Hydro Tasmania
The power of natural thinking

Mr Joe Dimasi,
Regulator,
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23 September 2016

Wholesale Regulated Contract Instrument Draft Report

Dear Joe,

Please find attached Hydro Tasmania's submission on the Draft Report.

Please contact me if you require any additional information.

Yours sincerely,

D. Bowker.

David Bowker
Manager Regulatory Affairs

Wholesale Regulated Contract Instrument Draft Report

Hydro Tasmania Submission

Overview

The Electricity Wholesale Contract Regulatory Instrument has been in effect for two and a half years which has included the severe drought of the spring of 2015 and the six month Basslink outage. The Instrument performed well in testing circumstances delivering sensible market outcomes and regulatory certainty.

Hydro Tasmania supports the basic approach by the Regulator to maintain the current pricing methodology. There are however some minor administrative changes that can be made in the light of the experience with the instrument.

The table in the overview section below summarises Hydro Tasmania's position on each of the Regulator's proposals. Where we do not agree with them we have referred to a later section in our submission to explain our position.

Hydro Tasmania's proposals where they are materially different from the Draft Report are:

- The term of the new instrument should be a minimum of 5.5 years
- Schedule 1 inputs should be reviewed annually to coincide with the demand forecast update from AEMO around late June
- Transition should be achieved by revoking the current instrument from 31 December 2016 and substituting the new instrument with a minimum term of 7.5 years from 1 January 2017.

Draft Report reference	Regulator's proposal	Hydro Tasmania Position
Wholesale Contract Regulatory Instrument		
3.1.1	The Regulator proposes maintaining the current market-based wholesale regulation framework	Supported
3.1.2	The Regulator does not propose making any changes to the Instrument in response to the current level of competition in the small customer segment of the Tasmanian electricity market.	Supported
3.1.3	The Regulator proposes: (a) setting the term of the new Instrument to align with a financial year basis rather than a calendar year basis as is currently the case under the existing Instrument; and (b) a 3.5 year term for the new Instrument so that it expires on 30 June 2022 to align with the expected end of the regulatory period for the next standing offer electricity price determination.	Alternative proposal see Section 1
3.1.4	The Regulator proposes retaining the current regulated contract types.	Supported
3.1.5	The Regulator proposes that the new Instrument not include the requirement for regulatory approval to be granted where parties wish to use either an existing Schedule or negotiate their own Schedule instead of using the Hydro Tasmania Schedule in the Instrument. The Regulator also proposes that the new Instrument require retailers to provide a letter notifying the Regulator that they have chosen to use an alternative Schedule to the Hydro Tasmania Schedule.	Supported
3.1.6	The Regulator proposes continuing with the current methodologies for calculating each of the peak period, baseload and load following swap prices.	Supported
3.1.7	The Regulator proposes continuing with the current methodology for determining the Maximum Baseload $300 Cap Contract Price but reviewing the cap price inputs.	Supported
3.1.8	The Regulator proposes that the new Instrument incorporate scaling provisions which are based on each retailer's proportion of the small customer load thereby ensuring there is sufficient volume of regulated contracts to enable retailers serving the small customer market to hedge their small customer load.	Supported and see section 2

3.1.9	The Regulator proposes that the new Instrument include a 'fast-track amendment provision'.	Supported
3.1.10	The Regulator proposes reviewing the inputs at least annually on the basis of the schedule outlined in section 3.1.10 of this Draft Report. The Regulator further proposes amending the Statement of Regulatory Intent to incorporate the formal review schedule for the inputs set by the Regulator as outlined in section 3.1.10 of this Draft Report.	Supported with minor enhancement see section 3
3.1.11	The Regulator proposes amending the Wholesale Contract Guideline to require Hydro Tasmania to: ▪ publish current and past 'Forecast current yield' values; ▪ maintain and publish a database of past prices on its website; and ▪ to clearly indicate, on its website, the date that updates have been made to the Model. The Regulator also proposes amending the Statement of Regulatory Intent to commit the Regulator to publishing details of any changes made to source data on its website.	Supported for data from the date of the new instrument
3.1.12	The Regulator proposes that the transition between the existing Instrument and the new Instrument should occur as outlined in Attachment 4.3 such that retailers should have the option of contracting under either the existing Instrument or the new Instrument.	Alternative proposal see section 4
3.1.13	The Regulator proposes that minor changes be made to the Instrument to replace references 'oil-fired peaking plant' with references to 'gas-fired peaking plant'; and amend Clause 2.3 to include "dates" in the list of values that the Regulator may change.	Supported
3.1.14	The Regulator proposes incorporating, where relevant and as appropriate, the changes proposed for the new Instrument in the existing Instrument. The Regulator also proposes applying changes made in relation to the administration of the new Instrument in administering the existing Instrument.	Supported
Wholesale Contract Guideline		
3.2.1	The Regulator proposes amending the Guideline to add a clause similar to the existing Clause 3.5 (exceptions to the standard weekly process) to allow for the possibility of Hydro Tasmania instigating a trading halt and not offering weekly prices. The Regulator also proposes requiring Hydro Tasmania to offer make-up volumes in the event that	Supported with some additional comments. See section 5

