



**Wholesale Contract Regulatory Instrument Pricing
Investigation**

Consultation Paper

March 2017

Printed March 2017
Office of the Tasmanian Economic Regulator
Level 3, 21 Murray Street, Hobart TAS 7000
GPO Box 770, Hobart TAS 7001
Phone: (03) 6166 4422

ISBN 978 0 7246 5442 0

Copyright
© Office of the Tasmanian Economic Regulator

INVITATION TO MAKE SUBMISSIONS

It is the Economic Regulator's policy to publish all submissions on the Office of the Tasmanian Economic Regulator's (OTTER) 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 confidential should be submitted as an attachment to that part suitable for publication.

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

Submissions should be received by close of business on 16 March 2017.

To facilitate the publication of submission on OTTER's website, submissions by email are preferred. Submissions and enquires may be made to:

office@economicregulator.tas.gov.au

or to

Todd Newett, Principal Policy Analyst
Office of the Tasmanian Economic Regulator
GPO Box 770,
Hobart 7001

Telephone: 03 6166 4422

A copy of this Consultation Paper is also available on the Economic Regulator's website: www.economicregulator.tas.gov.au.

Following consideration of submissions, the Economic Regulator will publish a final approach paper on its website.

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 with the new Instrument commencing on 1 January 2017.

In accordance with the requirements set out in the *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 (which are reflected in the new Instrument) required as a result of the investigation, the Model complies with the new 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 is a minor transpositional error in the Instrument relating to the calculation of the Tasmanian cap price which has been present since the original Instrument commenced in January 2014. The auditor considers 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 has consulted with market participants who consider 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 the 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 has therefore decided to conduct another pricing investigation to revoke the existing Instrument and make a new Instrument. The Economic Regulator believes that this course of action has the benefits of providing certainty for market participants and maintaining a consultative and transparent approach to wholesale regulation.

2 CLAUSE 11.7 OF THE WHOLESALE CONTRACT REGULATORY INSTRUMENT

Clause 11.7 set outs how the Initial Nominal Peaker Capacity Value is currently 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.

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

As such although the Model is currently inconsistent with the Instrument it is consistent with the intended approach to calculating the Tasmanian cap price and therefore clause 11.7 of the Instrument is incorrect. The Economic Regulator proposes correcting the error in clause 11.7 so that the Instrument is consistent with the intended approach 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).

3 NEXT STEPS

Following consideration of submissions made in response to this Consultation Paper, it is intended that the Economic Regulator's final investigation report will be published on 21 March 2017 along with the associated approvals that will be made under section 43G of the ESI Act.