INQUIRY INTO THE EFFECTIVENESS OF THE NT ELECTRICITY NETWORK ACCESS CODE:

DRAFT REPORT

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Glossary

the Act	means the *Electricity Networks (Third Party Access) Act 2000*
the Code	means the *Electricity Networks (Third Party Access) Code* which is a schedule to the *Electricity Networks (Third Party Access) Act 2000*
the Minister	means the NT Treasurer as the Regulatory Minister
NCC	National Competition Council
CPA	Competition Principles Agreement
TPA	means the *Trade Practices Act 1974*
NEC	means the National Electricity Code
NECA	National Electricity Code Administrator
ACCC	Australian Competition and Consumer Commission
National Gas Code	means the *National Third Party Access Code* for Natural Gas Pipeline Systems
NEMMCO	National Electricity Market Management Company Limited
Power and Water	Power and Water Corporation
NT Power	NT Power Generation Pty Ltd

CHAPTER

1

INTRODUCTION

Terms of Reference

1.1 Third-party[1] access to prescribed[2] electricity network infrastructure facilities in the Northern Territory's electricity supply industry is governed by the *Electricity Networks (Third Party Access) Code* ("the Code") which is a schedule to the *Electricity Networks (Third Party Access) Act 2000* ("the Act").

1.2 Both the Code and the Act can be viewed on the legislation page of the Commission's website (www.utilicom.nt.gov.au).

1.3 Section 8(2) of the Act requires that:

"The Minister must review the Network Access Code before 30 June 2003."

1.4 On 12 December 2002, the Treasurer as Regulatory Minister ("the Minister") requested the Commission to undertake an Inquiry into the Code's effectiveness – under section 31 of the *Utilities Commission Act 2000* – to assist the Minister in his review of the Code.

1.5 The Inquiry's Terms of Reference are reproduced at Appendix A.

Processes to date

1.6 To facilitate public consultation, in December 2002 the Commission published a paper ("Issues Paper") identifying the key issues within the scope of the Ministerial review of the Code and inviting submissions on those issues.

1.7 Submissions were received from the Power and Water Corporation ("Power and Water") and the Northern Territory Treasury ("NT Treasury"). These submissions can be viewed on the Electricity page of the Commission's website (www.utilicom.nt.gov.au).

1.8 No submissions were forthcoming from NT Power Generation Pty Ltd ("NT Power") or any contestable customer. Some of these parties may contemplate making a submission in response to this Draft Report.

1.9 Additionally, the Commission obtained the views of its legal adviser (Minter Ellison in association with Morgan Buckley) on certain related matters.

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[1] In the context of electricity networks, 'third parties' are generators or retailers other than the generator or retailer affiliated with the network operator.

[2] Currently, the networks covered by the Territory's access code are the networks owned or operated by the Power and Water Corporation ("Power and Water") in the Darwin/Katherine, Tennant Creek and Alice Springs regions.

Purpose of Draft Report

1.10 The Terms of Reference require that the Commission issue a draft report before delivering its final report.

1.11 To facilitate public consultation, this Draft Report is designed to set out the Commission's conclusions and recommendations based on its analysis of the issues and of the views put by interested parties in submissions received. The Commission is particularly interested in receiving further submissions that identify errors of fact, interpretation or judgment on the Commission's part.

1.12 Unless matters are raised in submissions that the Commission subsequently accepts warrant changing its conclusions and recommendations as stated in this Draft Report, those conclusions and recommendations will form the basis of the Commission's final report.

1.13 This Draft Report duplicates much of the material included previously in the Issues Paper. The Commission's intention in doing so is to ensure that this Draft Report represents a stand-alone document.

Next steps

1.14 The Terms of Reference require the Commission to transmit its final report and recommendations to the Minister by 31 March 2003.

1.15 The Commission acknowledges that it is unreasonable to expect interested parties to respond to matters raised in this Draft Report without a minimum consultation period (say 10 business days). By providing such a minimum period for further consultation, the Commission could be a week or more late in delivering its final report to the Minister. However, the Commission considers that such a delay is warranted, to give the parties time to deliberate on the Commission's draft conclusions and recommendations, and to allow the Commission to consider final submissions. The Commission will advise the Minister accordingly.

1.16 Submissions and comments regarding the Commission's conclusions and recommendations as detailed in this Draft Report should be directed to:

Executive Officer	Telephone:	(08) 8999 5480
Utilities Commission	Fax:	(08) 8999 6262
GPO Box 915		
DARWIN NT 0801	Email: utilities.commission@nt.gov.au	

1.17 The **closing date** for submissions is **Wednesday, 2 April 2003**.

1.18 Once the Minister receives the Commission's final report, in accordance with section 34 of the *Utilities Commission Act 2000*, the Minister is obliged to make the Commission's report publicly available no later than 28 days after receiving the report. The Commission will release the report at the same time.

Submissions

Confidentiality

1.19 In the interests of transparency and to promote informed discussion, the Commission intends to make submissions publicly available. However, if a person making a submission does not want their submission to be public, that person should claim confidentiality in respect of the document (or any part of the document). Claims for confidentiality should be clearly noted on the front page of the submission and the

relevant sections of the submission should be marked as confidential, so that the remainder of the document can be made publicly available.

Public access to submissions

1.20 Subject to the above, submissions will be made available for public inspection at the office of the Commission, and on its website.

1.21 To facilitate publication on the Commission's website, submissions should be made electronically by disk or email. However, if this is not possible, submissions can be made in writing.

1.22 Information about the role and current activities of the Commission, including copies of reports, papers and submissions, can also be found on the Commission's website.

CHAPTER

2

CONCLUSIONS AND RECOMMENDATIONS

General conclusions

2.1 The Commission has conducted an Inquiry – involving public consultation – into the Code's effectiveness, as input into the Ministerial review of the Code required under section 8(2) of the Act.

2.2 In general, the Commission has concluded that:

- The benefits possible warrant continuation of policy interventions aimed at facilitating third-party access to electricity networks, even in the Territory's circumstances (recommendation (1)).
- The Code is the most appropriate of policy instruments available for promoting third-party access to electricity networks in the Territory. A switching to alternative policy instruments would only increase costs for market participants without guaranteeing improved outcomes (recommendation (2)).
- The Code's general effectiveness can be improved by efforts to reduce associated administrative and compliance costs and to provide greater certainty to the network provider, wherever this can be achieved without unduly impacting on the public benefits possible from access regulation (recommendation (3)).
- The Code's general effectiveness can be improved wherever possible by efforts to reduce uncertainties and impediments facing access seekers and network users, wherever this can be achieved without unduly impacting on the public costs associated with access regulation (recommendation (4)).

Areas where no changes are required

2.3 In several important respects, the Commission recommends no change to the Code.

2.4 With regard to the provisions of the Act, the Commission recommends that the following be retained in their present form:

- the review and appeal provisions (recommendation (9));
- the Ministerial discretion in determining the Code's coverage of networks (recommendation (10)); and
- the enforcement provisions (recommendation (37)).

2.5 With regard to Part 1 of the Code, the Commission recommends that the following be retained in their present location:

- the generation-related provisions (recommendation (27)).

2.6 With regard to Part 3 of the Code, the Commission recommends that the following be retained in their present form:

- the network price control framework, involving an independent regulator (recommendation (45));
- the objectives of network pricing stated in clause 74 of the Code (recommendation (54));
- the network pricing structure provisions in clause 75 of the Code (recommendation (56));
- the pricing principles statement provisions in clause 78(1) of the Code (recommendation (58));
- the capital contributions provisions in chapter 8 of the Code (recommendation (59));
- the out-of-balance energy charging provisions in chapter 9 of the Code (recommendation (61)); and
- the provision for the regulator's determination of the methodology for estimating network energy losses in clause 82(2A)(b) of the Code (recommendation (62)).

Substantive recommendations for change

2.7 To improve the effectiveness of the Code, the Commission has seen fit to recommend a series of substantive changes to the Code (and supporting elements of the Act).

2.8 The Commission has framed all of its recommendations with a view to retaining the Code's consistency with the Competition Principles Agreement's clause 6 principles, so as not to impact upon the Code's status as a 'certified' effective State regime under Part IIIA of the *Trade Practices Act*.

