

FOR THE INFORMATION OF INTERESTED PARTIES

Electricity Networks Pricing: 2004 Regulatory Reset

Prices paid by network users for the conveyance of electricity through a prescribed electricity network in the Northern Territory are regulated under the *Electricity Networks (Third Party Access) Code* (“the Code”) which is a schedule to the *Electricity Networks (Third Party Access) Act 2000*.

The first regulatory control period is now due to finish on 30 June 2004. [A regulatory control period is the period between major price reviews (or “resets”) during which time the price regulation methodology used in setting prices is held constant.]

Accordingly, in the lead-up to the commencement of the second regulatory control period (the five-year period commencing 1 July 2004), the Code requires the Commission as regulator – in consultation with interested parties – to review the price regulation methodology used in the first regulatory control period with a view to modifying the methodology as appropriate. The Commission will be referring to this review and consideration of the price regulation methodology to apply from 1 July 2004 as the 2004 Regulatory Reset.

This letter sets out the Commission’s perspective on the intended nature, scope and timetable to apply to the 2004 Regulatory Reset.

Consultation process

When reviewing the price regulation methodology, clause 62(2) of the Code requires the Commission:

“...to conduct all its determination and approval processes in an open, transparent and competitively-neutral manner, including by consulting with network users, end-use customers, members of the public and all licensed electricity entities that may be affected, directly or indirectly, by the resultant prices.”

The Commission is therefore required to determine the methodology to be used in regulating network access prices in the second regulatory control period by facilitating public consultation and promoting wide-ranging discussion of the issues by all stakeholders.

Only in making their views known, and by articulating arguments in support of these views, can interested parties assist the Commission reach decisions which achieve an acceptable balancing of the interests of the network service provider, network users and the public interest.

The timetable that will be guiding the Commission’s consultation process is attached.

Scope of reset

Most obviously, deficiencies in either the design or the implementation of the price regulation methodology, as revealed by experience in the first regulatory control period, are to be identified and addressed. In addition, the Code also makes reference to possibly updating the methodology for measurement and definitional conventions as now generally accepted.

To kick-off the 2004 Regulatory Reset, the Commission intends to publish an issues paper which will list the main questions to be dealt with, and which will invite interested parties to add to or modify that list as well as to put forward possible answers.

Important issues to be dealt with include:

- the form of regulation;
- if appropriate, measuring the cost of capital; and
- the structure of network tariffs and charges.

On the form of regulation, the main question is whether – in order to better promote incentive regulation – the methodology should:

- continue to focus on the so-called building blocks approach, where the revenue that the network service provider may earn is directly related to the costs it can be expected to incur in providing its services in an efficient manner; or
- alternatively, move towards to an approach allowing prices to rise on average by CPI less an efficiency gains (or productivity) factor determined by reference to the industry or economy as a whole.

Whichever approach is taken, other related issues include:

- the form that any revenue or price cap should take;
- how best to handle ‘efficiency’ carryovers and ‘revenue under/over recovery’ carryovers from previous regulatory control period; and
- the form of regulation for network services treated ‘outside’ any revenue or price cap.

On the cost of capital, at issue will be:

- whether the Commission should adopt a ‘post-tax nominal’ approach (in contrast to the Code’s current reliance on a ‘pre-tax real’ approach); and
- the extent to which the parameters determining the weighted-average cost of capital (WACC) need to be revisited.

On the structure of network tariffs, at issue will be whether the pricing principles need to be more detailed, and whether the tariff structure adopted needs to change, for example:

- by re-weighting the demand and energy components; or

- by distinguishing connection and standing charges from usage charges, generation user charges from final consumer charges, and/or transmission from distribution charges; or
- by differentiating between customer groups.

Commission's objectives for the reset

The Commission will be guided by the objectives and principles set out in clauses 63, 68 and 74 of the Code and section 6(2) of the *Utilities Commission Act*.

In essence, these require the Commission to balance often conflicting objectives, namely:

- the interests of network users for tariffs that reflect efficient costs;
- the interests of the network service provider for incentive to maintain and invest in the network and continue to improve operational efficiency; and
- the interests of all stakeholders to ensure that regulatory costs are minimised and regulatory benefits are maximised.

The Commission wishes to give notice that it will be particularly mindful of the changing character of the Territory electricity market, following the withdrawal of NT Power from the generation and retail markets. In these circumstances, the Commission's view is that the reset needs to give particular focus to:

- the implications of the possible absence of third-party access for the foreseeable future, in the context of the 'vertical' integration between Power and Water's networks, retail and generation operations;
- when compared with larger markets with ongoing third-party access, the opportunities available in the NT context for making regulatory oversight 'simple' and low-cost; and
- the scope for reducing regulatory uncertainty (and giving increased emphasis to regulatory stability and predictability).

Further inquiries

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2004 Regulatory Reset Timetable

Target	Event
early July 2003	Publication of the Commission's Issues Paper
mid August 2003	Submissions on the Issues Paper due
end August 2003	Publication of the Commission's Draft Report on the price regulation methodology to apply in the second regulatory control period
end September 2003	Submissions on the Draft Report due
end October 2003	Publication of the Commission's Final Report on the price regulation methodology to apply in the second regulatory control period, including the data requirements for applying the revised methodology
end November 2003	Draft Pricing Principles Statement due from the network service provider Data required for applying the revised price regulation methodology due from network service provider
early December 2003	Publication, for comment, of the network service provider's Draft Pricing Principles Statement Publication of the Commission's Draft Determination of the numerical value of the parameters required by the price regulation methodology applying in the second regulatory control period
end December 2003	Submissions on the Draft Pricing Principles Statement due Submissions on the Draft Determination due
mid January 2004	Publication of the Pricing Principles Statement as approved by the Commission
end January 2004	Publication of the Commission's Final Determination of the numerical value of the parameters required by the price regulation methodology applying in the second regulatory control period
end February 2004	Proposed tariff schedules for 2004-05 due from network service provider
end March 2004	Publication of the Commission's approval of the tariff schedules for 2004-05