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30 March 2026

Hon Ruth Forrest MLC
Member for Murchison
PO Box 104
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Via email: Ruth.forrest@parliament.tas.gov.au

Dear Ms Forrest

Thank you for your correspondence dated 26 February 2026 and for taking the time to attend the briefing at our offices on 20 February 2026. As you note, Inter-Regional Settlement Residues (IRSRs) are an important consideration and we appreciate the opportunity to help clarify how they work in a regulated environment, and how Hydro Tasmania will be able to bid for Settlement Residue Auction (SRA) Units ahead of the relevant trading period.

Following your correspondence, we have developed a briefing note (see Attachment 1) giving an overview of the workings of the SRA process, SRA Units, and IRSR settlement. In addition, we have compiled answers to the specific questions raised in your letter (see Attachment 2).

I hope this will assist in ensuring you have a clear understanding of these principles, and confidence in the future of Hydro Tasmania and its ongoing contributions to the State.

We thank you for your time on this matter.

Yours sincerely

Rachel Watson
CEO, Hydro Tasmania

Attachment 1: Settlement Residue Auctions, Units, and Inter-Regional Settlement Residues

1.1.1 1. Executive Summary

This note provides an explanation of Inter-Regional Settlement Residues (IRSRs), Settlement Residue Auctions (SRAs), and negative residues (arising from "counter-price flows") associated with interconnection within the National Electricity Market (NEM). It sets out how these mechanisms operate and their financial significance.

Settlement residues arise when regional electricity prices separate due to interconnector constraints. These residues are overwhelmingly positive and are redistributed through AEMO run auctions known as SRAs. Negative residues do occur, but only in rare and tightly constrained circumstances when power flows counter to price signals (historical operation shows this to be ~1% of positive residuals for Basslink).

Regulated interconnector arrangements materially improve the efficiency of market outcomes by ensuring maximum link flows and the dispatch of the lowest cost generation in the NEM.

1.1.2 2. Background and Context

The NEM operates under the foundational settlement principle that total revenues collected from consumers equal total payments made to generators. In practice this means all generators in a region are paid the regional spot price, and all electricity consumers in that region pay the regional spot price for their loss-adjusted volumes, irrespective of individual contract positions.

Under normal operating conditions, prices can be set by a generator within a region, or by a generator in a connected region. Because of this, regional prices in interconnected regions are closely aligned and prices will equalise across regions[1] so long as there is room for additional power to flow. Regional prices will separate when interconnectors reach their operating limits because the next MW of power can no longer be sourced from the importing region. When this occurs, AEMO's settlement position in each region is no longer individually balanced, giving rise to IRSRs across regions.

Illustrative Worked Example

The following simplified example demonstrates how IRSRs arise when regional prices separate due to an interconnector constraint.

Assume, in a single trading hour:

- Basslink is flowing northward at its maximum capacity of **500 MW**.
- Tasmanian demand is **1,000 MW**, with total Tasmanian generation of **1,500 MW**.

[1] Except for differences due to losses

- Victorian demand is **10,000 MW**, with Victorian generation of **9,500 MW**.
- The Tasmanian regional price is **$100/MWh**.
- The Victorian regional price is **$300/MWh**.

Tasmania

- Wholesale customers (i.e. retailers, BBA) pay: 1,000 MW × $100/MWh = **$100,000**
- Generators are paid: 1,500 MW × $100/MWh = **$150,000**
- Net settlement position: **–$50,000**

Victoria

- Consumers pay: 10,000 MW × $300/MWh = **$3,000,000**
- Generators are paid: 9,500 MW × $300/MWh = **$2,850,000**
- Net settlement position: **+$150,000**

Net Outcome Across Both Regions

Across Tasmania and Victoria combined, AEMO collects **$100,000 more than it pays to generators**. This net amount is the **IRSR** for the hour.