2.9 Many of the Commission's recommendations are formulated as a principle rather than as a detailed amendment to the Code. The Commission will append to its Final Report the drafting that it considers would give effect to its *in-principle* recommendations.

2.10 The Commission recommends the following substantive changes to the Code (and to the Act), aimed at directly benefitting all Code participants:

- that provision be made in the Act whereby interested parties can initiate consideration of amendments to the Code, consistent with the approach followed under the National Electricity Code (recommendation (5));
- that a specific objects clause be added to the Code, along the lines of the Commonwealth Government's proposed objects clause for Part IIIA of the *Trade Practices Act* (recommendation (6));
- that clause 2(2) of the Code be amended by substituting the word 'must' in place of 'should' and by adding to the list of matters 'any other matters that the regulator considers are relevant', consistent with the wording in the National Gas Code (recommendation (7));
- that provision be made in the Act for the regulator to be authorised to develop and publish 'guidelines' and 'directions' where the regulator can demonstrate (a) that this is necessary to eliminate any uncertainty that may arise regarding the conduct of Code participants that is consistent with the requirements of the Code, and (b) that there is a net public benefit in promulgating such guidelines or directions (recommendation (8));

- that clause 72(2)(b) of the Code be amended to provide for a class of 'excluded services' that, because in the regulator's opinion such services are both not subject to effective competition and do not lend themselves to be regulated via the general price controls provided for in chapters 6 and 7 of the Code, are to be provided to network users on fair and reasonable terms as approved by the regulator (recommendation (49)); and
- that Part 3 of the Code (and associated Schedules) be amended where applicable to remove any doubt that the price control methodology to be used in the second and subsequent regulatory periods is to be determined by the regulator, in consultation with interested parties, in accordance with generally accepted regulatory best practice current at the time (recommendation (51)).

2.11 The following recommendations for substantive changes to the Code are designed to reduce the costs, and to increase the certainty, facing the network provider:

- that the criteria the Minister is to take into account in determining which networks are to be covered by the Code be included in section 5 of the Act (recommendation (11)); and
- that clause 63 of the Code be amended to explicitly include in the pricing principles that long-run costs of providing access should be taken into account, consistent with the Commonwealth Government's response to the Productivity Commission Review (recommendation (47)).

2.12 The Commission recommends the following substantive changes to the Code (and to the Act) aimed specifically at increasing the benefits, and increasing the certainty, available to access seekers and network users:

- that the Code be amended to provide for the regulator's approval of a default use-of-system agreement and a default connection agreement (recommendation (20));
- that clause 9 of the Code be amended to provide for a general approval power, and a derogation or exemption power in favour of the regulator, in relation to the network technical code and the network planning criteria (recommendation (21));
- that clause 9 of the Code be amended to confer a power on the regulator to initiate amendments to the network technical code and network planning criteria, including in response to suggestions by other Code participants (recommendation (23));
- that clause 35 of the Code be amended to allow any party to an access application to declare that a dispute exists by notifying the regulator (consistent with the process in the National Electricity Code) (recommendation (32));
- that the Act be amended to allow, in certain circumstances, a direct right to claim compensation for a contravention of the Code, consistent with provisions of the National Gas Code (recommendation (38));
- that clause 19(3) of the Code be amended to provide for the regulator to have a role in establishing the circumstances in which a financial guarantee should be applied (and the terms relating to the provision of that financial guarantee) (recommendation (42)); and
- that chapter 7 of the Code be amended to require that the network provider make arrangements with the retailer to include the network component of a contestable customer's bill in the statement of charges provided to each contestable customer (recommendation (57)).

Minor/technical recommendations for change

2.13 The Commission has also made a series of recommendations which involve minor technical or drafting improvements to the Code.

2.14 The Commission has made a series of such recommendations with regard to:

- Part 2 of the Code (recommendations 18, 19, 22, 24, 25, 30, 33 and 35);
- Part 3 of the Code (recommendations 46, 50, 52 and 55); and
- associated provisions of the Act (recommendations 12, 13, 14, 15 and 16).

2.15 Similarly, the Commission recommends that certain definitional and drafting anomalies identified by the Commission's legal advisers be addressed (recommendations 28, 31, 34, 36, 39, 43, 44, 48, 53 and 60).

Areas requiring further consideration

2.16 Finally, the Commission flags that some issues deserve further consideration, including in consultation with interested parties, notably with a view to:

- amending sections 26(1) and 26(2) of the Act with a view to capping, rather than excluding, the system controller's and network provider's liability for acts or omissions under the Code, consistent with recent amendments to the National Electricity Law (recommendation (17));
- amending clause 18 of the Code and the load balancing arrangements if a significant new generator was to emerge in the near future (recommendation (26));
- deciding on whether the contractual framework to apply between the generator and the network provider and between the retailer, end-use customer and network provider under the Code should be in the form of the 'straight-line' arrangement as applying in New South Wales and Victoria or the 'triangular' arrangement as in South Australia (recommendation (29));
- considering alternative arrangements to apply in clause 18 of the Code for assigning available network capacity between competing access applications (recommendation (40)); and
- clarifying the rights of network users under existing access agreements as currently defined in chapter 2 of the Code (recommendation (41)).

CHAPTER

3

INTERPRETING THE TERMS OF REFERENCE

Introduction

3.1 This chapter examines certain matters associated with interpretation of the Terms of Reference (reproduced at Appendix A).

Meaning and implications of "effectiveness"

3.2 The Terms of Reference state that:

> *"…the Utilities Commission is to inquire into and report on the effectiveness of the Network Access Code…"*

3.3 Effectiveness can have many meanings. In this Inquiry, the Commission has interpreted effectiveness to mean the extent to which the rights, obligations, processes, procedures and the like set out in the Code achieve desired policy outcomes.

3.4 In this sense, judging the Code's effectiveness involves both:

- knowledge of the desired policy outcomes; and
- a canvassing of alternative means of achieving those outcomes.

3.5 Chapter 4 briefly considers alternative regulatory and policy instruments to the Code at the general level, while later chapters deal with the scope for modifications to the current Code.

3.6 The Terms of Reference nominate two particular policy outcomes, namely:

- the facilitation of competition and the use of networks by electricity generators and retailers; and
- the prevention of abuse of monopoly power by the owners/operators of electricity networks.

Views in submissions

3.7 Power and Water expressed concern that:

> *"…the Terms of Reference are narrow and consequently risk not paying sufficient regard to the costs of regulation and incentives for investment." (p.9)*

3.8 In particular, Power and Water argued that the first clause of the Terms of Reference:

> *"…could imply that the assessment of the operations of the Code is limited to assessment against only two criteria, which appear to have a bias towards the interests of new or potential entrants to the NT Electricity Industry and to some extent overlook the interests of the incumbent network owner/ operator – Power and Water." (p.10)*

3.9 Power and Water further argued that:

> *"As a minimum, this review should, as the Code does, acknowledge that these objectives must be balanced against the need to provide incentives to make investments in significant essential infrastructure where it is economically efficient to do so." (p.10)*

3.10 Additional issues that Power and Water suggested should be considered in assessing the effectiveness of the Code were:

> *"*
> - *whether the benefits of the Code have exceeded the costs;*
> - *whether the Code has appropriately balanced the legitimate interests of all parties, including consumers, network owners/ operators and other elements of electricity supply industry; and*
> - *whether the Code has created an environment under which new efficient investment in electricity network infrastructure is appropriately recognised and encouraged." (p.11)*

Commission's analysis and conclusions

3.11 In assessing the effectiveness of access regulation, the Commission recognises that the 'public benefits' and 'public costs' of the intervention involved are important considerations. *Economic* efficiency gains and losses are important benefits and costs respectively for this purpose. Even if regulation is likely to have benefits:

- a particular form of regulation will only be *effective* if regulatory benefits exceed any regulatory costs; and
- a particular form of regulation will only be *more effective* than another where any associated net benefits (i.e., the extent to which regulatory benefits exceed regulatory costs) are greater than for that other form of regulation.

