

Mr Joe Dimasi,
Regulator,
Office of the Tasmanian Economic Regulator,
GPO Box 770,
Hobart, Tas 7001

27 January 2016

Review of Wholesale Contract Regulatory Instrument

Dear Mr Dimasi,

Please find attached Hydro Tasmania's submission into the Review of the Wholesale Contract Regulatory Instrument.

Hydro Tasmania supports the current methodology for setting the price for the wholesale regulated products which are used as a safety net for retailers in Tasmania. It has provided a robust pricing methodology which has delivered pricing certainty for retailers and provided good price transparency. We have identified some minor improvements.

Please contact the undersigned if you wish to discuss this issue.

Yours sincerely,



David Bowker

Regulation Manager

Hydro Tasmania Submission - Wholesale Contract Regulation Instrument Review

Overview

The key outcome from this review which is important from Hydro Tasmania's perspective; and we believe for Tasmania, is that the functionality of the electricity market in Tasmania is preserved. The instrument has demonstrated that it can operate effectively since it was initiated including the major pricing disruption of the removal of the carbon price.

Hydro Tasmania supports the current methodology for setting the price for the wholesale regulated products which are used as a safety net for retailers in Tasmania. It has provided a robust pricing methodology which has delivered pricing certainty for retailers and provided good price transparency.

We have noted some opportunities for improvement including the learnings from the Basslink failure in December.

Response to OTTER's Questions

Is the term of the existing Instrument appropriate for the new Instrument, in the context of the evaluation criteria?

Would market participants prefer the term of the new Instrument to align with financial years?

Hydro Tasmania supports a five year term in order to give regulatory certainty. Since much of the retail contracting is done on a financial year basis it would be useful to align it to financial years. The original reason for the calendar year approach was related to structural reforms of the electricity industry in Tasmania and is no longer relevant.

In addition, it would be useful to align the instrument's term with the retail determinations in Tasmania due to the close connection between them.

As the instrument affects contracting for up to two years into the future, we suggest it would be good to formalise an early review of the instrument. The Regulator has initiated an early review for the Instrument which becomes effective 1 January 2019. It is proposed that this should become a formal requirement. A process which allows the new instrument to be declared two years before the old one expires would also allow for any transitional arrangements to be phased in.

The Regulator is seeking feedback from stakeholders regarding the potential impact of any overlap between the existing Instrument and the new Instrument and the transitional arrangements, if any, that may be required.

A change to the instrument which causes a step change in the prices needs to be managed carefully. So if the methodology is changed in such a way as to introduce a step change in prices, there will need to be transitional arrangements that meet the following criteria:

- to create a smooth transition between the old and the new instruments; and
- to ensure that the transition minimises arbitrage opportunities for participants.

Would participants prefer greater flexibility to amend the Instrument to rectify errors and correct minor procedural and administrative matters over the certainty provided under the existing Instrument?

Hydro Tasmania supports giving the Regulator more flexibility in making minor adjustments. This will reduce the administrative burden of maintaining the instrument and is aligned to the current Government policy of reducing red tape.

The Regulator is seeking feedback from stakeholders regarding the determination and forecasting of values by Hydro Tasmania, as listed in Part One of the existing Instrument.

Hydro Tasmania has not been made aware of any issues from retailers with its provision of forecasting values.

Is the range of regulated products that are available to market participants appropriate in the context of the evaluation criteria?

Hydro Tasmania's view is that the products represent a good choice to allow retailers to manage their risks. The range of products offered includes all the products readily traded on the ASX (aside from options contracts) plus a Net System Load Following Swap which is not available on the exchange.

We note that the Instrument has been designed as a safety net and that retailers have generally preferred to contract commercially with Hydro Tasmania and that the safety net has not been used regularly (excluding the current Basslink outage period where it has been fully subscribed).

Does the Regulator need to approve alternative contractual arrangements in circumstances where both parties wish to use an existing Schedule, instead of the Hydro Tasmania Schedule?

