



Review of the Tasmanian Wholesale Electricity Market Regulatory Pricing Framework – Phase 2

Discussion Paper

for

**Tasmanian Department of Treasury and
Finance**

October 2018

www.emca.com.au

This Discussion Paper has been prepared to assist the Tasmanian Government, Department of Treasury and Finance, in its Review of the Tasmanian Wholesale Electricity Market Regulatory Pricing Framework.

To the extent that this Discussion Paper utilises quantitative data, it relies on information provided to EMCa or obtained from EMCa's sources. EMCa disclaims liability for any errors or omissions, for the validity of information provided to EMCa by the Tasmanian Government, Department of Treasury and Finance and stakeholders to this review, for the use of any information in this Discussion Paper by any party other than the Tasmanian Government, Department of Treasury and Finance and for the use of this Discussion Paper for any purpose other than the intended purpose.

**Energy Market Consulting associates
802 / 75 Miller St, North Sydney NSW 2060**

and

**Level 1, Suite 2 572 Hay St, Perth WA 6000
AUSTRALIA**

Email: contact@emca.com.au

Web: www.emca.com.au

About EMCa

Energy Market Consulting associates (EMCa) is a niche firm, established in 2002 and specialising in the policy, strategy, implementation and operation of energy markets and related network management, access and regulatory arrangements. EMCa combines senior energy economic and regulatory management consulting experience with the experience of senior managers with engineering/technical backgrounds in the electricity and gas sectors.

Authorship

Prepared by:	Scott Wallace and Paul Sell, with input from Rodney Ward
Quality approved by:	Paul Sell
Date saved:	3/10/2018 11:31 a.m.
Version:	V2.0

[This page intentionally blank]

Table of Contents

1	Introduction.....	1
	1.1 Introduction	1
	1.2 Purpose of this paper	1
	1.3 Scope & approach	2
2	Overview of Phase 1 Review	4
	2.1 Stakeholder views	4
	2.2 Interim Findings	5
3	Phase 2 Review.....	6
	3.1 Objective	6
	3.2 Design Principles	8
	3.3 Current issues, opportunities, and policy considerations	9
4	Next Steps.....	11

[This page is intentionally blank]

1 Introduction

1.1 Introduction

The scope for Phase 1 of the Tasmanian Wholesale Electricity Market Regulatory Pricing Framework Review required us to analyse whether the Wholesale Contract Regulatory Instrument (WCRI)¹ is operating as intended according to its original design and to investigate the potential to reduce the impact of mainland wholesale price volatility. For Phase 1 we focused solely on an assessment of the WCRI. Our interim findings from Phase 1 are summarised in Section 2.

Given the timing of the Phase 1 review, our findings did not take into account the new policy of the State Government of Tasmania which is set out in the ‘Lowest electricity prices in the nation’ election policy. A key feature of this policy is that the link with high and volatile mainland pricing would be broken and that the Tasmanian wholesale contract electricity price would be set to reflect Tasmania’s lower electricity system costs in order to deliver the lowest electricity prices in the nation by 2022. By doing this Tasmanians would not in the future be exposed to price volatility and high prices such as occurred in 2016/17 in the Victorian market, and which have been driven by mainland events.

For Phase 2 of this review, we will update our findings from Phase 1 of the review, and make new findings and recommendations, consistent with the Government’s current energy policy. The Government’s current policy requires consideration of a wider set of policy options, or as a minimum, consideration of how changes to the WCRI can support wider policy initiatives.

1.2 Purpose of this paper

The purpose of this Discussion Paper is to set out the objective, guiding principles, and current issues and policy considerations for Phase 2 of the Tasmanian Wholesale

¹ The WCRI provides Tasmanian retailers access to regulated contracts at prices linked to exchange-traded Victorian forward electricity contract prices.