3.12 The Commission is not convinced, however, that the two policy outcomes set out in the Terms of Reference are – as suggested by Power and Water – biased towards the interests of new entrants, or overlook the interests of the incumbent network owner. By definition, an access regime must be designed to permit new entrants to gain access to the services provided by an infrastructure facility operated by a monopoly owner. Therefore, the most critical benchmark of effectiveness must be whether the access regime provides an effective mechanism for achieving this end.

3.13 The Commission also questions which of Power and Water's interests, as a vertically integrated entity, are being overlooked. In assessing the Code's effectiveness, the Commission assumes that, in line with its ring-fencing obligations:

- Power and Water Retail and Power and Water Generation are in effect operating as separate entities; and
- Power and Water Retail and Power and Water Generation are subject to the same terms and conditions as would generally apply to new entrants with respect to the provision of network access services.

3.14 Power and Water's interests as a retailer or a generator should be the same as any other retailer or generator if the Code is achieving its objectives. Power and Water's interests as a network owner are already required to be taken into account pursuant to clause 6 of the Competition Principles Agreement ("CPA").[3]

3.15 In addition, the Commission believes that there is nothing in sections 31 to 34 of the *Utilities Commission Act* that suggests the Commission is entitled to inquire into matters which fall outside the Terms of Reference. In particular, section 31(4) of the *Utilities Commission Act* makes it clear that only the Minister is entitled to vary the Terms of Reference or a requirement or direction under section 31(3) of that Act. On

[3] Council of Australian Governments (COAG) – Meeting 11 April 1995. See National Competition Council, *The Compendium of National Competition Policy Agreements*, Second Edition 1998. Available on the NCC website (www.ncc.gov.au).

this basis, the Commission has restricted its assessments to the two policy outcomes identified in the Terms of Reference.

3.16 Moreover, in the Commission's view, these policy outcomes encompass the principal policy outcomes sought by governments generally from access regulation. However, this has not prevented the Commission from considering – in chapter 5 below – whether these outcomes are in themselves only a means to an end, rather than being ends in themselves.

Role of matters other than experience with the Code

3.17 The Terms of Reference state that the Commission is to inquire into and report on the Code's effectiveness:

"…including in light of experience with application of the Code since 1 April 2000."

3.18 As permitted by the word "including", the Commission's considerations have not been limited to experience with application of the Code since 1 April 2000.

3.19 It is possible to consider the effectiveness of aspects of the Code's design without necessarily having benefited from experience with that aspect to date. The Commission and affected parties have had the opportunity to consider in detail all aspects of the Code in anticipation of them applying if the situation arose. Moreover, access regimes more generally have been subject to a good deal of discussion in other jurisdictions over time, including in:

- the Hilmer Report[4];
- the Productivity Commission's report of its review of the national access regime;[5] and
- the National Competition Council's "(NCC)" submission to the Productivity Commission Review.[6]

In addition, the NCC's final report on the Territory's access regime is also suggestive in this regard.[7]

3.20 Hence, against such background, the Commission has reviewed the Code's design – whether or not particular features have had application to date.

Coverage of the Inquiry

3.21 The Terms of Reference state that the Commission is to:

"…consider and report on the [Network Access] Code in its entirety including:

- *the access framework …; and*
- *the access pricing provisions …"*

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[4] Independent Committee of Inquiry, *National Competition Policy*, Australian Government Publishing Service, Canberra, August 1993 (the "Hilmer Report").

[5] Productivity Commission, *Review of the National Access Regime*, Report No. 17, AusInfo, Canberra, 28 September 2001 ("Productivity Commission Review"). Available on the Productivity Commission website (www.pc.gov.au).

[6] National Competition Council, *Review of the National Access Regime – Submission in Response to the Productivity Commission's Position Paper*, July 2001 ("NCC Submission"). Available on the Productivity Commission website (www.pc.gov.au).

[7] *Northern Territory Electricity Network Access Regime, Application for Certification under Section 44M(2) of the Trade Practices Act 1974, Final Recommendation*, December 2001 ("NCC Final Recommendation Report"). Available on the NCC website (www.ncc.gov.au).

3.22 The access framework (covering negotiations, agreements and disputes) comprises Part 2 of the Code, whereas the access pricing provisions (covering pricing principles, revenue caps and tariff approvals) comprise Part 3 of the Code.

3.23 Besides the two aspects of the Code nominated in the Terms of Reference, and consistent with the requirement that the Commission review the Code "in its entirety", the Commission has also considered and reported on:

- Part 1 of the Code, which provides background and some important general provisions; and
- in conjunction with Part 1, the relevant provisions of the Act itself (specifically Parts 2 to 6 of the Act).

3.24 The Commission has nevertheless limited itself to considering the Code *per se* rather than the broader competition regime. The latter is associated with those reforms to the Territory's electricity supply industry which took effect on 1 April 2000, removing Power and Water's effective monopoly over the supply of electricity to end-use consumers and establishing a timetable for phasing-in competition among generators and retailers.

3.25 In support of these reforms, third-party generators and retailers have been granted the right to negotiate access to Power and Water's network infrastructure.

3.26 The Commission considers the market/regulatory design in sectors upstream and downstream from the electricity network to be clearly outside the Terms of Reference. This is consistent with the intent of section 8(2) of the Act that calls for the review of the Code, which the Act defines as the *Electricity Networks (Third Party Access) Code* contained in a schedule to the Act.

3.27 For similar reasons, the Commission has not addressed whether the scope for third-party entry into sectors upstream and downstream of the electricity networks in the Territory is sufficient to justify a third-party access regime. While such a question was not canvassed when NT Power was active in the Territory's electricity market, it has emerged as a possible issue following NT Power's departure from the market. However, the presumption underlying the Commission's Inquiry is that allowing for third-party entry is both necessary and desirable: necessary because the opening up of alternative gas (fuel) supplies may present future opportunities for entry into the Territory's electricity supply industry, and desirable because it serves to keep the incumbent generator/retailer on its toes.

Role of recertification

3.28 The Terms of Reference state that:

> *"As any changes to the Code are likely to require recertification by the relevant Commonwealth Minister, in making its recommendations the Commission is to take into account the requirements for certification under clause 6 of the Competition Principles Agreement and Part IIIA of the Trade Practices Act."*

3.29 Appendix B reproduces the relevant parts of clause 6 of the CPA.

3.30 Reflecting suggestions by the NCC, the Code was amended with effect on 1 July 2001, and subsequently was certified by the Commonwealth Treasurer as an effective State/Territory access regime under Part IIIA of the *Trade Practices Act 1974* ("TPA") on 21 March 2002. Certification precludes declaration of these services under Part IIIA's provisions, and means that the access regime represents the sole legal mechanism for third-party access to electricity networks in the Territory.[8]

[8] The certification process is only available for State and Territory access regimes – the CPA does not establish an equivalent process for Commonwealth and private access regimes. However, private individuals or businesses may seek to have an access framework approved by submitting an access

3.31 With regard to amendments to any certified access regime, the NCC is on the public record as stating the following:

> *"A certified access regime may cease to be effective if it no longer satisfies the CPA [Competition Principles Agreement] principles. This may occur if the regime, or the CPA principles themselves, are substantially modified: s.44G(4). While this would not affect the operability of the regime, it would expose relevant services to the risk of declaration.*
>
> *If a State proposes amending an access regime after it has been certified, it may seek the Council's view as to whether the modifications are substantial. While the Council can give an informal view, it would not bind the Council if, for example, a party applied to have a service covered by the regime declared under Part IIIA.*
>
> *If a jurisdiction seeks a greater degree of certainty, it may seek recertification of the regime by formally applying to the Council."*[9]

3.32 In general, as the desired policy outcomes of the Code are consistent with the CPA's clause 6 principles, any recommendations by the Commission aimed at improving the effectiveness of the Code are only ever likely to be *in principle* consistent with the CPA. The NCC's understandable concern, however, appears to be to judge such matters for itself, with a distinction being made for that purpose between 'substantial' and 'minor' modifications.

