



**Wholesale Contract Regulatory Instrument Pricing
Investigation**

Final Report

July 2019

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TABLE OF CONTENTS

1. BACKGROUND	1
1.1 Reason for pricing investigation	1
1.2 Objective of pricing investigation.....	2
1.3 Submissions	2
2. OPTIONS ASSESSED	3
2.1 Option 1	3
2.2 Option 2.....	4
2.3 Economic Regulator’s Decision.....	4
3. CHANGES TO INSTRUMENT	5
3.1 Current Instrument - relevant parts	5
3.2 New Instrument - relevant parts	8

1. BACKGROUND

The Economic Regulator is responsible for the regulation of some of Hydro Tasmania's wholesale contract activities under the *Electricity Supply Industry Act 1995* (ESI Act).

Under section 43G(1) of the ESI Act, the Economic Regulator is required to approve a number of matters relating to Hydro Tasmania's wholesale contract activities. The approvals include: the type of financial risk contract that Hydro Tasmania must offer; the standard form of these contracts; and the method for determining the prices and volumes of contracts that must be offered. The Economic Regulator is also required to declare a load following swap as an approved contract type (section 43G(3)). These approvals and the declaration have been effected by the Economic Regulator making a Wholesale Contract Regulatory Instrument (the Instrument).

Hydro Tasmania is required under section 43I of the ESI Act to offer approved financial risk contracts (approved contracts) to authorised retailers selling electricity in Tasmania, and, if requested by the retailers, to enter into these contracts with these retailers.

1.1 Reason for pricing investigation

On 28 November 2017, the Australian Energy Market Commission amended the National Electricity Rules by changing the settlement period for the electricity spot price in the National Electricity Market (NEM) from 30 minutes to five minutes. The change will take effect from 1 July 2021 and will therefore apply from the third quarter of 2021.

On 19 June 2019, Hydro Tasmania raised concerns with the Economic Regulator that the current Instrument¹ does not provide for the change in the settlement period that will apply from 1 July 2021.

The Instrument requires Hydro Tasmania to offer prices for approved contracts each week for at least eight future quarters. Therefore, from 1 July 2019, Hydro Tasmania will be required to offer prices for approved contracts to extend to the third quarter in 2021.

Consequently, under the current Instrument, Hydro Tasmania may be required to enter into one or more approved contracts from 1 July 2019 that refer to time periods that will be inconsistent with the National Electricity Rules from 1 July 2021.

The Economic Regulator does not have the ability to amend the approvals made under section 43G(1). However, under section 43G(4) the Economic Regulator has the ability to revoke an approval made under section 43G(1) and make a new approval. Regulation 21 of the *Electricity Supply Industry (Pricing and Related Matters) Regulations 2013* (the Pricing Regulations) requires the Economic Regulator to conduct a pricing investigation prior to revoking or making an approval.

¹ The current Instrument is effective from 1 December 2017 and embodies the approval and declaration made under section 43G of the ESI Act on 30 November 2017.

1.2 Objective of pricing investigation

The objective of the pricing investigation was to provide information to the Economic Regulator to determine whether to revoke the approvals and the declaration contained within the current Instrument, and whether to make new approvals and the declaration in a new Instrument that reflects the spot market settlement arrangements in the NEM both before and after 1 July 2021.

The investigation has not considered any other potential changes to the current Instrument, except where there may be consequential changes arising from the changed spot market settlement arrangement.

The relatively brief consultation period was necessary to enable a new instrument to take effect from 2 July 2019, which is the first date on which Hydro Tasmania must offer contract prices that extend to the third quarter in 2021.

1.3 Submissions

Submissions were sought by 27 June 2019. No submissions were received. However, there was consultation with Hydro Tasmania and all authorised retailers in Tasmania during the week commencing 24 June 2019, including on the options considered by the Economic Regulator. The outcome of this consultation is reported in the following chapter.

2. OPTIONS ASSESSED

The Economic Regulator released the *Pricing investigation relating to certain provisions in the Wholesale Contract Regulatory Instrument, Consultation Paper, June 2019* on 24 June 2019.

The Consultation Paper proposed that the inconsistency between the new settlement arrangements in the NEM and the approvals in the current Instrument be addressed by revoking the approvals in the current Instrument and making approvals in a new Instrument that contained different definitions of 'Calculation Periods' and 'Peak Calculation Period'. For the reasons set out below, this proposal has not been accepted.