This outcome can also be expressed more directly as:

IRSR = (Price difference between regions) × interconnector flow
= ($300 – $100) × 500 MW = **$100,000**

[Note in practice there are also small adjustments made for transmission losses across the link but this simplified example does not detail this.]

Consistent with market rules, AEMO does not retain this surplus. Instead, the rights to portions of these IRSRs are sold as Units through **Settlement Residue Auctions (SRAs).** These auctions are conducted progressively in advance of the operating period.

1.1.3 3. Settlement Residue Auctions (SRAs) and Inter-Regional Settlement Residues

SRAs are the mechanism through which Units are acquired. These Units form the basis for the distribution of IRSRs to market participants.

Key characteristics include:

- Units are auctioned incrementally in quarterly auctions over a three-year horizon preceding the quarter of interest.
- Units are directional between regions (i.e. VIC to TAS Units and Tas to VIC Units are separate and will relate to separate residue pools for settlement)
- Participants acquire Units representing financial rights to a proportion of IRSRs, independent of physical generation or load.

- In the auction the Units are allocated to the highest price bids progressively in order until all Units are allocated. The clearing price for the auction (the price all participants pay) is set by the lowest price bid that is allocated a Unit after they have all been allocated[2].
- Auction proceeds are distributed to the Coordinating TNSP for the importing region
- Units are used by generators and retailers to manage exposure to regional price separation.
- Speculative participation is possible but involves risk in the absence of a natural hedging position.
- IRSRs are calculated directionally for each trading interval based on the net energy flow between regions.
- We understand AEMO intends to auction 500 units for northward flows and 500 units for southward flows for Basslink. Each unit will therefore relate to 1/500th of the settlement residues for the relevant direction of flow.
- AEMO allocates all positive settlement residues to the owners of the relevant Units (net of the allocation fees arising from the auction expenses).

For example, a participant holding 50% (or 250) of the northward SRA Units for the relevant quarter in the worked example above would receive **$50,000** for that hour[3].

1.1.4 4. Direction of Flow and Units

Settlement residues arise regardless of the direction of interconnector flow.

- Northward flows (Tasmania to Victoria) relate to **TAS-VIC SRA Units**.
- Southward flows (Victoria to Tasmania) relate to **VIC-TAS SRA Units**.

Usually residues are **positive** (that is because when an interconnector is constrained, power is generally flowing from a lower-priced towards a higher-priced region).

Negative residues occur only when there are 'counter price flows' - ie: **power flows from a higher priced region to a lower priced region.** Exports or imports do not systematically generate negative residues.

This outcome is contrary to normal dispatch logic and occurs only under rare operating conditions, typically involving multiple, interacting transmission constraints; or at times where AEMO has intervened in the dispatch process.

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[2] If insufficient bids were received to clear all units the units sold would be priced at $0 and the unsold units will be auctioned off in subsequent auctions. If after all auctions for a quarter there are still unsold units the IRSRs for those units are allocated to the relevant co-ordinating TNSP.

[3] Note settlements in the NEM are actually calculated on a 5-minute basis, but this example is for an hour to keep the math simple.

In the case of Basslink, negative residues:

- Make up only around 1% of all residues historically
- Are typically associated with brief transitions between import and export modes.
- Generally occur at low flows, materially limiting financial impact.

For regulated interconnectors, AEMO actively monitors the forecast level of counter-price flows and will take steps to constrain counter-price flows when negative residues are forecast to exceed a defined threshold of $100k in a period, further reducing risk of material negative residues accruing.

Negative residues for regulated interconnectors are allocated to the co-ordinating Transmission Network Service Provider (TNSP) for the importing region. Negative Residues are not offset against positive residues, nor are they charged to the holders of Units.

1.1.5 5. Cashflows from SRA Proceeds and from IRSR settlements

The settlement of the IRSR proceeds is entirely separate to the auction process. Positive residues are distributed to the parties that bought Units in the preceding auctions in proportion to their Unit holdings. Negative residues are collected weekly from the appropriate TNSPs.