3.33 Accordingly, the Commission has borne in mind those of its recommendations where the modifications involved could be regarded as:

- substantial, and why; and
- minor (i.e., not substantial), and why.

Views in submissions

3.34 NT Treasury suggested that the Commission should not be overly influenced by the distinction between 'minor' and 'substantial' modifications, as even substantial modifications may not necessarily materially affect the effectiveness of the regime.

Commission's analysis and conclusions

3.35 The Commission agrees with NT Treasury that substantial changes to the Code may not necessarily materially affect the Code's effectiveness. In fact, the Commission is strongly of the view that the recommendations it has made for changes to the Code – whether minor or substantive – all would serve to strengthen the Code's effectiveness in terms of the requirements of Part IIIA of the TPA and clause 6 of the CPA.

undertaking to the Australian Competition and Consumer Commission "(ACCC)". Acceptance of an undertaking provides an equivalent outcome to certification – services covered by that regime are made immune from declaration.

[9] NCC Final Recommendation Report, pp.82-83.

CHAPTER

4

ALTERNATIVES TO THE CODE

Introduction

4.1 The following chapters deal with different parts of the Code, and canvass modifications that might improve the overall effectiveness of the Code.

4.2 This chapter looks at matters associated with the Code as a whole, and whether there are alternatives to the Code itself or changes that could be affected across-the-board to the Code.

4.3 Reflecting the steps policy-makers need to take to ensure that regulatory responses to access problems are effective, this chapter examines, in turn:

- the market failure(s) that policy-makers are seeking to address;
- whether there are more effective regulatory alternatives to the access regime found in the Code; and
- whether any regulatory intervention can be sufficiently well calibrated so that the likely costs of intervention are not so great as to outweigh the likely benefits of ameliorating any identified market failure.

The benefits of access regulation

4.4 Granting third-party access to essential infrastructure within the electricity supply industry involves an unbundling of electricity supply into:

- generation services (relating to the production of electricity);
- retail services (relating to the sale of electricity to end-use customers); and
- network services (relating to the transportation of electricity from generators to end-use customers via network infrastructure (or "facilities"), being the system of poles and wires operated for this purpose).

4.5 Network infrastructure providing the transportation of electricity forms an essential input into other goods or services and cannot economically be duplicated. Hence, the owner or operator of network infrastructure ("network provider") occupies a strategic position in the supply chain, since a generator or retailer can only supply electricity to its customers if it can transport this electricity via the network. To allow firms to compete effectively in the upstream and downstream markets, all parties – irrespective of their affiliation with the network provider – must have access to the network.

4.6 Reflecting the CPA (and the Hilmer Report before it), the Code first creates a right of third-party access to infrastructure operated by network providers in the Northern Territory, on the basis that:

- access to the network is essential to permit effective competition in upstream or downstream activities; and
- the granting of the right is in the public interest having regard to the significance of the industry and the expected impact of effective competition in that industry.

4.7 At the same time, the legitimate interests of the network provider are protected through the imposition of an access fee and other terms and conditions that are fair and reasonable, including in recognising the network provider's current and potential future requirements for the capacity of the facility.

4.8 To these various ends, the Code establishes a commercial negotiation framework, with formal arbitration as the principal mechanism to resolve disputes.

4.9 In support of this negotiate-arbitrate approach, a regulatory framework also aims at addressing any imbalance between the bargaining position of the network provider and third-parties seeking access ("access seekers").

Views in submissions

4.10 Power and Water argued that the scope for abuse of monopoly power in the Northern Territory has if anything been overstated, and hence the benefits of access regulation might themselves be overstated. At the same time, Power and Water acknowledged that:

> *"…the benefits of access regulation in an environment of one monopoly operator and no competitors are difficult to measure." (p.13)*

4.11 NT Treasury argued that, while benefits may not materialise until competition becomes a reality, there is scope for such benefits to be realised in the future.

Commission's analysis and conclusions

4.12 Access legislation is intended to curb the market power that attaches to the network infrastructure involved in the supply of electricity. Electricity networks are generally regarded as 'natural monopolies', that is they involve facilities that cannot be economically duplicated.

4.13 Particularly where they also operate in upstream or downstream markets, the concern is that owners of such facilities may deny potential competitors in these related markets access to their facilities, either directly, or indirectly through 'unreasonable' terms and conditions.

4.14 In addition, being in a strong monopoly position, a network provider has the scope to undertake monopoly pricing of services, even if access is provided to all those seeking it.

4.15 Together, as well as detracting from the efficient use of the services concerned, such behaviour can compromise efficient investment in related markets. Moreover, the pursuit of monopoly rents might also have adverse consequences for the timing of investment to provide new essential services and to augment existing networks.

4.16 While potential problems arising from monopoly power in the delivery of essential infrastructure services are easy to identify, the actual extent and significance of these problems is less so.

4.17 None of this denies that refinement of the Code could not increase the benefits to be achieved. Many of the recommendations elsewhere in this Draft Report are intended to improve the scope for potential benefits.

Recommendation (1) The benefits possible warrant continuation of policy interventions aimed at facilitating third-party access to electricity networks, even in the Territory's circumstances.

Policy alternatives to access regulation

4.18 Access regimes are only one of several instruments for addressing monopoly power in the delivery of essential infrastructure services. Other possible instruments include:

- structural separation of vertically-integrated providers;
- general laws against anti-competitive conduct; and
- greater reliance on the negotiate-arbitrate approach.

4.19 Structural separation to address the essential services 'problem' was strongly advocated in the Hilmer Report.[10] Underlying this approach is the presumption that a non-integrated provider will have no incentive to deny access to firms operating in upstream or downstream markets. Structural separation may also remove the capacity for 'strategic' cost shifting between the input and final markets.

4.20 The competition law provisions most relevant to access are contained in section 46 of the TPA. Reliance on this approach would see a court-based approach to access relying on general competitive conduct rules. The courts would play an *ex post* role in providing detail and precision to general 'standards' of conduct.

4.21 Absent conventional price controls, the negotiate-arbitrate approach would see the network provider and access seekers taking greater responsibility for negotiating the price – as well as other conditions – of access. It has the potential to become self-policing, such that many of the transactions costs of access regulation might be avoided.

Views in submissions

4.22 While stopping short of advocating replacement of the Code by reliance instead on section 46 of the TPA, Power and Water pointed out that any improper use of its market power as a monopoly network service provider would also be actionable under section 46 and therefore unlikely.

4.23 NT Treasury saw no case for replacing the Code with an alternative policy instrument, noting that:

> *"The alternative forms of regulation suggested by the Commission, while potentially achieving the same outcome, appear more costly and on their own lack the coverage of specific access regulation." (p.2)*

Commission's analysis and conclusions

4.24 The Commission agrees that, while integrated provision and denial of access gives a network provider greater scope to capture monopoly profits from network users (and end-use consumers), integrated provision is likely to be more efficient in the context of the small Territory market as:

- fixed administrative and marketing costs can be spread across wholesale and retail outputs;
- wasteful duplication of effort can be reduced; and

[10] Hilmer Report, pp.240-242.

- there may be cost savings from overcoming information imbalances that can make contracting and contract enforcement difficult under separated provision.

4.25 Likewise, the Commission considers that the costs of a court-based approach would be considerable, and its effectiveness would depend on the capacity of the courts to address issues related to the detailed terms and conditions of access. Moreover, the application of section 46 of the TPA continues to be limited to circumstance where there is a proven use of market power for one of the prohibited purposes. Indeed, the Commission is mindful that one of the factors supporting the enactment of Part IIIA of the TPA was the fact that section 46 of the TPA was seen to be inadequate to deal with access issues.

4.26 Finally, particularly in the short term, the Commission considers that a pure negotiate-arbitrate regime is likely to have higher transaction costs than the Code's approach where price controls augment an obligation to supply.

4.27 On these various grounds, the Commission agrees with NT Treasury that the alternatives to access regulation are likely to be more costly in the Territory context. Hence, the Commission accepts the submitted views that no change in the balance between access regulation and other policy instruments available for promoting efficient access to essential electricity infrastructure is required at this point in time.

