



Draft Statement of Regulatory Intent
Wholesale Contract Regulation

Consultation Paper

March 2014

Printed March 2014

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ISBN 978-0-7246-5281-5

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TABLE OF CONTENTS

GLOSSARY	II
1 PURPOSE AND BACKGROUND	3
2 FAILURE TO CORRECTLY APPLY APPROVED METHODOLOGY	5
2.1 PROPOSED CONDITIONS FOR THE REGULATOR TO FIX PRICES	5
2.2 PROPOSED PROCESS FOR FIXING PRICES.....	6
2.3 HOW WILL PRICES BE SET?	6
3 SUPPLY DISRUPTION EVENT.....	7
3.1 FORMING A VIEW ON THE IMPACT OF A SUPPLY DISRUPTION EVENT.....	7
3.2 PROPOSED PROCESS FOR FIXING PRICES.....	8
4 PROCESS FOR UPDATING INPUTS	11
4.1 BASIS FOR UPDATING VALUES.....	11
4.2 PROPOSED PROCESS.....	11
5 RESPONDING TO THIS CONSULTATION PAPER	13
5.1 RESPONDING TO THIS CONSULTATION PAPER.....	13

GLOSSARY

“**Act**” means the *Electricity Supply Industry Act 1995*.

“**Authorised Retailer**” has the same meaning as in the **Wholesale Contract Regulatory Instrument**.

“**audited wholesale pricing model**” means the model used to calculate wholesale contract prices that **Hydro Tasmania** provided to the Regulator on 20 December 2013 and as revised from time to time.

“**Economic Regulator**” means the Tasmanian Economic Regulator established under the *Economic Regulator Act 2009*.

“**Guideline**” means the *Electricity Wholesale Contract Guideline*.

“**Hydro Tasmania**” means the Hydro-Electric Corporation (ARBN 072 377 158).

“**Regulations**” means the *Electricity Supply Industry (Pricing and Related Matters) Regulations 2013*.

“**Statement**” means this Statement of Regulatory Intent.

“**Wholesale Contract Regulatory Instrument**” means the instrument that specifies the regulated contracts **Hydro Tasmania** must offer to **Authorised Retailers**. The instrument is:

- (i) the approval made by the Minister for Finance on 29 July 2013 (as amended from time to time), in accordance with sections 43G and 43O of the *Electricity Supply Industry Act 1995* and Regulation 20 of the *Electricity Supply Industry (Pricing and Related Matters) Regulations 2013*, having taken into account the principles set out in section 43H of the *Electricity Supply Industry Act 1995*; or
- (ii) the approval made by the Regulator (as amended from time to time), in accordance with section 43G of the *Electricity Supply Industry Act 1995*, having taken into account the principles set out in section 43H of the *Electricity Supply Industry Act 1995*.

1 PURPOSE AND BACKGROUND

Under the Government's electricity reform program implemented during 2013, the **Economic Regulator** was given a number of new roles and responsibilities. One of those new roles is the administration of the framework under which **Hydro Tasmania** is required to offer regulated electricity derivative contracts to authorised retailers that are retailing electricity in Tasmania.

Under this framework, in December 2013 the **Economic Regulator** issued a **Guideline** that outlines Hydro Tasmania's responsibilities in relation to regulated wholesale market contracting and also sets out the weekly regulated contract offer process. This Guideline is also intended to be supported by other regulatory arrangements administered by the Regulator.

Whilst the **Guideline** focuses on **Hydro Tasmania's** responsibilities, during consultation on the **Guideline**, stakeholders supported the **Economic Regulator** providing greater clarity with respect to some of its specific responsibilities under the framework. These include how and when the **Economic Regulator** may step in and fix prices and the process it may undertake in updating of inputs listed in the **Wholesale Contract Regulatory Instrument**. Given this, in the statement of reasons that accompanied the final **Guideline**, the **Economic Regulator** committed to providing a Statement of Regulatory Intent (**Statement**) to clarify its intentions with respect to these responsibilities.

The purpose of this paper is to discuss issues associated with the draft **Statement** and seek feedback from stakeholders.

The paper is structure as follow:

- Chapter 2 discusses the proposed conditions, the process it may follow and how prices may be set if the **Economic Regulator** were to step in and fix prices in the event that Hydro Tasmania failed to correctly apply the approved methodology when calculating prices;
- Chapter 3 discusses the proposed conditions, the process it may follow and how prices may be set if the **Economic Regulator** were to step in and fix prices if a supply disruption event occurred; and
- Chapter 4 discusses the proposed process for the **Economic Regulator** to follow in updating the inputs listed in Schedule 1 of the **Wholesale Contract Regulatory Instrument**.