Settlement residues are not netted off against the regulated revenue for the interconnector before being provided to unit holders. Unit holders are entitled to all the positive IRSRs in respect of the relevant quarter and direction of flow their units relate to.

A co-ordinating TNSP is appointed for any region where there is more than one TNSP. It is responsible for collecting revenue on its own behalf as well as for other TNSPs in the region. For Tasmania we understand TasNetworks is likely to be appointed the co-ordinating TNSP. It will recover transmission charges from customers to meet its own revenue requirements related to the Tasmanian transmission system plus charges to cover the Tasmanian portion of Basslink's revenue requirements.

AEMO will allocate the auction proceeds generated by the sale of Units at the SRA process to the coordinating TNSP for the importing region. In the case of Basslink this means AEMO will allocate the auction proceeds for the Inter-regional settlement residues for southward flows on Basslink to TasNetworks. TasNetworks are required to apply these proceeds to reduce or offset APA's revenue requirements in Tasmania.

1.1.6 7. Impacts of Regulated Interconnection on Hydro Tasmania

Concerns that regulated arrangements reduce Hydro's revenues are unfounded.

Historically Hydro paid Basslink's owner for two key rights:

- The right to receive inter-regional revenue rights; and
- The commitment from Basslink that the link would be available to the market for free.

Inter-regional settlement residues are sometimes loosely referred to as providing "access" to the Victorian price. That can be a helpful in some contexts, but it can also overstate their significance.

Access to the Victorian price is primarily provided by having an open (free) link, which makes Tas and Vic operate like one region when the link is flowing unconstrained.

We say a free link enables us to access Victorian prices because prices will flow across a free interconnector (adjusted for losses) up until the point where the link is constrained (that is full capacity is reached)

> *By way of example: if Basslink is flowing freely (not at a limit) and the marginal (price setting) generator is a Victorian generator then that generator's bid will set the price in both Victoria and Tasmania and the prices for Victoria and Tasmania will therefore be the same (except for small differences to account for losses in the network).*

Under regulation:

- Basslink will be made available to the market for free indefinitely.
- A free interconnector benefits the entire market as it enables the cheapest generation available in the NEM to be dispatched meet demand.
- This aspect of regulation should result in significantly higher utilisation of the link in both directions relative to this year; and will enable energy to flow between regions without any toll being applied. This is expected to increase Hydro Tasmania's net revenues materially.
- Hydro Tasmania will also have the ability to bid for Units at auction should it choose to do so as part of its strategy for any given quarter.

The benefits of regulation and reasons Hydro Tasmania supports it are also detailed in Hydro Tasmania's public submissions to the Australian Energy Regulator.

1.1.7 8. Key Conclusions

- IRSRs are a normal and expected outcome of price separation between regions in the NEM.
- SRAs provide an effective, transparent mechanism for selling the Units that form the basis of allocating IRSR revenues for regulated interconnectors.
- Negative residues are rare, small, and there are operational controls which AEMO will apply to ensure they are not excessive.
- Regulated interconnector arrangements materially improve outcomes for Hydro Tasmania and market efficiency overall.

Attachment 2: Response to specific questions from Ruth Forrest MLC correspondence dated 26 February 2026

Note acronyms used here have the same meaning as in Attachment 1.

Q1. Does Hydro agree that Basslink's Regulated Revenue Requirement must be funded first from the residue pool, before any amount is available for auction and if not, please explain how the AEMO process applies?