Recommendation (2) The Code is the most appropriate of policy instruments available for promoting third-party access to electricity networks in the Territory. A switching to alternative policy instruments would only increase costs for market participants without guaranteeing improved outcomes.

The costs of access regulation

4.28 In assessing the case for any regulation, the *costs* of intervention are an important consideration. Even if regulation is likely to have benefits, intervention can only be warranted if those benefits exceed the regulatory costs.

Views in submissions

4.29 Power and Water argued that the costs of access regulation in the Territory are significant, with the main costs of access regulation relating to compliance. After listing a number of instruments with which its network licence requires compliance, as well as the obligations imposed by the Code, Power and Water contended that:

> *"The compliance costs to date, while difficult to measure, have exceeded $2 million since the commencement of access regulation." (p.13)*

4.30 NT Treasury argued that:

> *"Costs related to compliance and enforcement are unlikely to be avoided as market failure in the provision of network infrastructure services is well recognised. As the Commission notes, many costs associated with access regulation relate to "getting it wrong". Without sufficient experience in the Code's use, and data on associated impacts, the costs associated with regulatory failure are difficult to estimate. To the extent that the Territory's networks are not nationally significant, unnecessary costs may be accruing to the network provider and the Territory Government." (p.2)*

Commission's analysis and conclusions

4.31 Access regulation can give rise to a range of costs, including:

- administrative costs for government and compliance costs for business;
- constraints on the scope for a network provider to deliver and price its services efficiently;
- reduced incentives to invest in infrastructure facilities;
- inefficient investment in related markets; and
- wasteful strategic behaviour by both a network provider and access seekers.

4.32 Many of these potential costs reflect the possibility of 'regulatory failure', given the difficulties of regulating access to essential facilities. The role played by 'regulatory discretion' in this regard is addressed in chapter 5.

4.33 However, the Commission is of the view that many of the costs referred to in Power and Water's submission would have been incurred, regardless of whether or not a network access regime applied in the Northern Territory, and as such do not constitute significant costs of the Code:

- Instruments such as the System Control Technical Code, Network Technical Code and Network Planning Criteria should apply to Power and Water Generation/Retail in the same way as they apply to a third-party generator or retailer.
- In addition, many of these codes reflect the principle that the licensing and regulatory functions previously conducted by government-owned electricity entities should be transferred to appropriately qualified and independent regulators. This has nothing to do with access.
- Finally, many of these regulatory requirements are designed to ensure that there exist no barriers to the entry into the relevant market. In other words, it is unlikely that a new competitor will enter the Territory's electricity market unless these types of regulatory arrangements first exist. The Commission considers that it is inappropriate to suggest that regulation should only be put in place once a potential competitor indicates that it wishes to enter the market.

4.34 None of this denies that refinement of the Code could not reduce costs. Some of the recommendations elsewhere in this Draft Report are intended to reduce the scope for unnecessary costs.

Recommendation (3) The Code's general effectiveness can be improved by efforts to reduce associated administrative and compliance costs and to provide greater certainty to the network provider, wherever this can be achieved without unduly impacting on the public benefits possible from access regulation.

Setting the costs against the benefits

4.35 In deciding on the form of any regulation, the focus is on designing arrangements that are likely to result in a *net public benefit*. This requires a comparison of the costs and the benefits of the form of regulation under consideration.

Views in submissions

4.36 Noting that the Productivity Commission Review recommended no significant change in the balance between access regulation and other policy instruments in a national context, Power and Water submitted its support of this view in the Territory context.

4.37 NT Treasury argued that:

> *"It seems prudent that judgement on the net cost of the Code be reserved until competition becomes a reality. While costs associated with the administration and review of the Code may exist at present, offsetting benefits might be realised in the future." (p.2)*

4.38 In addition, NT Treasury supported reviews of the Code prior to the commencement of each regulatory control period. No special provision was considered necessary, however, as the Code already allows for review at any time.

4.39 Power and Water proposed an alternative approach to future reviews of the Code. First, Power and Water argued that the Code should be reviewed again once the form of off-shore gas arrangements, and subsequent market impacts, are more fully understood.

4.40 In addition, Power and Water argued that:

> *".....a Code change mechanism is appropriate in order to maintain its effectiveness. In order to balance this objective with the provision of regulatory certainty, the process should occur prior to the commencement of each regulatory period and prior to the assessment of allowed prices and revenues for that period." (p.14)*

4.41 Power and Water noted that, while section 6 of the Act allows the Minister to amend the Code and section 8 allows the Minister to review the Code at any time, there is currently no provision for industry-led Code amendments or suggestions, or for an independent body to review whether Code changes are necessary. This is distinct from processes in other jurisdictions where Code Change Panels have been constituted to provide ongoing consideration of, and recommendations for, proposed Code changes. In addition, any person might submit a Code change proposal to the regulator.

Commission's analysis and conclusions

4.42 The Territory's experience with access regulation is still limited. Furthermore, in addition to its limited history, a number of the Code's key provisions have yet to be fully exercised.

4.43 In line with the Productivity Commission Review's conclusion regarding the national access regime, the Commission considers that it would be inappropriate to abandon access regulation in such circumstances. A preferable strategy is to monitor the effects of the Code (modified to reflect the outcome of this Inquiry) and to review it again when there has been further experience with third-party access.

4.44 The Commission agrees with Power and Water's comment that the Code should include a procedure whereby interested parties can initiate consideration of amendments to the Code. Currently, the Minister's power to amend the Code under section 6 of the Act is not constrained by any requirement to consult with interested parties prior to making that amendment. By way of comparison, the National Electricity Code ("NEC") can only be amended after extensive consultation with interested parties and the completion of separate reviews by the National Electricity Code Administrator ("NECA"), the ACCC and, finally, the relevant Ministers.

4.45 A truncated version of this process would seem appropriate for the Code. In the small Territory market, however, the Commission considers that a Code Change Panel may not be cost-effective. Rather, the Commission could be charged with overseeing any amendment review and consultation process.

Recommendation (4) The Code's general effectiveness can be improved wherever possible by efforts to reduce uncertainties and impediments facing access seekers and network users, wherever this can be achieved without unduly impacting on the public costs associated with access regulation.

Recommendation (5) Provision should be made in the Act whereby interested parties can initiate consideration of amendments to the Code, consistent with the approach followed under the National Electricity Code.

CHAPTER

5

OBJECTS AND DISCRETIONS

Introduction

5.1 This chapter looks at the effectiveness of Part 1 of the Code.

5.2 Part 1 provides background and some general provisions. In this context, Part 1 must be considered in conjunction with the relevant provisions of the Act itself (specifically Parts 2 to 6 of the Act).

5.3 Clause 3 of the Code provides definitions of key terms used in the Code. The appropriateness of particular definitions is not addressed in this chapter, but under the later chapter dealing with the most applicable Part of the Code (i.e., chapter 6 for Part 2 and chapter 7 for Part 3).

Objects of the Code

5.4 Clause 2(1) sets out the 'aim' of the Code as being:

> *"…to be an effective access regime under Part IIIA of the Trade Practices Act 1974 of the Commonwealth and so meet the requirements laid down in clause 6 of the Competition Principles Agreement."*

5.5 Furthermore, clause 2(2) of the Code provides that, in deciding on the terms and conditions for access, the regulator and any arbitrator should take into account:

> *"(a) the network provider's legitimate business interests and investment in the electricity network;*
>
> *(b) the costs to the network provider of providing access, including any costs of extending the electricity network but not costs associated with losses arising from increased competition in upstream or downstream markets;*
>
> *(c) the economic value to the network provider of any additional investment that an access applicant or the network provider has agreed to undertake;*
>
> *(d) the interests of all persons holding access agreements for use of the electricity network;*
>
> *(e) firm and binding contractual obligations of the network provider or other persons (or both) already using the electricity network;*
>
> *(f) the operational and technical requirements necessary for the safe and reliable operation of the electricity network;*
>
> *(g) the economically efficient operation of the electricity network; and*
>
> *(h) the benefit to the public from having competitive markets."*

These factors repeat the factors specified in clause 6(4)(i) of the CPA.

