



**Wholesale Contract Regulatory Instrument Pricing
Investigation**

Final Report

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1 BACKGROUND

The Economic Regulator is responsible for the regulation of Hydro Tasmania's wholesale contract activities and for the administration of the Wholesale Contract Regulatory Instrument (the Instrument) under the *Electricity Supply Industry Act 1995* (ESI Act).

Under section 43G of the ESI Act the Instrument contains a number of 'approvals', made by the Minister or the Economic Regulator. These approvals relate to the types of contracts that Hydro Tasmania must offer as regulated contract products, the standard form(s) of these contracts and the methodology for determining the prices and volumes of contracts that must be offered.

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.

The Regulator completed a pricing investigation into the Wholesale Contract Regulatory Instrument (Instrument) in December 2016 and made the required approvals on 21 December 2016. The new Instrument commenced on 1 January 2017.

In accordance with the requirements set out in the Economic Regulator's *Electricity Wholesale Contract Guideline (Version 2, December 2016)*, Hydro Tasmania is required to undertake an audit of the wholesale pricing model (Model) where changes are made to the Model as a result of changes made to the Instrument. The objective of the audit is to ensure that, post the implementation of the changes to the Instrument that are required as a result of the investigation, the Model complies with the Instrument.

On 13 January 2017, Hydro Tasmania appointed an auditor to undertake an audit of the Model. On 9 February 2017, Hydro Tasmania advised the Economic Regulator that the auditor had identified an inconsistency between the Model and the Instrument with respect to the calculation of the Tasmanian cap price.

The inconsistency related to the calculation of the Tasmanian cap price and to sub-clauses in the Instrument being transposed. This transposition had been present since the original Instrument commenced in January 2014. The auditor considered that, although the relevant formula in the Model is inconsistent with the Instrument with respect to the calculation of the cap price, it is consistent with the intended approach to calculating the Tasmanian cap price. The Economic Regulator consulted with market participants who considered that the Instrument should be changed to align with the Model (and therefore the intended approach), as soon as possible.

There is no legislative ability for the Economic Regulator to amend an existing Instrument. Nor does the Economic Regulator have the legislative ability to revoke

an existing Instrument and make a new one unless the Economic Regulator first conducts a pricing investigation. To address the identified inconsistency within the Instrument as soon as possible the Economic Regulator therefore decided to conduct a pricing investigation to revoke the existing Instrument and make a new Instrument. The Economic Regulator considered that this course of action has the benefits of providing certainty for market participants and maintaining a consultative and transparent approach to wholesale regulation.

On 2 March 2017, the Economic Regulator announced its intention to conduct an investigation.

2 ISSUES

The Economic Regulator released a Consultation Paper on 2 March 2017, outlining the proposed changes to clause 11.7 of the Instrument and invited interested parties to make a submission.

2.1 Clause 11.7 of the Wholesale Contract Regulatory Instrument

2.1.1 Existing Instrument

Clause 11.7 of the existing Instrument dated 21 December 2016 set out that the Initial Nominal Peaker Capacity was calculated as follows:

11.7 Initial Nominal Peaker Capacity Value

The Initial Nominal Peaker Capacity Value, for a Quarter, is the amount calculated as follows:

$$INPCV = \frac{RPC \times (1 + FIR)^{NQP/4}}{(1 + NPTDC)^{NQC/4}}$$

where:

- (a) **INPCV** is the Initial Nominal Peaker Capacity Value, in \$/MWh;
- (b) **RPC** is the Real Peaker Cost, in \$/MWh, calculated in accordance with clause 11.8;
- (c) **FIR** is the Forecast Inflation Rate, expressed as a percentage per annum;
- (d) **NQP** is equal to the number of Quarters between:
 - (i) the Quarter in which the Calculation Date occurs (excluding that Quarter); and
 - (ii) the Construction Quarter (including that Quarter);
- (e) **NPTDC** is the Nominal Post-Tax Debt Cost, expressed as a percentage per annum; and
- (f) **NQC** is equal to the number of Quarters between:
 - (i) the Costing Quarter (excluding that Quarter); and
 - (ii) the Construction Quarter (including that Quarter).

The Initial Nominal Peak Capacity Value is used in calculating the Tasmanian cap price which in turn affects the Tasmanian baseload and peak swaps and the Load Following Swap prices.

2.1.2 Audit of the Model

The audit identified that NQP and NQC, as defined in clauses 11.7(d) and 11.7(f) respectively of the existing Instrument, had been transposed in the Instrument relative to the Model.

As such, although the Model was inconsistent with the Instrument it was consistent with the intended approach to calculating the Tasmanian cap price.

2.1.3 Proposed Changes to the Instrument

In its Consultation Paper the Economic Regulator proposed amending clause 11.7 so that the new Instrument would be consistent with the intended approach, and with the Model, to calculating this particular price by swapping the definitions of NQP and NQC in clauses 11.7(d)(i) and 11.7(f)(i) as follows:

11.7 Initial Nominal Peaker Capacity Value

The Initial Nominal Peaker Capacity Value, for a Quarter, is the amount calculated as follows:

$$INPCV = \frac{RPC \times (1 + FIR)^{NQP/4}}{(1 + NPTDC)^{NQC/4}}$$

where:

- (a) **INPCV** is the Initial Nominal Peaker Capacity Value, in \$/MWh;
- (b) **RPC** is the Real Peaker Cost, in \$/MWh, calculated in accordance with clause 11.8;
- (c) **FIR** is the Forecast Inflation Rate, expressed as a percentage per annum;
- (d) **NQP** is equal to the number of Quarters between:
 - (i) the Costing Quarter (excluding that Quarter); and
 - (ii) the Construction Quarter (including that Quarter);
- (e) **NPTDC** is the Nominal Post-Tax Debt Cost, expressed as a percentage per annum; and
- (f) **NQC** is equal to the number of Quarters between:
 - (i) the Quarter in which the Calculation Date occurs (excluding that Quarter); and
 - (ii) the Construction Quarter (including that Quarter).

2.2 Submissions

The Economic Regulator received submissions from Aurora Energy and Hydro Tasmania.

In its submission, Aurora Energy agreed with the findings from the audit of the Model and also expressed support for the Economic Regulator's approach of revoking the existing Instrument and making a new Instrument to rectify the identified error.

Hydro Tasmania's submission noted the findings from the audit, stating that the Model was inconsistent with the Instrument. The submission also expressed Hydro Tasmania's support for the Instrument being updated as proposed in the Economic Regulator's Consultation Paper.

2.3 The Economic Regulator's Decision

The Economic Regulator has considered the submissions received and decided to address the inconsistency between the Instrument and the Model by swapping the definitions of NQP and NQC in clauses 11.7(d)(i) and 11.7(f)(i) as described in section 2.1.3 above.