Information on how to provide comment on the draft **Statement** is provided in Chapter 5.

2 FAILURE TO CORRECTLY APPLY APPROVED METHODOLOGY

Chapter 2 of the **Statement** discusses the conditions under which the **Economic Regulator** may fix regulated wholesale contract prices if it is satisfied that **Hydro Tasmania** has failed to correctly apply the approved methodology.

2.1 Proposed conditions for the Regulator to fix prices

Section 43M(1) of the **Act** provides for the **Economic Regulator** to decide to approve the fixing of prices for regulated products if satisfied that there has been a significant, deliberate or repeated failure by **Hydro Tasmania** to correctly apply the approved pricing methodology.

However, none of the terms ‘significant’, ‘deliberate’ or ‘repeated’ are defined in the **Act** or in the **Regulations**. Based on the comments provided during consultation on the **Guideline**, the **Economic Regulator** understands that stakeholders desire greater clarity as to how the **Economic Regulator** would interpret these terms when considering whether or not to step in and fix prices.

For the purposes of the **Statement**, the **Economic Regulator** therefore proposes defining each of these terms as follows:

- (1) Significant - the prices calculated by **Hydro Tasmania** for regulated contracts differ by five per cent or more from the prices calculated by the **Economic Regulator** using the **audited wholesale pricing model**.
- (2) Deliberate - a circumstance in which the **Economic Regulator** considers, based on information it has obtained, that **Hydro Tasmania** has intentionally used a methodology to calculate prices that is inconsistent with the **Wholesale Contract Regulatory Instrument**.
- (3) Repeated - the prices calculated by **Hydro Tasmania** for regulated contracts differ by any amount from the prices calculated by the **Economic Regulator** using the **audited wholesale pricing model**:
 - on more than two occasions during any 30 day period on a rolling basis;
or
 - on more than six occasions during any 365 day period on a rolling basis.

Should any of these situations arise, the **Economic Regulator** would consider stepping in to fix prices and, subsequently, undertaking a compliance investigation.

These definitions are based on the **Economic Regulator’s** judgement as to what may constitute a reasonable approach having regard to balance the competing interests of the various stakeholders, protecting consumers, ensuring the market is

functioning well whilst not unduly penalising any one party. In particular, the **Economic Regulator** notes:

- with respect to the definition of ‘significant’ five per cent is a typical magnitude when considering materiality, particularly for accounting purposes;
- the proposed definition of ‘deliberate’ provides the **Economic Regulator** with the flexibility to consider information from a range of different sources in making its assessment; and
- with respect to ‘repeated’ the **Economic Regulator** considers the proposed definition sufficiently protects market participants without being too restrictive on any particular party. For example, the **Economic Regulator** considers a condition of twice in a 30 day period, ensures that **authorised retailers** still have two weeks within a month to purchase contracts at the regulated price. Furthermore, regulatory intervention, with its associated costs, is avoided for immaterial or one-off errors.

2.2 Proposed process for fixing prices

In Section 2.3 of the **Statement**, the **Economic Regulator** has outlined a proposed process that it will follow in forming a view on whether it will step in and fix prices based on the conditions outlined in Section 2.2. of the **Statement** (as further explained in Section 2.1 above). The intention of this section is to provide greater clarity as to the steps the **Economic Regulator** would take in assessing whether Hydro Tasmania has failed to apply the correct methodology and how the **Economic Regulator** would resolve the problem if the available evidence suggest such a failure has occurred.

2.3 How will prices be set?

Section 2.4 of the **Statement** outlines how the **Economic Regulator** proposes to set prices. Section 43N(2) of the **Act** requires the **Economic Regulator** to fix prices using the approved pricing methodology for those contracts. Given this the **Economic Regulator** proposes to fix prices by carrying out the relevant calculations using the copy of the **audited wholesale pricing model Hydro Tasmania** has provided to the **Economic Regulator**.

The Regulator is seeking feedback on:

- the proposed definitions of ‘significant’, ‘deliberate’ and ‘repeated’ in determining whether the **Economic Regulator** should step in a fix prices;
- the proposed process in Section 2.3 of the **Statement** that the **Economic Regulator** would follow in forming a view on stepping in and fixing prices; and
- how the **Economic Regulator** proposes to set prices.

3 SUPPLY DISRUPTION EVENT

Chapter 3 of the **Statement** discusses the conditions under which the **Economic Regulator** may fix regulated wholesale contract prices when, in the **Economic Regulator’s** opinion, a ‘supply disruption’ event has occurred.