Electricity Market Regulatory Pricing Framework Review. This paper will form the basis for initial consultation meetings with stakeholders. It is intended to generate discussion and to give stakeholders an opportunity to contribute towards finalising those matters, and to give stakeholders an opportunity to contribute their ideas to the development of reform options. The views and ideas expressed by stakeholders will be considered in developing the options paper.

1.3 Scope & approach

Scope and Review Objective

The scope for Phase 2 of the review is to develop and assess options for changing the Tasmanian Wholesale Electricity Market Regulatory Pricing Framework, that advance the objective for the review, as set out in Section 3. We also set out guiding principles for the review in Section 3.

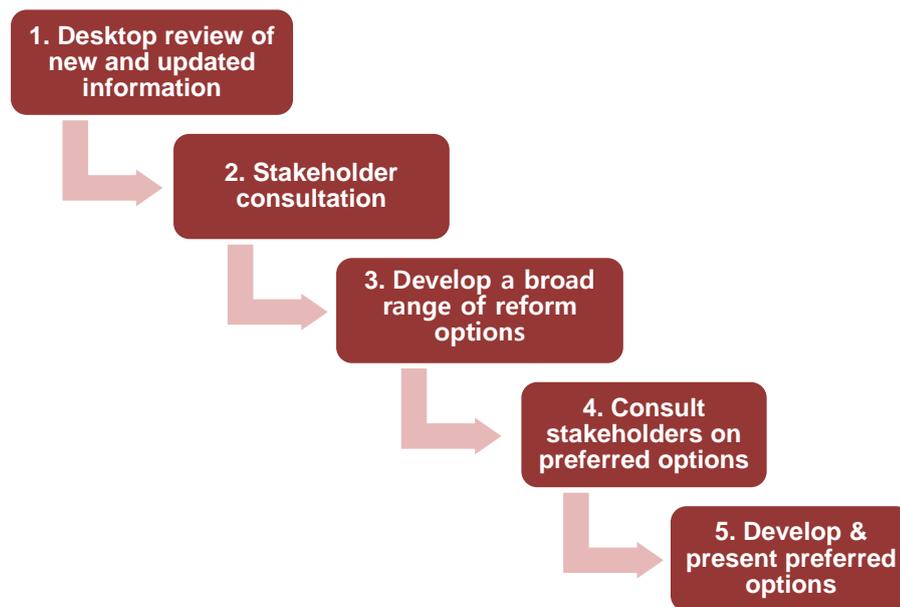
Approach

Phase 2 will build on the significant learnings and interim findings from Phase 1 and the approach for this phase will adopt a similarly consultative approach. Stakeholder consultation will include:

1. Consultation on this Discussion Paper, with the objective to seek stakeholder views on:
 - a. the review objective, the review guiding principles, and the current issues as set out in this paper; and
 - b. potential reform options to advance the reviews objective;
2. Consultation on an Options Paper, with the objective to seek stakeholder views on specific reform options; and
3. Once a decision has been made by Government, further consultation may be undertaken on the design of the preferred reform option.

The approach for Phase 2 of the review, including stakeholder consultation, is illustrated in the figure below.

Figure 1: Review approach



Next steps and timing

We expect to undertake initial consultation on this discussion paper with stakeholders soon after its release to stakeholders and to subsequently produce an Options Paper.

We expect to provide our Final Report to Government in early 2019.

2 Overview of Phase 1 Review

In this Section we provide a summary of stakeholder views and our interim findings from Phase 1 of the review. Whilst new government energy policies have been introduced since Phase 1, we consider that many of the Phase 1 interim findings remain relevant to the Phase 2 review.

2.1 Stakeholder views

The original WCRI design was based on the following principles:

1. Market participants should have confidence that they can manage their wholesale risks appropriately in Tasmania;
2. The risks of operation in the Tasmanian market should be no greater than those in other NEM jurisdictions;
3. Market participants should have flexibility to manage wholesale market risk using similar business models to those used in other NEM jurisdictions;
4. The framework should not unduly constrain Tasmania's ability to maximise carbon value accessed through Basslink; and
5. The reform option should recognise the interaction between spot and contract markets without creating unintended incentives or consequences.