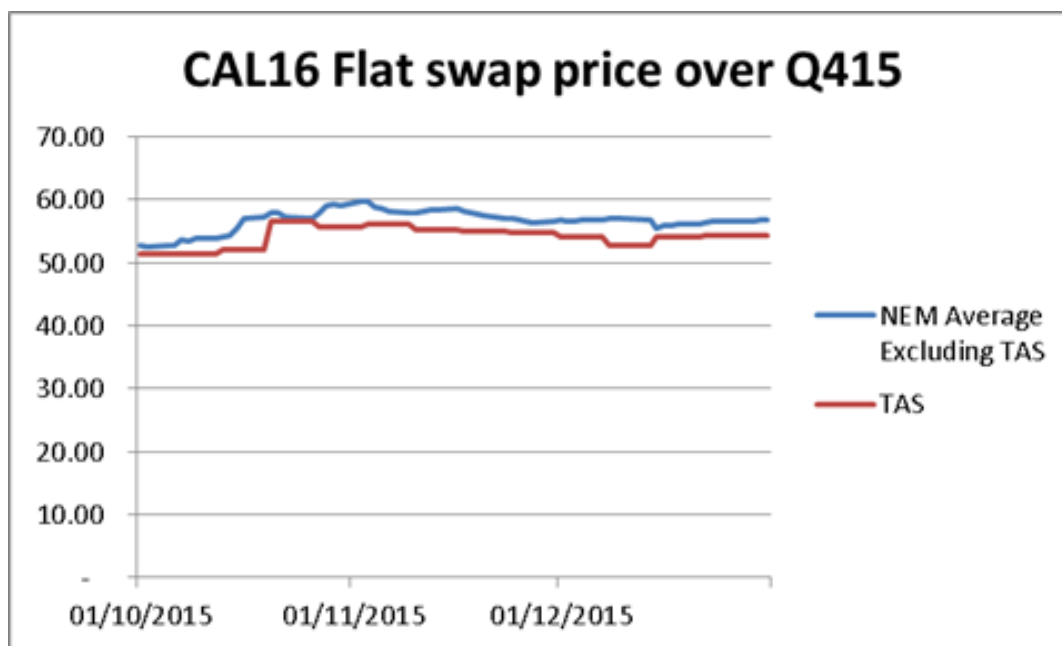
The parties who are contracting with Hydro Tasmania are wholesale market participants who should be well aware of the risks involved in the market. In place of the Regulator approving alternative contract forms, Hydro Tasmania suggests that a letter from the retailer requesting that they be allowed to use their existing ISDA form would be sufficient.

The Regulator is seeking feedback from stakeholders regarding the calculation of the prices for the peak period swap, baseload swap and load following swap products, as mentioned above, in the context of the evaluation criteria.

Hydro Tasmania supports the current methodology for calculating the swap prices.

The ESI Act in Section 43H (See Attachment) lays down some principles for the setting of prices. These principles can be paraphrased as the contract pricing needs to be based upon the price in contracts that relate to managing the financial risks associated with the wholesale purchase of electricity in the Victorian region adjusted for the difference between the supply of, and demand for, electricity in Tasmania. These are the principles which the methodology currently uses. Any change to these principles requires a change to the legislation and is outside the scope of this review.

The graph below shows how the regulated prices for a flat swap for Tasmania compare with a four state average for the mainland states during the last quarter of 2015. This shows a good correlation between Tasmanian regulated prices and the four state average. This demonstrates that the Instrument delivers a very reasonable outcome. Whilst the price is higher than the Victorian price, Victoria is based on very low cost brown coal generation.



The recent Basslink outage has highlighted an opportunity to improve the Instrument. Hydro Tasmania has raised this change informally with the Regulator so it has been raised here in case no action is taken to make a change in the current instrument.

The proposed change is to link the Basslink capacity assumption in the existing methodology to reflect actual Basslink capacity¹ during outages rather than the fixed value currently used. This would be consistent with the design of the instrument but we understand this is not currently possible without extended consultation. The current assumption is included in Schedule 1 which contains the assumptions under the auspices of the Regulator.

Hydro Tasmania has assessed this approach and supports its use for regulated pricing during Basslink outages.

The benefits of this approach are:

- No change to the methodology so pricing is still consistent with the Instrument
- Understandable and predictable approach for participants
- Maintains the integrity of the wholesale contract framework
- No change to the coding of the model with potential for unforeseen consequences

¹ For clarity this doesn't mean that a different value is applied for different periods as this will not provide the right signal for future periods

At the conclusion of a Basslink outage, the original assumption could be re-instated subject to Basslink returning at full capacity.

In future, Hydro Tasmania believes the value of this variable should be linked to some external source such as the AEMO MTPASA so the instrument can respond quickly to this type of event.

Is there an alternative methodology that may be applied to the calculation of the maximum baseload \$300 cap contract price in the context of the evaluation criteria?

Hydro Tasmania supports the current methodology. At the time the instrument was created there was significant discussion on the methodology for the baseload cap. At the time it was recognised that there were issues with the methodology chosen but it was considered that it was the most logical of the available solutions.