3.1 Forming a view on the impact of a supply disruption event

Sections 43M(2) of the **Act** provides for the **Economic Regulator** to step in and fix prices where there has been a ‘supply disruption event’. Section 43M(3) of the **Act** defines a supply disruption event as:

“...an event (other than a drought) that, in the opinion of the Regulator, is likely to cause a prolonged interruption to a substantial quantity of the electricity that would otherwise be supplied under normal circumstances by Hydro”.

In forming a view on whether a supply disruption event has occurred consistent with the above definition, the **Economic Regulator** has proposed, in Section 3.2 of the **Statement**, that it will consider:

- estimates of the impact on generation capacity relative to the total generation capacity at the time of the disruption and likely demand;
- the likely duration of the disruption; and
- any other matters that the **Economic Regulator** deems relevant.

One of the key principles of good regulatory practice is to provide certainty to market participants. This is particularly the case for a statement of regulatory intent as set out in the draft **Statement**.

In this context, the **Economic Regulator** considered whether it should be more prescriptive in defining the impact of a supply disruption event on Hydro Tasmania’s ability to supply electricity. In particular the **Economic Regulator** considered whether a definition should be considered in terms of the capacity of the Tasmanian generation market (including Basslink) or the amount of energy that cannot be produced over a period of time (for example from an unplanned interruption at a generation plant or from transmission faults)¹.

However, the **Economic Regulator** understands that it is difficult to prescribe a uniform capacity or energy impact because capacity and energy can vary significantly throughout the year due to dam storage levels and other factors. Furthermore, the **Economic Regulator** is concerned that a prescriptive definition may lead to the situation where the conditions have not been met but it would be

¹ Planned interruptions would not be included in determining a supply disruption as these would be considered part of normal operations under normal circumstances.

beneficial for market participants if the **Economic Regulator** stepped in and fixed prices. Alternatively, if a prescriptive condition was met, the Regulator would be obliged to step in irrespective of whether or not that action would benefit market participants.

The **Economic Regulator** considers that the proposed definition would provide it with enough flexibility to consider each event on its merits relative to market conditions and available supply and demand at the time of the event.

Whilst the Regulator has proposed the criteria based approach as set out above it is prepared to consider specific/more prescriptive suggestions from stakeholders.

3.2 Proposed process for fixing prices

In Section 3.3 of the **Statement**, the **Economic Regulator** has outlined a proposed process that it will follow in forming a view on whether a supply disruption event has occurred and how it will step in and fix prices.

To begin with this involves considering the timing for the **Economic Regulator** to declare whether a supply disruption has occurred. The **Economic Regulator** has proposed using the general definition of “as soon as is reasonable practicable”. Some stakeholders suggested that a more prescriptive definition should be used such as between 24 and 48 hours given the risks and potential impact on the market. However, the **Economic Regulator** considers this may not necessarily be practical in all circumstances. This is due to the requirement to obtain relevant information, analyse that information and for the **Economic Regulator** to form and make a decision. In addition the Treasurer needs to be consulted before a decision is made.

In terms of the risk to stakeholders, the **Economic Regulator** acknowledges that there may be some exposure particularly in circumstances when **Hydro Tasmania** is required to offer regulated contracts before a supply disruption is declared and an appropriate price fix is put in place. However, the **Economic Regulator** notes that there are boundaries to the level of exposure faced by **Hydro Tasmania** and other stakeholders in that **Hydro Tasmania** would only be required to offer between twenty and thirty MW as part of its compulsory minimum and supplementary weekly offers. This significantly limits the exposure compared to other markets. Given this, the **Economic Regulator** considers the use of the definition “as soon as reasonable practicable” is a workable definition.

Following the above, if the **Economic Regulator** considers that a supply disruption event has occurred the **Economic Regulator** will, after consulting the Treasurer, step in and set prices using a two part process.

The first step would be to instruct **Hydro Tasmania** to set all contract prices to \$300/MWh. The aim of this approach is to effectively implement a trading halt for regulated contracts in the immediate term after the supply disruption event has occurred, which the **Economic Regulator** considers is the appropriate outcome during the initial uncertain times following the supply disruption event. The **Economic Regulator** notes that it has legislative power to step in and set prices but

does not have the power to change **Hydro Tasmania's** requirements to offer to sell volumes as per the requirements of the **Instrument**. By setting prices at this level, the **Economic Regulator** considers it highly unlikely that **authorised retailers** would be interested in purchasing contracts at that price thereby effectively halting trading in regulated contracts. Further, this is particularly the case as retailers would be aware that pricing during the supply disruption event would be conducted in accordance with the process set out in the **Statement**.