The following section sets out the Economic Regulator's assessment of the option proposed in the Consultation Paper and sets out an alternative option that has been accepted by the Economic Regulator. Other options were considered during the investigations but were found by the Economic Regulator to be unviable or not consistent with the objectives of the relevant provisions in the ESI Act.

2.1 Option 1

On 1 July 2019, revoke the current approval and make a new approval that contains different definitions of 'Calculation Periods' and 'Peak Calculation Period' (this was the option proposed in the Consultation Paper)

The definition of 'Calculation Periods' in clause 28.1 of the Instrument is removed and, in the relevant Schedules to the new Instrument, there are new definitions for 'Calculation Periods' and 'Peak Calculation Period'. These new definitions state that, up to midnight on 30 June 2021, the period is a consecutive period of 30 minutes and, after that date, the period is a consecutive period of 5 minutes.

All other the provisions in the new Instrument are unchanged from the current Instrument.

Hydro Tasmania has advised the Economic Regulator that there are several other parts of the Instrument that assume the settlement period is 30 minutes. For example, the formulae for the Current Average Net System Load and the Historical Average Net System Load are based on a settlement period of 30 minutes (pages 93 and 94). The formula relating to transmission fee increases is also based on a settlement period of 30 minutes (page 96).

The Economic Regulator has assessed that the task of preparing new formulae to reflect the new settlement arrangements, and ensuring that there are no unforeseen consequences in other parts of the Instrument, cannot be completed within the required timelines.

Option 1 has, therefore, not been accepted by the Economic Regulator.

2.2 Option 2

Revoke the current approval and make a new approval effective from 2 July 2019 that requires Hydro Tasmania to offer approved contracts for a minimum of at least seven, rather than eight, future quarters during the third quarter 2019.

Subsequently, conduct another pricing investigation and revoke the July 2019 approval and make a new approval to apply from the fourth quarter 2019 that fully reflects the new settlement arrangements in the NEM.

No other changes to the contents of the current Instrument are intended beyond those necessary:

- to reduce the minimum period to seven quarters effective from 2 July 2019; and
- for a new approval to be made before 1 October 2019, to reflect the NEM settlement arrangements before and from 1 July 2021 and to restore the minimum period to eight quarters.

Under this option, the approved financial risk contracts that Hydro Tasmania has a statutory obligation to offer, during the third quarter 2019, do not extend beyond 30 June 2021, therefore, do not contain any provisions that are inconsistent with NEM settlement arrangements. To reduce the minimum period to seven quarters, the changes are required to the wording in the current Instrument, which are set out in the following chapter.

By 1 October 2019, a new approval will be made, covering a minimum period of eight quarters that reflects NEM settlement arrangements before and from 1 July 2021.

The Economic Regulator is satisfied that existing or new retailers would not be disadvantaged by being offered approved financial risk contracts that cover a minimum of seven, rather than eight, quarters. Hydro Tasmania and all retailers currently operating in the State have expressed support for, or no concerns with, Option 2.

For the reasons set out above, the Economic Regulator has decided to implement Option 2.

2.3 Economic Regulator's Decision

The Economic Regulator has decided, in accordance with Option 2 to:

- revoke the current approval and declaration and make a new approval and declaration effective from the beginning of 2 July 2019; and
- conduct a further pricing investigation that is finalised prior to 30 September 2019 whereby the approval made fully reflects the new NEM settlement arrangements.

3. CHANGES TO INSTRUMENT

The Economic Regulator has decided to remove the requirement for Hydro Tasmania to offer contracts for a minimum of eight future quarters. The new Instrument will require Hydro Tasmania to offer contracts for a minimum of seven future quarters.

The relevant sections of the Instrument and the required changes are shown below.

3.1 Current Instrument - relevant parts

Part 4 – Offer Process and Limits on Offer Obligations

Overview of Part 4

Hydro Tasmania's obligation to offer Approved Financial Risk Contracts arises under section 43I of the ESI Act. Under section 43K of the ESI Act, Hydro Tasmania is not required to offer Approved Financial Risk Contracts where certain minimum volumes would be exceeded. This Part 4 sets out the formulae for calculating those minimum volumes.