a. No, this is incorrect. The residue pool and the regulated return are not directly linked.
b. The SRA process progressively auctions all Units for the IRSR's (quarterly auctions for up to three years in advance)
c. The participants who win the Units are entitled to receive all of the positive IRSRs which accumulate during the relevant quarter (in proportion to their Unit holding).
d. Basslink's revenue requirements are not funded by the IRSR pool. The Co-ordinating TNSP for each region is responsible for collecting the money needed to fund the revenue requirements for all the TNSPs in their region. In the case of Tasmania we expect this to be TasNetworks and so TasNetworks will be responsible for collecting revenue on behalf of itself as well as Basslink's owner (for the portion of Basslink's revenue requirements which is allocated to Tasmania.)
e. AEMO allocates the proceeds of the Settlement Residue Auction (i.e. the amounts paid by participants to purchase Units) to the co-ordinating TNSP for the importing region for the relevant Unit. These proceeds must be used by that TNSP to reduce the amount they need to recover from consumers to meet the revenue requirement for the interconnector.
f. This means TasNetworks will be allocated the proceeds from the sale of southward Units on Basslink; and it will use those proceeds to offset the Tasmanian portion of Basslink's revenue requirements.
g. Any negative IRSRs are also allocated to the co-ordinating TNSP for the importing region.

Q2. Has Hydro modelled the likelihood that, after funding the Regulated Revenue Requirement, no surplus residue will remain to auction – and what probability does Hydro assign to that outcome?

h. Per the response to question 1 the proceeds from the SRA process are provided to the co-ordinating TNSPs to reduce the amounts they need to recover directly from consumers. The IRSRs are not used to fund the Regulated Revenue Requirement, but rather are distributed proportionately to the holders of SRA Units.

Q3. If the auctions are directional but the residue pool is netted across both directions, how can Hydro rely on South-to-North trading value when negative residues in the opposite direction reduce the pool before any auction distribution occurs?

a. This question is based on a false premise. It is correct that the auctions are directional (i.e. the VIC to TAS Units are separate from TAS to VIC Units), however the residue pool is not netted across both directions, a separate pool for positive residues is created for each direction and apportioned out to the unitholders. Negative residues do not form part of the

IRSR pool and are allocated to the co-ordinating TNSP for the importing region. Therefore, the issue raised is not relevant.

b. Note: This question may be based on confusion between Notional Interconnectors (i.e. individual links) and Directional interconnectors (the net sum of interconnection between two regions). For example, Victoria and SA have multiple regulated interconnectors with the 200-220MW Murraylink Interconnector and the 550-600MW Heywood Interconnector. It is possible that SA price is lower than VIC price and SA could be importing up to 220MW at Murraylink while exporting up to 550MW at Heywood at the same time (i.e. in order to meet localised network constraints). This would be treated by AEMO as the Directional Interconnector providing 330MW from SA to VIC and creating positive SA->VIC residues (and would not impact the VIC->SA residue pool for that interval).
    i. Please refer to section 5 of the AEMO Guide to the Settlements Residue Auction for further detail
    ii. We also note that while there has been much recent discussion regarding "Looping" in networks following the recent AEMC process this is not something which is relevant for Basslink because there is no transmission loop involving Tasmania. This rule change is only relevant where three or more regions are all interconnected with each other to create a "Loop" . (For completeness Marinus will not create a loop. Marinus and Basslink will be treated as a single directional interconnector for SRA purposes and participants will be able to purchase units related to Vic / Tas or Tas Vic which will relate to the inter-regional settlement residues across both interconnectors.)

Q4. Does Hydro accept that when its generation suppresses Tasmanian prices below Victorian prices, Basslink flows north and negative residues are created and if so, how often does Hydro expect this to be the case?

a. No, this is incorrect, if Tasmanian prices are below Victorian prices this will result in exports (or northward flows). Those flows will not result in negative residues they will result in positive revenues because AEMO will collect more money from Victorian customers for those flows than it needs to pay Tasmanian generators.

b. Negative residues only occur if you are importing from a higher-priced region to a lower-priced region (i.e. when counter-price flows occur). This can happen briefly due to localised network constraints causing energy to flow counter to normal market expectations, or may occur at times due to AEMO intervention in pricing but AEMO has a process to monitor any negative IRSRs which arise on regulated links and take steps to constrain the accumulation of large amounts of negative residues.