The second step would involve the **Economic Regulator** undertaking an investigation to determine if a new pricing methodology was required. This would involve considering the nature of the event, the duration of the impact of the event and determining whether a new pricing methodology is required given the change in market conditions. Following this, **Hydro Tasmania** would be instructed to offer regulated contracts at prices using either the methodology proposed by the **Economic Regulator** or the existing methodology.

Hydro Tasmania would also be expected to provide catch-up volumes consistent with the principles outlined in clause 26 of the **Wholesale Contract Regulatory Instrument** and for all volumes not sold when the price was set at \$300/MW. In this way, the **Economic Regulator** considers that **authorised retailers** would be not necessarily be worse off as they would have the ability to purchase additional contracts to make up for the contracts they decided not to purchase when the prices were set at \$300/MwH (i.e. effectively the trading halt).

Depending on the nature of the cause of the supply disruption event, the **Economic Regulator** may suggest the Government consider introducing new legislative or regulatory requirements to put the **Economic Regulator's** methodology into law or to implement a new methodology as it saw fit.

The Regulator is seeking feedback on:

- the Regulator's proposed approach to assessing the impact of a supply disruption event in forming a view on whether a supply disruption event has occurred prior to the **Economic Regulator** stepping in and fixing prices; and
- the proposed process in Section 3.3 of the **Statement** that the **Economic Regulator** intends following in stepping in and fixing prices where a supply disruption event occurs.

4 PROCESS FOR UPDATING INPUTS

Chapter 4 of the Statement discusses the proposed process under which the **Economic Regulator** may update the inputs contained in Schedule 1 of the **Wholesale Contract Regulatory Instrument**.

4.1 Basis for updating values

The **Economic Regulator** is not limited as to the reasons why it may consider updating the input values in Schedule 1 of the **Wholesale Contract Regulatory Instrument**. Given this, the **Economic Regulator** proposes that it may consider updating the inputs as a result of one or more of the following actions:

- the **Economic Regulator** itself may initiate a review of the inputs;
- **Hydro Tasmania** may approach the **Economic Regulator** to initiate a review; or
- **authorised retailers** or other stakeholders may approach the **Economic Regulator** to initiate a review.

4.2 Proposed process

In updating the inputs, the **Economic Regulator** proposes to adopt the following process:

- assess the proposal for the update and decide whether or not an update is appropriate;
- publicly consult on the **Economic Regulator's** proposed changes; and
- if the **Economic Regulator** decides to update the inputs it will notify both **Hydro Tasmania** and **authorised retailers** operating in Tasmania of the nature and timing of the update.

As noted in the draft **Statement**, the **Economic Regulator** would, whenever practicable, undertake consultation with **Hydro Tasmania** and **authorised retailers** in relation to any proposal to update values under the **Wholesale Contract Regulatory Instrument** prior to doing so. However, there may be situations where there is a requirement to rectify an issue with the values in a more timely manner such that the opportunity to consult with stakeholders may be limited. However, in these limited instances, stakeholders could request a further review of the inputs after the values have been updated.

The **Economic Regulator** considers that this approach promotes consultation and transparency as is the normal approach of the **Economic Regulator** in any investigation. However, the proposed approach also allows the **Economic Regulator** to act quickly if need be for the benefit of the market and its participants.

Furthermore, subsequent to any immediate decisions, the **Economic Regulator** considers that allowing stakeholders to request a further review ensures affected parties to raise issues at several stages of the process.

The Regulator is seeking feedback on:

- its proposed basis for updating the inputs in Schedule 1 of the **Wholesale Contract Regulatory Instrument**; and
- the proposed process for updating those inputs.

5 RESPONDING TO THIS CONSULTATION PAPER

5.1 Responding to this consultation paper

The Regulator invites written comment on the draft Statement and other issues in this Consultation Paper. Submissions will be considered prior to the draft Statement being finalised and must be received by **close of business on 28 March 2014**.

It is normal practice for all submissions to be published on the Regulator's website unless the author of the submission requests confidentiality in relation to the submission (or any part of the submission). Those parts of a submission that are requested to be kept confidential should be submitted as an attachment to that part suitable for publication.

The Regulator will not publish submissions which contain material that the Regulator believes is, or could be, derogatory or defamatory.

If you would like further information on the treatment of confidential submissions, please refer to the Economic Regulator's *Policy on the treatment of confidential submissions* document on its website.

Submissions by email are preferred to assist in publishing submissions on the website.

Submissions and enquiries may be made to:

office@economicregulator.tas.gov.au

or to

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A copy of the draft Statement and this Consultation Paper may also be found on the Economic Regulator's website: www.economicregulator.tas.gov.au