasts Tasmanian demand to increase by approximately one third (reaching over ~3.5 TWh annually by 2033). TasNetworks' 2023 Annual Planning Report forecasts over a 20-year forecast period to 2043, energy consumption in their base scenario is forecast to increase moderately at an average of 0.6% annually. Furthermore, they found that if expected hydrogen developments and major industrial load growth are realised, even meeting the Tasmanian Government's Tasmanian Renewable Energy Target (TRET) will be insufficient to meet the state's generation needs (see Figure 4 below).

Figure 4 – Annual energy forecast – impacts of new hydrogen developments and major industrial load growth



Source: TasNetworks, 2023 Annual Planning Report, link.

These demand forecasts suggest that there is a need for new energy and storage projects (and likely new transmission) within the state. This is truer today than in the past when Tasmania's consumption was relatively stable, making this change to the WCRI even more perverse. Changing the new entrant construction time to 20 years would dampen the market's signal to build new capacity for when it's needed (i.e. when load growth occurs). The lack of an appropriate market signal for new investment may result in underinvestment in new electricity generation infrastructure in Tasmania, resulting in inefficient market price outcomes for consumers.

Hydro Tasmania would also note that there was no discussion in the Draft Report of the impact of changing the construction time of the gas peaker and the change to the cap price methodology together. By implementing both, you may be double solving the same issue. Both should be analysed in isolation and together for their impacts.

Hydro Tasmania's key recommendations

- The construction time for new capacity (absent indication of a specific period by AEMO) should remain set at ten years in the future to ensure the WCRI continues to have an appropriate price signal for new generation capacity to be built.