Hydro Tasmania is not required to offer Approved Financial Risk Contracts for a Contract Quarter where:

- a liquidity test in relation to Victorian baseload swap contracts is not met for that Contract Quarter;*
- that Contract Quarter has already commenced; or*
- that Contract Quarter is more than 2 years (8 Quarters) in the future.*

In other circumstances, Hydro Tasmania's weekly offer obligation is limited in terms of both capacity and energy, and different limits apply depending on the remaining "headroom" for the Contract Quarter (calculated by subtracting the volumes of contracts already on foot from the total forecast demand). Hydro Tasmania will make a weekly offer (again, in both capacity and energy terms), which must be greater than or equal to this limit. It should also be noted that where a weekly offer is not made because the liquidity test is not satisfied for a Contract Quarter, that weekly offer obligation carries forward into the following weeks.

Where the total volume of Approved Financial Risk Contracts (in terms of either capacity or energy) requested by Authorised Retailers exceeds Hydro Tasmania's weekly offer, scaling rules apply to determine the minimum volume of Approved Financial Risk Contracts that must be offered to each Authorised Retailer (although Hydro Tasmania may meet the requests in full if it so chooses). A priority allocation is made to Authorised Retailers who serve Small Customers, based on the share of the Small Customer market (in terms of the Small Customer Load) that they supply.

Any contract volume offered by Hydro Tasmania that is not allocated in the priority allocation will be allocated on a pro rata basis according to the volume of contracts requested by each Authorised Retailer. The process by which allocation proceeds depends on whether it is the capacity or energy limit that has been exceeded in respect of a given Week and Contract Quarter.

19 Limits on weekly aggregate offer obligations

Hydro Tasmania is not required to offer to an Authorised Retailer an Approved Financial Risk Contract for a Contract Quarter (**Contract Quarter t**) in a Week:

- (a) where the Baseload Swap Open Interest for Contract Quarter t does not exceed the Open Interest Limit as at the beginning of the Offer Date for that Week;
- (b) where the Offer Date for that Week falls in Contract Quarter t – 9 or an earlier Quarter;
- (c) where Contract Quarter t commences, or commenced, on or before the Allocation Date for that Week;
- (d) subject to clause 27.1(a), to the extent that the Capacity Volume of such Approved Financial Risk Contracts would exceed the Weekly Aggregate Capacity Limit for that Contract Quarter in that Week, determined in accordance with clause 21.1; or
- (e) subject to clause 27.1(a), to the extent that the Energy Volume of such Approved Financial Risk Contracts would exceed the Weekly Aggregate Energy Limit for that Contract Quarter in that Week, determined in accordance with clause 21.2.

26.3 Cumulative Catch-Up Capacity

- (a) The Cumulative Catch-Up Capacity for each Contract Quarter:
 - (i) is equal to zero as at the commencement of this Approval; and
 - (ii) changes only to the extent that it is adjusted in accordance with this clause 26.3.
- (b) The Cumulative Catch-Up Capacity for a Contract Quarter (**Contract Quarter t**) in a Week (**Week w+1**), where the Offer Date for Week w occurs in Contract Quarter t-8 or a later Quarter, is:

$$CCC_{w+1} = CCC_w + WACL_w - WACO_w - MCC_w$$

where:

- (i) **CCC_{w+1}** is the Cumulative Catch-Up Capacity for Contract Quarter t in Week w+1, in MW;
- (ii) **CCC_w** is the Cumulative Catch-Up Capacity for Contract Quarter t in Week w, in MW;
- (iii) **WACL_w** is calculated as follows:
 - (A) if, as at the beginning of the Offer Date for Week w, the Baseload Swap Open Interest for Contract Quarter t exceeds the Open Interest Limit, **WACL_w** is the Weekly Aggregate Capacity Limit for Contract Quarter t in Week w, in MW; or
 - (B) if, as at the beginning of the Offer Date for Week w, the Baseload Swap Open Interest for Contract Quarter t does not exceed the Open Interest Limit, **WACL_w** is the Weekly Aggregate Capacity Limit, in MW, that would have applied in respect of Contract Quarter t in Week w, had the Baseload Swap Open Interest for Contract Quarter t exceeded the Open Interest Limit as at the beginning of the Offer Date for Week w;

- (iv) **WACO_w** is the Weekly Aggregate Capacity Offer for Contract Quarter t in Week w, in MW; and
 - (v) **MCC_w** is the Minimum Catch-Up Capacity for Contract Quarter t in Week w, in MW.
- (c) Where the Cumulative Catch-Up Capacity for a Contract Quarter in a Week would, following an adjustment to that Cumulative Catch-Up Capacity in accordance with paragraph (b), be less than 0.5MW, the Cumulative Catch-Up Capacity for that Contract Quarter in that Week is equal to zero.