The current methodology is theoretically sound because the physical way of backing a cap product is to have an open cycle gas turbine which is the methodology embodied in the Instrument currently.

In addition, the Instrument needs to be considered as a whole so amending one aspect of the pricing methodology may well have flow on effects. A proposal to change the baseload cap methodology may have far reaching effects. It is consequently important to have a good reason to change it before embarking on such an exercise.

The Regulator is seeking feedback from stakeholders regarding the weekly offer process and limits, scaling rules and calculations included in Part Four of the Instrument.

Hydro Tasmania believes the weekly offer process is working well.

However, there is one potential area for improvement. In the weekly offer process there is a need for the Regulator to be able to allow Hydro Tasmania to not offer contracts under some circumstances. Under the current instrument, the Regulator is not able to allow Hydro Tasmania to stop offering contracts in the event of a supply disruption. The work around for this was to set prices to \$300. This issue is being considered during the current Basslink outage and it is apparent that care needs to be taken in how price setting is communicated in a clear and concise manner that cannot be misconstrued by stakeholders and/or uninformed commentators. It would be preferable to change the Instrument to allow the Regulator to cause Hydro Tasmania to not offer contracts under some well-defined situations in preference setting the price to \$300.

Also in relation to the Supply Disruption event, the Regulator has decided to consider these situations on a case by case basis. A Supply Disruption event must be “prolonged” and “material”. Hydro Tasmania would support the Guidelines incorporating some better definition of “prolonged” and “material”. This need not remove the Regulator’s discretion if the guidance provided is non-binding and allows the Regulator to use discretion relevant to the specific circumstances.

Hydro Tasmania’ view is that the scaling is working well although it has not had much use other than during supply disruption.

There is one minor change which we suggest for scaling. The focus when the instrument was designed was on the mass market. In the current situation we have two active retailers competing in the business sector and no competition in the mass market. The scaling is based the market share within the mass market. We suggest that it would now be more appropriate if it was based on all customer numbers.

The Regulator is seeking feedback from stakeholders regarding the perceived validity of the values currently listed in Schedule One together with the validity of the assumptions adopted for, and the associated sources of, those values.

The values in Schedule 1 are a very mixed bag and consequently there needs to be different approaches to suit the type of data in each section. Some of the values are parameters which drive the methodology and are unlikely to change over time.

For those values which vary over time, we suggest that the Regulator should be committed to review them at least annually. Other variables can be reviewed by the Regulator on request and we see this as a useful way for minimising the administrative burden of holding unnecessary reviews. The following table summarises Hydro Tasmania’s view of the appropriate treatment for each section.

Topic	Comments
1 Off Peak Cap Values	Methodology parameter. No need to change unless issues arise from the value of the parameter.
2 Absolute Minimum Capacity Volume	Methodology parameter. No need to change unless issues arise from the value of the parameter.
3 Supplementary Offer Volumes, Headroom buffers and reserved percentages	Methodology parameter. No need to change unless issues arise from the value of the parameter.
4 Marginal Loss Factors	No change unless major power system changes occur
5 New Committed Wind Generation	See note below. Annual Review
6 Calculation of Tasmanian Cap Value	Several commercial values which will vary over time. Annual review
7 Contract premiums	Annual Review

Note on New Committed Wind Generation

The historical input from new wind farms is only included once they have been commissioned for three years. During this time the volume they are assumed to generate is based on this table. Musselroe will have been commissioned three years ago on 9 October 2016 and so the methodology should switch from the estimates in this table to picking up the historical generation. At that time, the values in this table should be switched to zero as there are currently no new wind farms committed.

This change should be an automatic change and not need consultation by the Regulator. Potentially, Hydro Tasmania should notify the Regulator of this change and the Regulator should notify relevant parties.

Attachment

Extract from Electricity Supply Industry Act 1995 – Clause 43H

(3) In determining whether to approve a methodology to be used for the calculation of prices in contracts that are in an approved standard form in relation to an approved type of contract, the Regulator must take into account the principle that –

(a) prices in such contracts should be based upon the price in contracts that –

(i) relate to managing the financial risks associated with the wholesale purchase of electricity in the Victorian region of the national electricity market; and

(ii) are of the approved type of contract –
as adjusted to accommodate any estimation by the Regulator of the effect of the difference between the supply of, and demand for, electricity in Tasmania after the approval is made; and

(b) prices in such contracts should reflect the risks, to an authorised retailer that enters into a contract that is in an approved standard form in relation to an approved type of contract, of variations in the demand for, or supply of, electricity in Tasmania that the retailer is required to provide under standard retail contracts with small customers.