Stakeholders who responded to the Phase 1 consultation² were generally supportive of the WCRI, and were supportive of it remaining stable, transparent, and market-based to deliver certainty and efficient outcomes to existing participants and investors.

Some stakeholders cautioned against making wholesale changes to the WCRI at a time of national energy policy uncertainty and given that the elevated NEM wholesale prices may be temporary only.

² Through both written submissions and through face to face meetings.

Some stakeholders suggested using government rebates to address temporary increases in wholesale prices, as preferable to making changes to the WCRI. They said that if any intervention is contemplated by Government to manage wholesale price volatility, this should occur outside of the wholesale market regulatory pricing framework.

Submissions included suggestions for a number of small changes to the WCRI such as addressing issues with contract allocations, the pricing of regulated cap contracts, and standing offer prices. One stakeholder suggested changes to cap pricing and volumes under the WCRI, and another suggested that Hydro Tasmania should be obliged to offer firming products to support new projects.

2.2 Interim Findings

Overall, we found that the WCRI has performed reasonably well against its original design principles³, that is to provide Tasmanian market participants an instrument that allows them to confidently manage wholesale market risk in the Tasmanian market. However, we did have concerns that prospective new entrant market participants (both generators and retailers) may not share this confidence in the WCRI, given they can be disadvantaged in their access to WCRI contracts and rate card volume and pricing, WCRI complexity, and WCRI scaling rules. The WCRI may therefore not be assisting to increase competition in the Tasmanian market as originally envisaged.

We also found that the WCRI had not consistently delivered 'affordable energy at competitive and predictable prices amongst the lowest in Australia' (as outlined in the 2015 Tasmanian Energy Strategy). The design principles for the WCRI did not include a principle relating to pricing, and as such this finding was not a criticism of the design of the WCRI against those principles, but more a finding that the WCRI design principles do not reflect the 2015 Tasmanian Energy Strategy.

During the review we identified a number of potential improvements to the Tasmanian Wholesale Electricity Market Regulatory Pricing Framework that would not have jeopardised the benefits of maintaining market-based pricing. These included, for example:

- amending those elements of the WCRI methodology that are creating additional price variability and additional premiums above Victorian contract prices;
- better aligning the mechanism for access and allocation of WCRI contracts with the customer load that the WCRI contracts are used to manage;
- simplifying the WCRI pricing methodology, which would have the effect of increasing transparency and certainty of outcomes for potential new market entrants; and
- improving the predictability of Government rebates.

We noted numerous Government interventions in electricity pricing to achieve its objective of delivering affordable electricity to Tasmanian customers, including the WCRI itself, the Wholesale Electricity Price Order and Energy Rebates. The adhoc nature of these schemes meant that prices lacked certainty and predictability, making it difficult for consumers to make long term decisions regarding their electricity requirements. Many of these Government interventions would not be required with improvements to the Tasmanian Wholesale Electricity Market Regulatory Pricing Framework.

³ As outlined above

3 Phase 2 Review

This section sets out the objectives, guiding principles, and the issues, opportunities and policy considerations for Phase 2 of the review.

3.1 Objective

The objective for Phase 2 of the review has been defined as follows.

The Tasmanian Wholesale Electricity Market Regulatory Pricing Framework should provide a robust and transparent mechanism for the setting of wholesale electricity contract prices in Tasmania consistent with Government's energy policy.

The Framework should also support maximisation of the economic value of Tasmanian generation resources, including through trade with mainland National Electricity Market regions.