Q5. Who does Hydro understand bears the financial liability for negative residues under the National Electricity Rules? Does Hydro agree this ultimately falls on TasNetworks and Tasmanian consumers through TUOS charges?

a. This is partially correct: negative IRSRs for a trading interval will be recovered directly from the relevant co-ordinating Transmission Network Service Provider (TNSP) – this could be TasNetworks or the Victorian co-ordinating TNSP VicGrid depending on which region is

importing. (Negative IRSRs are allocated to the TNSP for the importing region for the relevant trading interval (5 minute period).)

b. However, it is important not to overstate the volume/frequency of counter-price flows – they are a rare and short-lived phenomenon that are tightly controlled by AEMO for regulated links. Basslink has historically had negative IRRs equivalent to ~1% of positive IRRs.

Q6. Has Hydro assessed whether an export-driven bidding strategy increases the frequency or size of negative residues, thereby reducing the residue pool available to fund Basslink's regulated revenue?

a. No, the premise is incorrect. As explained in response to question 4, negative residues generally only occur due to significant network constraints or AEMO interventions and are not caused by ordinary exports. Exporting in and of itself does not create negative residues, rather it usually creates positive TAS->VIC residues.

b. There is also no 'export-driven strategy' being pursued by Hydro Tasmania. On average Tasmania's import and export volumes are largely similar (depending on inflows and storage levels), however the imports are typically at low (or even negative) prices and the exports are at typically at higher prices. With additional development of wind or solar farms in Tasmania, it is plausible that Tasmania could be a net exporter in future.

Q7. In years where Basslink's net residues are less than the Regulated Revenue Requirement, does Hydro accept that no SRA surplus will exist and therefore Hydro cannot receive any value from auction units?

a. As explained in the answer to question 1 Basslink's revenue requirements are not funded by the IRSR pool. The size of Basslink's revenue requirement year on year therefore has no impact on the amount of units that are available for purchase through the SRA process.

Q8. Has Hydro disclosed to Government the permanent loss of Basslink inter-regional revenue from 1 July 2026 as a material change to its revenue outlook?

a. Hydro Tasmania will not suffer a "permanent loss of inter-regional revenue form 1 July". Hydro Tasmania expects to still receive significant revenue from generating into high priced periods when Basslink is exporting and low priced periods when it is importing (noting that as covered in the explainer IRSRs are not needed to 'access' Victorian prices at times when Basslink is unconstrained as prices equalise across the interconnector when there are no constraints.)

b. Hydro Tasmania can also bid in the SRA process to purchase Units to receive revenue from the settlement residues in future periods should it wish to do so for any quarters as part of its strategy.

Q9. What was the annual value of IRR income Hydro received under the Network Services Agreement in the past three years, and how has Hydro adjusted its projected distributions to government to reflect the loss of that income stream?

a. Gross revenue from IRR's (excluding facility fees with Basslink under current and previous owners) for the prior three years can be calculated from publicly available data. The values Hydro Tasmania recorded in our General Ledgers are $165.7m for FY25, $114.6m (FY24) and $87.3m (FY23). Note: these revenues are largely offset by the significant facility fees.
b. IRRs are a component of an integrated and complex system and viewing them in isolation does not provide the full picture of performance or trading dynamics. As explained above, IRRs are also not essential to facilitating access to Victorian prices and the arbitrage opportunities which this presents.
c. We will provide details of any impacts to our trading margins forecast as a result of Basslink regulation in the 2026 Draft Corporate Plan to Shareholding ministers and the Department of Treasury and Finance.
d. The details of this are commercial in confidence however we expect regulation to have a positive impact on our trading margins.
e. NOTE: as explained above, even if no SRA Units are purchased we consider there is significant benefit to the market and Hydro Tasmania in Basslink being an open link (which was something that Hydro Tasmania historically had to pay a fee to secure.)