5.6 Altogether, the unstated 'objects' of the Code are clearly the same as those of Part IIIA of the TPA and clause 6 of the CPA.

5.7 The objects of the Code must be imputed from those of clause 6 of the CPA and of Part IIIA of the TPA. Moreover, how satisfactory these objects are in this regard depends upon how satisfactory the objects are of clause 6 of the CPA and of Part IIIA of the TPA.

5.8 The CPA does not have an objects clause as such.

5.9 As to Part IIIA of the TPA (which gives effect to the infrastructure access provisions of the CPA), section 2 of that Act identifies the object of the Act as being to:

> *"…enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer welfare".*

5.10 The NCC is on the record as suggesting that this general high-level objects clause is:

> *"… somewhat ambiguous in the role and priority to be accorded to the various concepts identified and there is no explicit indication as to how the section is to be taken into account in interpreting specific provisions. … the specific context of Part IIIA would benefit from a more explicit objects clause."*[11]

5.11 The Productivity Commission Review also supported the insertion of an objects clause into Part IIIA in order:

> *"…to provide guidance which has been lacking for this relatively new area of economic regulation … [and to] reduce uncertainty by assisting all parties – regulators, the judiciary, access seekers, facility owners and potential infrastructure investors – to interpret the intent of various criteria."*[12]

5.12 An objects clause must capture the intent of often complex legislation in relatively few words – otherwise misconstrued purposes and/or over-emphasis on particular matters could lead to unintended outcomes. In this regard, there can be tensions between:

- the different interests of users and facility owners;
- efficient use of infrastructure and efficient investment; and
- short-term versus long-term efficiency considerations.

5.13 Competition is a means to an end, rather than an end in itself. Competition policy initiatives, in the main, aim to improve efficiency by removing institutional barriers and/or impediments which artificially distort or mask price signals (for example, production quotas and mandated cross-subsidies).

5.14 In the case of access regulation, the presumption is that unregulated markets will not promote efficiency – thus, regulatory intervention to induce competition is required to promote efficient outcomes. However, it is possible to have too many competitors as a result of providing access on terms and conditions that are too favourable to third parties. This can promote wasteful activity in downstream markets and deny the community the benefits of dynamic efficiency gains – for example, by deterring investment in new essential infrastructure.

5.15 Viewed in this light, the Productivity Commission Review considered that an objects clause in Part IIIA should:

> *"…incorporate an explicit efficiency objective reflecting both short term and long term considerations – in particular, recognising legitimate user/consumer interests and long term investment dimensions…"*

suggesting, in particular, that the objects clause could read as follows:

> *"…enhance overall economic efficiency by promoting efficient use of, and investment in, essential infrastructure services…"*[13]

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[11] NCC Submission, p.8.

[12] Productivity Commission Review, p.126.

[13] Productivity Commission Review, p.130.

Views in submissions

5.16 Both NT Treasury and Power and Water supported the introduction of an objects clause in the Code.

5.17 Power and Water recommended that a specific objects clause should:

> *"…unambiguously require the regulator to follow key principles when making decisions under the Code." (p.15)*

5.18 Additionally, Power and Water argued that:

> *"…the current Clause 2 be retained, but that the term 'should' be replaced with 'must'." (p.15)*

Power and Water argued that the term "should" renders clause 2 of the Code largely ineffective, suggesting that this was supported by the recent Epic decision[14] which demonstrated that an operating objects clause can be fundamental to the manner in which a regulator's discretion is directed.

5.19 Power and Water also noted that:

> *"Clause 2.2 of the Code replicates Clause 6(4) of the Competition Principles Agreement (CPA), which sets out a series of principles that State and Territory access regimes should incorporate. Clause 2(2) of the Code sets out a series of matters that the 'dispute resolution body' should consider when determining the terms and conditions on which access should be granted." (p.15)*

5.20 NT Treasury expressed the view that:

> *"…an objects clause could only enhance the Code by providing more clarity for market participants and increased guidance and accountability for market participants." (p.2)*

5.21 In this regard, NT Treasury supported the adoption of the Commonwealth Government's proposed Part IIIA objects clause, in response to the Productivity Commission Review:

> *"a) promote the economically efficient operation and use of, and investment in, essential infrastructure services, thereby promoting effective competition in upstream and downstream markets; and*
>
> *b) provide a framework and guiding principles to encourage a consistent approach to access regulation in each industry." (pp.2-3)*

Commission's analysis and conclusions

5.22 For access regimes to function effectively, clear objectives are needed to promote:

- decisions that are well targeted to the identified problem and which minimise unintended side effects;
- greater certainty for current and prospective facility owners, access seekers and other interested parties;
- consistency among policymakers, regulators and the judiciary responsible for implementation and enforcement; and
- regulatory accountability.

5.23 The Commission notes that the wording of clause 2(2) of the Code repeats the words set out in clause 6(4)(i) of the CPA and, as such, reflects the specific requirements of the NCC. Amendment of clause 2(2) of the Code in the absence of a similar amendment to clause 6(4)(i) of the CPA could raise issues with regard to certification.

[14] Western Australian Supreme Court, *Re Dr Ken Michael AM; Ex Parte Epic Energy (WA) Nominees & Anor* [2002], WASCA 231.

5.24 The matters listed in clause 6(4)(i) of the CPA are only intended to apply when a dispute resolution body is deciding upon the terms and conditions for access. Hence, the Commission has concerns as to whether these objectives are adequate to provide direction in relation to the administration of the Code as it applies to matters other than terms and conditions for access.

5.25 For this reason, the use of the word 'must' in place of 'should' in clause 2(2) of the Code would raise the question as to whether the list of matters set out in clause 2(2) is an exhaustive list (i.e., should the Commission or an arbitrator also be entitled to take into account any other relevant matters?)

5.26 While Power and Water refers to section 2.24 of the *National Gas Code*[15] as an example of the approach which should be adopted in the Code, the Commission notes that section 2.24(g) of the *National Gas Code* also refers to 'any other matters that the relevant regulator considers are relevant'. These additional words would need to be included in clause 2(2) of the Code if this section were expressed as a mandatory obligation.

5.27 Section 6(2) of the *Utilities Commission Act* also requires the Commission to have regard to a number of matters when performing its functions. One of the functions of the Commission under section 6(1) of that Act is to perform functions assigned to the Commission under other Acts. If clause 2(2) of the Code is amended to provide that the Commission must only take into account the matters listed in that clause when undertaking a function assigned to the Commission under the Code, a question arises as to how to reconcile this mandatory obligation with the mandatory obligation set out in section 6(2) of the *Utilities Commission Act*.

5.28 As supported by both parties who made submissions, the Commission recommends that a specific objects clause be added to the Code, and agrees with NT Treasury that the Commonwealth's proposed objects clause would be appropriate.

Recommendation (6) A specific objects clause should be added to the Code, along the lines of the Commonwealth Government's proposed objects clause for Part IIIA of the Trade Practices Act.

Recommendation (7) Clause 2(2) of the Code should be amended by substituting the word 'must' in place of 'should' and by adding to the list of matters 'any other matters that the regulator considers are relevant', consistent with the wording in the National Gas Code.

Extent of regulatory discretion

5.29 The Code itself does not have force of law and is, in effect, an 'extrinsic code'. The provisions of the access regime that have force of law are included in the Act.

5.30 Notably, section 11(2) of the Act expressly prohibits the Minister from directing the Commission to suppress or vary determinations or approvals made by the Commission under the Code or in any other way to adopt a course of action that would directly affect the terms and conditions under which network users have access to electricity networks under the Code.

5.31 Regulatory discretion can give rise to regulatory uncertainty. This has been explained as follows:

> *"One of the most fundamental reasons for addressing competition issues through regulation rather than through legislation is that a complete set of rules is very difficult (if not impossible) to specify in advance, and the costs of adapting pre-specified rules to*

[15] *National Third Party Access Code for Natural Gas Pipeline Systems*

changing circumstances through legislative amendment are considered to be greater than those of relying on regulatory decisions made within the terms of more open-ended standards. Thus, regulators always have some non-trivial decisions to make. As a consequence, the outcomes from the future stream of regulatory decision making processes cannot be predicted with certainty."[16]

5.32 Regulatory errors can take two general forms:

- a regulator may wrongly identify a case of market failure requiring intervention where there is in fact no market failure (or the costs of that failure are less than the costs of attempting to correct it); or
- conversely, a regulator may fail to correct market failure where such market failure exists.