	Hydro Tasmania instigates a trading halt and does not offer weekly prices.	
3.2.2	The Regulator does not propose any changes to the weekly offer process.	Supported
Statement of Regulatory Intent		
3.3.1	The Regulator proposes: (a) removing the current reference, in the Statement of Regulatory Intent, to the Regulator instructing Hydro Tasmania to set all regulated contract prices at $300/MWh; and (b) adding the following criteria to the Statement of Regulatory Intent: (i) Will the Regulator's proposed response provide regulatory certainty and transparency? (ii) Will the benefit of any proposed changes to the current Wholesale Regulatory Framework outweigh the costs to change the Framework? (iii) Will the Regulator's proposed response effect the efficiency of the Tasmanian Wholesale Electricity derivatives market? (c) if a supply disruption event occurs in the future, adopting the following process: (i) the current weekly offer process will continue to operate unless advised otherwise; (ii) the Regulator will contact all current market participants to seek their views as to the appropriate response to the event; (iii) in its deliberations, the Regulator will apply the criteria noted in (b)(i)-(iii) inclusive above to assess the most appropriate course of action to take in response to the event.	Supported with some comments. See section 6

Detailed response

Section 1 Term of the New Instrument

3.1.3	The Regulator proposes: (a) setting the term of the new Instrument to align with a financial year basis rather than a calendar year basis as is currently the case under the existing Instrument; and (b) a 3.5 year term for the new Instrument so that it expires on 30 June 2022 to align with the expected end of the regulatory period for the next standing offer electricity price determination.

Hydro Tasmania supports the alignment of the Instrument expiry to financial years.

Hydro Tasmania sees no need for a term as short as 3.5 years and we would propose a minimum term of 5.5 years. Additional reviews increase the costs for the industry and generate regulatory uncertainty. The only risk that the longer term would cause is that some event might set up a need for a review. The Regulator is able to instigate a price investigation and revoke the current instrument at any time that such an event occurs. So, we see increased costs and no benefit to the 3.5 years proposed.

We do not see that there is any benefit in aligning the termination of the instrument with the expected next standing offer determination. However, if others see a benefit, this alignment could be achieved by a 6.5 year term which we would support.

Section 2 Scaling Provisions

3.1.8	The Regulator proposes that the new Instrument incorporate scaling provisions which are based on each retailer's proportion of the small customer load thereby ensuring there is sufficient volume of regulated contracts to enable retailers serving the small customer market to hedge their small customer load.

Hydro Tasmania supports the use of load in place of number of customers as the load is what causes the need for financial contracts. A change to a proportion of load is an intrinsically fairer approach.

Section 3 Review of Inputs

3.1.10	The Regulator proposes reviewing the inputs at least annually on the basis of the schedule outlined in section 3.1.10 of this Draft Report. The Regulator further proposes amending the Statement of Regulatory Intent to incorporate the formal review schedule for the inputs set by the Regulator as outlined in section 3.1.10 of this Draft Report.

The Regulator has expressed concern at allowing participants to request a change to a parameter on page 32 of the draft report. The Regulator is concerned that participants will only request a review when it is to their advantage.

This is undoubtedly true but this is just the trigger for the Regulator to undertake a review of this parameter. Whilst the participant may believe this parameter should change to their advantage, it is also possible that the parameter will change to their disadvantage. There is also a need to guard against frivolous reviews so Hydro Tasmania believes that any participant requesting a review should be required to make a case for why the parameter needs to be updated.

The Regulator has proposed a quarterly update for 3 parameters. Hydro Tasmania's view is that there is little value in these parameters being updated more frequently than annually and there is an additional administrative cost as well as the increased risk of errors from a more frequent update.

In regards to when the annual update should be done; Hydro Tasmania's view is that it should be done after the Wholesale Energy Price has been set so that price shocks are not introduced into that process. This means it should be done in June or later.

In late June there is a major update for the new annual update of the forecast demand (the NEFR) from AEMO. This is typically released in late June and early July. There is a significant benefit in combining the annual variable update with the demand forecast update. If these changes drive prices in opposite directions, they will cancel each other so a price rise followed by a price fall will be avoided. They may both push prices in the same direction in which case nothing is lost.

Hydro Tasmania's proposal is that the Schedule 1 updates should be effective in the same week as the new AEMO demand forecasts are available. This would mean that the first annual update would occur in June 2017. For values which are linked to a website, this would mean using the latest available data from that site at the time the update is done.