The Government energy policies relevant to this review are set out in the Liberal Party's election policy document '*Lowest electricity prices in the nation*'. To deliver the objective for the review, it is important to understand the Government's energy policies. The policy document includes the following three targets:

Target #19: *Lowest regulated electricity prices in the country by 2022.*

Target #20: *Keep cost of living increases for Government services, on average, at or below the rate of inflation for the next four years of government.*

Target #41: *Become 100 per cent self-sufficient in renewable energy generation by 2022.*

The policy document also includes several key statements that describe the intent of the policy, including:

'A re-elected Majority Hodgman Liberal Government will undertake a NEM Exit to set wholesale contract prices based on the Tasmanian system costs which will lower current wholesale contract prices. This will de-link the prices Tasmanian customers

get from the volatile Victorian market and enable us to target the lowest prices in the country by 2022 by setting them ourselves.'

'... maintain the physical electricity connection...'

'... target to be 100 per cent self-sufficient in renewable energy by 2022 and [with the] major wind farms at Cattle Hill and Granville Harbour already underway there will continue to be downward pressure on wholesale prices in Tasmania.'

The policy document essentially comprises three requirements that will be advanced by this review. These are as follows:

1. Wholesale electricity contract prices should reflect the cost of generation in Tasmania, not higher Victorian prices (Target #19 & Target #20).

We note the policy intent for Tasmanian customers to benefit from local generation cost of supply that is currently lower than mainland wholesale market prices.

We will explore the best models for how and when to de-link Tasmanian and Victorian wholesale contract prices, to deliver maximum benefit to consumers. We will consider both short and long term implications for pricing, productive efficiency, and investment.

2. Wholesale electricity contract prices should contribute to delivering investment in new renewable generation (Target #41).

We note that investment in new generation will improve energy security in Tasmania and enable more renewable energy to be exported to mainland markets.

We will explore mechanisms to signal the type and timing of investment that will maximise benefit to Tasmanian consumers.

3. Tasmania will remain electrically connected to the mainland and will remain a participating NEM jurisdiction.

We note that this will allow Tasmania to continue to maintain the security and reliability benefits of mainland grid connection and will enable Tasmania to expand its export of renewable energy into the mainland market as investment in renewable generation in Tasmania grows.

Stakeholder Consultation

Through our meetings with stakeholders, we are interested in hearing stakeholder views on:

- our interpretation of the Government's energy policy, and any issues with or conflicts between elements of the energy policy;*
- any other elements of Government energy policy that should be considered in this review; and*
- the objective specified for the review.*

3.2 Design Principles

To ensure that the Government's energy policies are implemented to the benefit of Tasmanian consumers, we have developed the following principles to guide the development of options to reform the Tasmanian Wholesale Electricity Market Regulatory Pricing Framework. These guiding principles are outlined below.

1. Support the Tasmanian Government's energy policies

Reform options must advance the Government's energy policies as discussed above in Section 3.1.

2. Support the Tasmanian Government's objectives for retail prices

Reform options should contribute to the Tasmanian Government's target to have the lowest regulated electricity prices in the country by 2022.

3. As far as possible be consistent for, and accessible to, all Tasmanian customers and retailers

The reform options should as far as possible avoid introducing cross-subsidies between sectors of the Tasmanian economy which would have the potential to distort efficient operational and investment signals which would be detrimental to overall economic efficiency.

The reform options should apply equally to all NEM participants for their Tasmanian customer load. This will allow efficient market forces to incentivise behaviour that will place downward pressure on prices.

4. Minimise barriers to new generation investment

The reform options should minimise barriers to efficient investment in new generation.

As noted above, investment in new generation will improve energy security in Tasmania and enable more renewable energy to be exported to mainland markets.

Efficient investment signals are required to signal the type and timing of investment that will maximise benefit to Tasmanian consumers.

5. Minimise barriers to retail competition

The reform options should minimise barriers to new retailers entering the Tasmanian retail market, and also barriers to existing retailers offering competitive products on an equal basis with competitors. The reform options should apply equally to potential new entrant retailers as they do to existing retailers.

6. Minimise distortions to efficient market operations, to economic dispatch and to the security of the Tasmanian power system

The reform options should not introduce market distortions that might otherwise incentivise inefficient operation and/or inefficient investment. Any inefficient market operation and/or investment is likely to be passed to consumers in the form of higher prices.