26.4 Cumulative Catch-Up Energy

- (a) The Cumulative Catch-Up Energy for each Contract Quarter:
 - (i) is equal to zero as at the commencement of this Approval; and
 - (ii) changes only to the extent that it is adjusted in accordance with this clause 26.4.
- (b) The Cumulative Catch-Up Energy for a Contract Quarter (**Contract Quarter t**) in a Week (**Week w+1**), where the Offer Date for Week w occurs in Contract Quarter t-8 or a later Quarter, is:

$$CCE_{w+1} = CCE_w + WAEL_w - WAEO_w - MCE_w$$

where:

- (i) **CCE_{w+1}** is the Cumulative Catch-Up Energy for Contract Quarter t in Week w+1, in GWh;
 - (ii) **CCE_w** is the Cumulative Catch-Up Energy for Contract Quarter t in Week w, in GWh;
 - (iii) **WAEL_w** is the amount calculated as follows:
 - (A) if, as at the beginning of the Offer Date for Week w, the Baseload Swap Open Interest for Contract Quarter t exceeds the Open Interest Limit, **WAEL_w** is the Weekly Aggregate Energy Limit for Contract Quarter t in Week w, in GWh; or
 - (B) if, as at the beginning of the Offer Date for Week w, the Baseload Swap Open Interest for Contract Quarter t does not exceed the Open Interest Limit, **WAEL_w** is the Weekly Aggregate Energy Limit, in GWh, that would have applied in respect of Contract Quarter t in Week w had the Baseload Swap Open Interest for Contract Quarter t exceeded the Open Interest Limit as at the beginning of the Offer Date for Week w;
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- (c) Where the Cumulative Catch-Up Energy for a Contract Quarter in a Week would, following an adjustment to that Cumulative Catch-Up Energy in accordance with paragraph (b), be less than 0.5GWh, the Cumulative Catch-Up Energy for that Contract Quarter in that Week is equal to zero.

3.2 New Instrument - relevant parts

The changes relative to the current Instrument are shown in red.

Part 4 – Offer Process and Limits on Offer Obligations

Overview of Part 4

Hydro Tasmania's obligation to offer Approved Financial Risk Contracts arises under section 43I of the ESI Act. Under section 43K of the ESI Act, Hydro Tasmania is not required to offer Approved Financial Risk Contracts where certain minimum volumes would be exceeded. This Part 4 sets out the formulae for calculating those minimum volumes.

Hydro Tasmania is not required to offer Approved Financial Risk Contracts for a Contract Quarter where:

- a liquidity test in relation to Victorian baseload swap contracts is not met for that Contract Quarter;*
- that Contract Quarter has already commenced; or*
- that Contract Quarter is more than 7.2-years (8 Quarters) in the future.*

In other circumstances, Hydro Tasmania's weekly offer obligation is limited in terms of both capacity and energy, and different limits apply depending on the remaining "headroom" for the Contract Quarter (calculated by subtracting the volumes of contracts already on foot from the total forecast demand). Hydro Tasmania will make a weekly offer (again, in both capacity and energy terms), which must be greater than or equal to this limit. It should also be noted that where a weekly offer is not made because the liquidity test is not satisfied for a Contract Quarter, that weekly offer obligation carries forward into the following weeks.

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- (b) where the Offer Date for that Week falls in Contract Quarter t – 9-8 or an earlier Quarter;

- (c) where Contract Quarter t commences, or commenced, on or before the Allocation Date for that Week;
- (d) subject to clause 27.1(a), to the extent that the Capacity Volume of such Approved Financial Risk Contracts would exceed the Weekly Aggregate Capacity Limit for that Contract Quarter in that Week, determined in accordance with clause 21.1 or
- (e) subject to clause 27.1(a), to the extent that the Energy Volume of such Approved Financial Risk Contracts would exceed the Weekly Aggregate Energy Limit for that Contract Quarter in that Week, determined in accordance with clause 21.2

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where:

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$$CCE_{w+1} = CCE_w + WAEL_w - WAEO_w - MCE_w$$

where:

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