5.33 In an access context, the potential costs of such errors in regulatory decision-making include:

- diminishing the incentives for businesses to invest in infrastructure facilities and thus limiting, rather than enhancing, overall competition and economic efficiency;
- impinging on the private property rights of infrastructure owners;
- creating distortions in market outcomes, where the choice of regulatory tool (in the present case, access regulation) is not correctly aligned with the source of the market power problems;
- imposing administrative costs for government and compliance costs for business;
- constraining the scope for infrastructure providers to deliver and price their services efficiently;
- encouraging inefficient investment in related markets; and
- facilitating wasteful strategic behaviour by both service providers and access seekers.[17]

Views in submissions

5.34 Power and Water argued that:

"…the issue of how prescriptive the various terms and conditions of the Code should be … is a fundamental issue that goes to the question of how best to achieve the regulatory objectives underpinning in the Code, and the cost effectiveness of the regulatory regime.

The decision on how to achieve these objectives involves a simple but important choice between compulsion and the provision of incentives. The evidence suggests that the latter is ultimately a more effective way of achieving most regulatory objectives. Indeed, the national regulatory regime was established firmly on the premise that the provision of incentives is the most effective means of meeting customers' needs.

…the Code should be prescriptive in relation to outputs but not in relation to how Power and Water should achieve those outputs. Power and Water believe that this will facilitate the flexibility necessary to ensure that the Code can be applied appropriately in the NT context.

…Highly prescriptive regulation would provide all participants with certainty as to the regulatory environment, but would reduce the flexibility of the regulatory system to adapt to change. Regulation, however, when characterised by a very broad set of general principles, offers increased flexibility and will likely encourage more innovative and commercial outcomes, but at the cost of regulatory certainty." (pp.8,16)

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[16] Ergas, Hornby, Little and Small (Network Economics Consulting Group), "Regulatory Risk", a paper prepared for the ACCC Regulation and Investment Conference, Manly, March 2001, p.8. Available on the ACCC website (www.accc.gov.au).

[17] Productivity Commission Review, p.59.

5.35 NT Treasury argued that, as far as possible, the Code should leave matters of access to be decided between market participants. In addition, it noted that the Code already contained considerable guidance to facilitate access arrangements "either by agreement or regulatory intervention". On this basis, NT Treasury argued that no change was required.

Commission's analysis and conclusions

5.36 While Power and Water's suggestion that the provision of incentives rather than prescription can be a more effective way of achieving regulatory objectives is no doubt true in certain circumstances, there exists a number of examples where such 'incentives' have failed to achieve the relevant objective and have been replaced with more prescriptive regulation.

5.37 For example, the rights of a retailer to gain access to the services provided by distribution networks in Victoria and New South Wales were, until recently, regulated in a very light-handed manner (i.e., in a manner very similar to the access framework set out in Part 2 of the Code).

5.38 Distribution network providers were required to grant access to the services of their distribution networks on fair and reasonable terms. If a retailer and network provider could not agree on those terms, either party was entitled to refer the matter to the regulator for determination as to what was fair and reasonable in the circumstances.

5.39 Despite the existence of this form of review, no third-party retailer in New South Wales or Victoria entered into a use-of-system agreement with a distribution network provider during the first five years of the operation of the network access regimes in each of those States. This situation was exacerbated by the lack of minimum service standards in relation to the network access services covered by the regulated maximum tariffs.

5.40 This vacuum continued until the regulator in Victoria and the Government in New South Wales amended the regulatory arrangements to require distribution network providers to offer a mandated or default use-of-system agreement as a starting point in any negotiations with a third-party retailer.

5.41 Experience has shown that the level of prescription in New South Wales, Victoria and South Australia in relation to the provision of network access services has not prevented the establishment of flexible arrangements where that is required.

5.42 Rather, the continued lack of prescription (or application of the light-handed regulation principle) has tended to discourage, or at the very least make it more difficult for, access seekers seeking services which fall outside of the standard arrangements.

5.43 For example, the provision of network access services with respect to embedded generators falls outside of the default connection agreement arrangements in New South Wales, Victoria and South Australia. As a result, potential embedded generators have experienced difficulties in negotiating the terms of access with distribution network providers. Given the time imperatives usually associated with these types of projects, embedded generators are often faced with the choice of:

- accepting fairly onerous terms offered by the distribution network provider; or
- deciding not to proceed with the project,

rather than risk the potential delays, uncertainties and costs associated with a dispute resolution process.

5.44 While Power and Water correctly notes that highly prescriptive regulation would provide all participants with certainty as to the regulatory environment, the Commission does not accept that a high level of prescription necessarily reduces the

flexibility of the regulatory system to adapt to change. Rather, the regulatory system needs to incorporate an appropriate process for dealing with change in a timely manner.

5.45 The Commission does not agree that increased prescription increases the risk of the Code becoming inappropriate or unworkable. Rather, lack of certainty is more likely to lead to a situation where the Code has no application at all. As noted above, light-handed regulation led to a situation in Victoria and New South Wales where retailers were purchasing network access services from network providers for over five years without any written agreement relating to the terms upon which those services would have been provided. This situation would have continued if the regulator had not commenced a process designed to prescribe a form of default use-of-system agreement.

5.46 However, given the unique nature of the Territory's electricity supply industry, the Commission agrees that the Code should not itself be amended to deal prescriptively with all the issues that might be identified. Rather, the Commission considers that it would be preferable if the Act was to grant the Commission the power to develop, in conjunction with interested parties, detailed guidelines and direction as and when those guidelines and directions are required.

5.47 In this way, the Commission would be provided with the tools necessary to fine tune the regulatory arrangements once it becomes apparent that fine tuning is required in order to facilitate or permit the entry of new generators or retailers. A high level of prescription in all areas may, in the current circumstances, result in increased costs without any associated benefit. However, the Commission should have available the means by which these requirements can be progressively developed and introduced as and when the Commission considers that the necessary benefits will arise.

Recommendation (8) Provision should be made in the Act for the regulator to be authorised to develop and publish 'guidelines' and 'directions' where the regulator can demonstrate (a) that this is necessary to eliminate any uncertainty that may arise regarding the conduct of Code participants that is consistent with the requirements of the Code, and (b) that there is a net public benefit in promulgating such guidelines or directions.

Review and appeal

5.48 Section 14 of the Act provides that the determinations and approvals made by the Commission under the Code are final, with appeals to the courts limited to questions of bias and misinterpretation of facts.

5.49 The Productivity Commission Review has suggested that increased accountability and transparency of regulatory decision-making is warranted in current access regimes, including on the grounds that:

> *"Eliminating the scope for an appeal removes the possible divulgence of regulatory error, but it does not remove its consequences for parties…"*

and:

> *"[appeal rights] are critical where regulatory decisions have such importance for investment incentives and efficiency for access seekers and providers. They recognise the sizeable potential for regulatory error and provide an incentive for the regulator to maintain balance in its decisions."*[18]

[18] Productivity Commission, *Telecommunications Competition Regulation*, Final Report, AusInfo, Canberra, 28 September 2001, p.340 and p.xxxii. Available on the Productivity commission website (www.pc.gov.au).

Views in submissions

5.50 Power and Water favours an extension of the grounds for appeal of regulatory decisions beyond 'bias' or 'errors of fact or interpretation', and also advocates that a separate body be established to review decisions on issues of fact.