7. Be simple & transparent

The reform options must be simple to understand and be transparent. Complexity and lack of transparency creates risk for market participants, particularly new entrants not familiar with how schemes function. Market risk, complexity and lack of transparency tends to be passed to consumers in the form of higher prices.

Stakeholder Consultation

Through our meetings with stakeholders, we are interested in hearing stakeholder views on the Design Principles set out above, specifically:

- *are the design principles, as specified, appropriate for guiding the development of reform options that will maximise benefit to consumer; and*
- *are there any additional design principles that should be included?*

3.3 Current issues, opportunities, and policy considerations

In addition to the Government's energy policies, we have identified a number of issues, opportunities, and other policy considerations that must be taken into account in developing reform options. These are outlined below.

1. Price to Tasmanian consumers

Consumers and the Tasmanian Government consider that electricity prices are unnecessarily high in Tasmania. Wholesale contract prices in Tasmania are currently linked to Victorian prices, and it is argued that consumers are not directly benefiting from Tasmania's cost of generation.

This review will consider mechanisms to enable Tasmanian consumers to more directly benefit from the cost of local generation. This will include both customers on regulated standing offer contracts and customers on market contracts.

2. Export Opportunities – new generation

Tasmania is currently a net importer of electricity from the mainland. As the economics of wind and other generation technologies continues to improve, and given Tasmania has a strong and reliable wind resource with timing complementary to the mainland⁴, there is a growing opportunity for Tasmania to export more electricity to the mainland.

Relevant to this review are the long-term wholesale price agreements required by windfarm proponents to secure financial backing.

This review will consider wholesale pricing requirements for windfarm proponents, and proponents of other forms of generation, to minimise barriers to entry.

⁴ That is, the wind in Tasmania is generally strongest when the wind on the mainland is at its weakest, thus smoothing out overall wind generation across the NEM.

3. Export Opportunities – additional interconnector capacity

Capacity constraints on Basslink will limit the opportunity to export electricity to the mainland.

This review will take account of the opportunities for interconnector capacity augmentation to ensure that wholesale contract reform options do not inefficiently impact the economics of further interconnection. The review will also consider the management of capacity in the existing HVDC link and to any future interconnector capacity as part of the mix of options to the address the review objective.

4. Battery of the Nation

Increased investment in intermittent generation across the NEM will increase the value of fast responding hydro generators to provide firming for non-firm generation. This is the main driver behind Tasmania's proposed Battery of the Nation project.

This review will take account of the opportunities for investment in increased hydro generation (including pumped hydro) to ensure that wholesale contract reform options do not inefficiently impact the economics of the Battery of the Nation or similar projects.

5. National Energy Policy

There remains considerable uncertainty in national energy policy.

This review will take account of potential future national energy policy in developing the reform options to ensure that wholesale contract reform options do not restrict Tasmania's ability to benefit from possible future carbon emission or reliability requirements.

Stakeholder Consultation

Through our meetings with stakeholders, we are interested in hearing stakeholder views on current issues, opportunities, and policy considerations, particularly whether any have not been considered in this report.

While the focus of this review will be on the wholesale electricity market regulatory pricing framework, it will be of benefit for the work to consider and include related aspects of energy policy, to the extent that they will work in conjunction with that framework to meet the objectives above.

Any such ancillary policy areas will be described at an overview level, in order to identify and characterise linkages between those policy areas and the objectives of the wholesale electricity regulatory pricing framework. This will assist with integrating work on the wholesale market pricing framework with other Tasmanian energy policy work that is being undertaken.

4 Next Steps

The key milestones for the review are set out in the table below.

Target Date	Milestone
Mid October 2018	Stakeholder consultation meetings
Late 2018	Options paper and stakeholder consultation
Early 2019	Draft and final reports providing an assessment of preferred options