Section 4 Transition Arrangements

3.1.12	The Regulator proposes that the transition between the existing Instrument and the new Instrument should occur as outlined in Attachment 4.3 such that retailers should have the option of contracting under either the existing Instrument or the new Instrument.

The Regulator’s proposal is that the transition as outlined in Attachment 4.3 should be implemented.

Hydro Tasmania has two serious concerns with this approach being:

- This option gives retailers an arbitrage opportunity if the methodologies in the two instruments are different and
- It requires the creation of two instruments with the associated complexities and potential for errors

The Regulator has indicated that it is proposed to update the current instrument with any changes made to the new instrument. This means effectively that there should be a seamless transition from the current instrument to the new instrument if the methodology is not changing.

In this situation, Hydro Tasmania proposes that the current instrument should be revoked on 31 December 2016 and the new instrument should become effective from 1 January 2017. The term of the new instrument should then be a minimum of 5.5 years, as discussed in Section 1, plus 2 years for the period when the instrument was revoked. This approach will give administrative simplicity, regulatory certainty and reduces arbitrage opportunities.

Section 5 Trading Halt Arrangements

3.2.1	The Regulator proposes amending the Guideline to add a clause similar to the existing Clause 3.5 (exceptions to the standard weekly process) to allow for the possibility of Hydro Tasmania instigating a trading halt and not offering weekly prices. The Regulator also proposes requiring Hydro Tasmania to offer make-up volumes in the event that Hydro Tasmania instigates a trading halt and does not offer weekly prices.

Hydro Tasmania supports the Regulator’s approach. Aurora has raised the issue of losing an opportunity to purchase volume for a quarter if the trading halt happens in the last couple of days of a quarter. The Regulator has recognised this issue in requiring Hydro Tasmania to offer make-up volumes.

To address this concern, it is proposed that if a trading halt stops an auction, an auction for the same volume will be held as soon as practical once the trading halt is lifted. The prices offered will be updated to reflect the new auction date.

Section 6 Supply Disruption Event

3.3.1	The Regulator proposes: (a) removing the current reference, in the Statement of Regulatory Intent, to the Regulator instructing Hydro Tasmania to set all regulated contract prices at $300/MWh; and (b) adding the following criteria to the Statement of Regulatory Intent: (i) Will the Regulator’s proposed response provide regulatory certainty and transparency? (ii) Will the benefit of any proposed changes to the current Wholesale Regulatory Framework outweigh the costs to change the Framework? (iii) Will the Regulator’s proposed response effect the efficiency of the Tasmanian Wholesale Electricity derivatives market? (c) if a supply disruption event occurs in the future, adopting the following process: (i) the current weekly offer process will continue to operate unless advised otherwise; (ii) the Regulator will contact all current market participants to seek their views as to the appropriate response to the event; (iii) in its deliberations, the Regulator will apply the criteria noted in (b)(i)-(iii) inclusive above to assess the most appropriate course of action to take in response to the event.

Hydro Tasmania has some suggested changes to sections (b) and (c). Firstly, Hydro Tasmania supports the Regulator’s intent to continue offering contracts.

Hydro Tasmania proposes that (b) (ii) and (iii) are both extremely difficult to measure. In particular the benefit to a participant will depend on their contract position which will not be known to the Regulator. As an alternative we propose a single point which is:

> (ii) Does the proposed price reflect the level which would be seen if Tasmania had a competitive wholesale market

In section (c) there should be an additional dot point after (i) which says:

> (ii) All traffic lights will be set to red pending the outcome of the Regulator’s deliberations in (b) (iii).

This will limit the risk to Hydro Tasmania by reducing the volume which is required to be offered. This is a reasonable compromise for being required to make offers at a price which may well be below the “market” price.

It is also important, if contracts are to continue to be offered, that some time limit be placed on the Regulator. Consequently Hydro Tasmania proposes a further point:

(iv) the Regulator must implement the revised pricing arrangement, if there is to be one, within 4 weeks of receiving the first notification of the Supply Disruption Event.

Section 8 Load Following Swap Description

In the Draft Report in Figure 1, page 14 there is a description of a Load Following Swap. We suggest replacing the text with the following text would clarify the issue.

> **Load Following Swap Contracts**
>
> In Tasmania, the load following swap product is a contract that is shaped to the Tasmanian net system load. The net system load is the load which remains after the load for all the customers with half hourly meters has been taken off. It therefore represents the load shape for small customers who do not have half hourly meters and is the shape used by AEMO to bill retailers of those customers. A retailer can then manage the risk from the profile of small customers by purchasing a load following swap contract. The retailer will still be exposed to volume risk if the customers use more energy than expected. i.e the retailer would be exposed to spot prices to the extent that it does not have hedging contracts in place for this additional volume.