Additional observations on the further comments in the letter:

1. ***LGCs and Forward Hedging***
   a. Hydro Tasmania provides for our onerous LGC contracts through the annual accounts as per accounting standards.
   b. Hydro Tasmania utilises an inventory methodology to value LGC performance, with the creations, purchases and forward sales impacting the Statement of Profit and Loss and Balance sheet as per accounting standards.

2. ***Spill Events***
   As per the discussion in the briefing on Friday, 20 February 2026, spillage has many drivers and we have a very complex portfolio.
   a. Whilst we have had two of the driest years on record in aggregate, they have both had periods of very significant inflows over short periods.
   b. Given the nature of our portfolio, some of the generation assets have very small storage capacities; these are known as "run-of-river" stations. These run-of-river stations can end up on spill if inflows are very significant and/or upstream generation assets are also operating. This was expected during the design of these stations and storages.
   c. There can be spillage related to generation plants being on outage.
   d. There may also be spillage in scenarios where prices go negative and it is financially better to import energy and spill water rather than generating.
   e. There can be spillage caused by periods of export constraint (i.e. either physically or financially restricted export on Basslink) and high VRE generation. This has been seen

recently in periods where Basslink has been bid into the market with high tolls. This will no longer happen following regulation where the link is managed by AEMO and will effectively be available to the market for free.

3. ***Short-term Profit Expectations***
    a. The forecast uplift in coming years is due to increased price spreads and volatility from the expected closure of the Yallourn Power Station as well as our storage draw down strategy, driving significant potential value for Hydro Tasmania.
    b. Updated profit forecasts will be included in the upcoming State Budget forward estimates.

4. ***BFF Swap***
    a. Hydro Tasmania will consider this feedback when preparing our annual accounts and in line with the new standards.

5. ***AASB 18***
    a. AASB 18 Presentation and Disclosure in Financial Statements is the Australian equivalent of IFRS 18 and becomes effective for annual reporting periods after 1 January 2027.
    b. AASB 18 introduces its most significant changes in the Statement of Profit or Loss, with very limited implications for the Statement of Financial Position and the Statement of Cash Flows, and no impact on the Statement of Comprehensive Income or the Statement of Changes in Equity.
    c. Under the new standard, income and expenses will be classified into five categories within the Statement of Profit or Loss:
        - Operating
        - Investing
        - Financing
        - Income taxes
        - Discontinued operations
    d. There will also be two new subtotals required to be presented, Operating profit and Profit before financing and income taxes. In addition, entities will be expected to provide clearer explanations in notes for any management-defined performance measures.
    e. For Hydro, the overall impact of AASB 18 on the P&L presentation will be relatively small, as our financial reporting already aligns closely with the underlying principles of the new standard. Most changes are anticipated to involve a regrouping of existing account structures and ensuring what is required to be grouped and separated are adhered too. An example of additional disclosure will be the requirement to separate presentation of interest expenses, i.e. interest expenses raised for properties we hold vs interest expenses related to financing activities. This is a focus area we will work through over the next two years to ensure we understand what is required in each category and what should be presented on the face vs notes of the Accounts.

6. ***Overarching comments***
    a. We note your statement: "As we understand it, arbitrage opportunities that once flowed directly to Hydro will now be absorbed by the regulated revenue framework, with most of the value captured by the interconnector owner and the residue pool."
        i. This is not correct. As explained in prior responses this embodies a fundamental misunderstanding of how interconnection works, the benefits of an open link and how SRAs and IRSRs function in a regulated market. In a regulated environment Hydro Tasmania will be able to operate to capture arbitrage benefits without cost when the interconnector is not constrained.
        ii. In addition, even when the link is constrained, Hydro can still receive some arbitrage benefits without the Units as there will still be opportunities to take advantage of Tasmanian price spreads.
        iii. Finally, Hydro Tasmania can bid for a share of the IRSRs through the SRA processes leading up to the trading period.