5.51 Power and Water argued that:

> *"The current appeal provision provides an appeal to the Supreme Court on only two grounds:*
>
> - *bias; or*
> - ***material** misinterpretation of the facts underlying the decision.*
>
> *It is unlikely that bias would ever be proven, therefore participants only have one real grounds for a merits appeal to the Supreme Court – a material misinterpretation of the facts underlying the decision. Power and Water is of the view that a 'material misinterpretation' of the facts may set the test too high to allow legitimate differences of interpretation between the Utilities Commission and Code participants to be put to an appellate body." (p.17)*

5.52 Power and Water therefore proposed:

> *".....an expansion of the rights to allow appeals against the merits of determinations, approvals or other decisions made by the Regulator under the Code.*
>
> *Power and Water suggests that Government considers constituting an intermediate body to examine appeals under an expanded section 14 – similar to the Victorian appeals panel provision (section 38 of the ORG Act) which may be more cost effective than the courts." (pp.27-28)*

5.53 By contrast, NT Treasury submitted that the grounds for appeal currently contained within the Code were appropriate. It also noted that:

> *"In practice regulatory decisions are issued in draft form which allows parties to identify issues such as bias and errors of fact or interpretation prior to a final decision being made by the regulator." (p.3)*

Commission's analysis and conclusions

5.54 Section 27 of the *Utilities Commission Act* provides that persons affected by any decision or determination by the Commission may request that the Commission review that decision or determination. There are no limits on the grounds for such reviews. The Commission is required to publish its decision on such a review, and the reasons for the decision.

5.55 With respect to Power and Water's suggestion of the establishment of a separate expert panel, the Commission is of the view that there is ample opportunity for the opinions of experts to be taken into account during the decision and initial review processes. The establishment of an expert panel is not warranted given the small size of the Territory market.

5.56 As to the appropriate grounds for subsequent appeal to the courts against the Commission's decisions or determinations, access seekers generally prefer limits on the scope of review on the basis that speedier, even if more imperfect, decisions flow. On the other hand, access providers generally prefer to expand the scope of appeal of regulatory decision-making on the basis that more opportunities for review of regulatory decisions allow a greater number of errors to be filtered out, or the extent of error minimised, than would otherwise be the case.

5.57 From the Commission's perspective, this matter relates to two separate sections of the Act, being sections 14 and 18.

5.58 Section 14 of the Act only applies to determinations or approvals of the Commission made under Part 3 of the Code (i.e., access pricing).

5.59 Currently, section 14(3) of the Act does not extend to questions of law. This is consistent with similar rights of appeal under other access regimes. For example,

section 55 of the Victoria's *Essential Services Commission Act 2001* provides that the only grounds of appeal are bias or where the determination is based wholly or partly on an error of fact in a material respect. This is not significantly different to the wording set out in section 14(3)(b) of the Act.

5.60 However, this can also be contrasted to section 32 of the South Australian *Essential Services Commission Act 2002*, where:

> *"…if an applicant for review is dissatisfied with a price determination or decision which has been confirmed, varied or substituted by the Commission on review, he or she may appeal to the Administrative and Disciplinary Division of the District Court against that determination or decision."*

The appellant is not required to demonstrate any bias or error of law or fact. The only restriction is that the District Court can only have regard to the same information as was made available to the Commission in making its decision. A further right of appeal from the decision of the District Court is permitted but only with respect to questions of law.

5.61 In relation to section 14 of the Act, the Commission considers that limiting the grounds for appeal to bias or errors of law or fact should be sufficient given there are no limits on the grounds for the preceding review process.

5.62 In relation to section 18 of the Act, the Commission's legal advisers have indicated that it is very common to limit the grounds of appeal in relation to an arbitration award to questions of law. On this basis, the Commission's legal advisers did not recommend any extension of the grounds of appeal with respect to awards made under the Code.

Recommendation (9) The review and appeal provisions of the Act should be retained in their present form.

Coverage of the Code

5.63 Section 5(1) of the Act provides that:

> *"The Network Access Code applies to the electricity networks prescribed by the Minister by notice in the Gazette."*

5.64 The electricity networks prescribed by the Minister are currently:

- Darwin/Katherine, including the Darwin-Katherine transmission line ("DKTL");
- Tennant Creek; and
- Alice Springs.

5.65 The DKTL was not covered by the Code while it was privately owned. At that time, to facilitate access to the DKTL, the Commission gave some consideration to other options for applying the Code in whole or in part to non-prescribed electricity networks. In particular, the Commission considered the provision of a mechanism whereby an owner of an asset could give an undertaking in relation to access to the asset which could take the form of a modified access code.

Views in submissions

5.66 Power and Water supported the inclusion in the Code of some guidance on the criteria the Minister should adopt when determining whether a network is to be regulated by the Code.

5.67 Power and Water argued that:

> *"Criteria should be provided in the Code to provide guidance to network investors.*

> *From a practical standpoint, investments require significant lead time for technical and economic feasibility to be established prior to the start of construction. The ability to seek finance for new investments, whether from the open market or internally, depends on a demonstrated business case and expectations of returns. This process is difficult especially without criteria with which to form a preliminary view of regulatory risk. (p.18)"*

Further, Power and Water suggested that:

> *"Such guidance could follow section 1.9 of the Gas Code which requires the regulator to be satisfied that:*
>
> - *access (or increased access) to Services provided by means of the (Pipeline) would promote competition in at least one market (whether or not in Australia), other than the market for the Services provided by means of the (Pipeline);*
> - *it would be uneconomic for anyone to develop another (Pipeline) to provide the Services provided by means of the (Pipeline);*
> - *access (or increased access) to the Services provided by means of the (Pipeline) can be provided without undue risk to human health or safety; and*
> - *access (or increased access) to the Services provided by means of the (Pipeline) would not be contrary to the public interest." (p.19)*

5.68 While allowing that the inclusion of criteria which a Minister should take into account in determining which networks are to be covered may be appropriate, NT Treasury expressed the view that, due to the unique characteristics of the Territory, Ministerial discretion in determining coverage should remain.

5.69 With respect to what modifications are needed to the Code before coverage could be extended beyond government-owned networks, Power and Water argued on competitive neutrality ground that there were no grounds for any such modifications. It argued that privately-owned networks should be subject to the same form of regulation as a government-owned network.

5.70 By contrast, NT Treasury argued that any modifications to the Code should provide sufficient incentive for new investment, including provisions for access holidays and truncation premiums, along lines supported in chapter 11 of the Productivity Commission Review.

Commission's analysis and conclusions

5.71 The Commission accepts the arguments that decision on expanding the coverage of the Code should remain with the Minister.

5.72 That said, investor uncertainties need to be addressed by including in the Act the criteria that the Minister is to take into account in determining whether a network is to be covered by the Code.

Recommendation (10) Ministerial discretion in determining the Code's coverage of networks should remain.

Recommendation (11) Consideration should be given to including in section 5 of the Act the criteria that the Minister is to take into account in determining which networks are to be covered by the Code.

Other issues

Section 11 of the Act – Ministerial direction

5.73 The Commission's legal advisers have noted that section 11 of the Act appears inconsistent with section 8 of the *Utilities Commission Act* and the general principles applying to other access regimes.

5.74 Section 8 of the *Utilities Commission Act* provides that the Commission is not subject to the control or direction of the Minister in respect of the content of any determination, order or decision made by the Commission under the *Utilities Commission Act* (other than where specifically provided to the contrary in that Act). This is consistent with the approach adopted in other jurisdictions. For example, section 12 of the Victorian *Essential Services Commission Act 2001* contains a very similar provision.

5.75 Section 11(1) of the Act provides that the Commission is subject to the direction of the Minister with regard to general policies to be followed by the Commission in matters of administration (including financial administration). This requirement is at odds with the principle enunciated in section 8 of the *Utilities Commission Act*. In addition, it is unclear what is meant by the words 'general policies' and 'matters of administration'.

5.76 Section 11(2) of the Act goes on to specifically exclude a number of matters from the scope of the Minister's power to direct the Commission. It could be argued that the current wording of section 11(2) of the Act suggests that this list is exclusive rather than inclusive (i.e., these are the only limitations on the Minister's power of direction under section 11(1) of the Act).

5.77 Finally, the Commission's legal advisers have noted that it is unclear what is meant by the restriction set out in section 11(2) of the Act. This lack of clarity relates primarily to the use of the term 'contestable customer' which is not defined in section 3 of the Act. It would also appear that a direction from the Minister could indirectly affect access terms and conditions.

Recommendation (12) Section 11(1) of the Act should be amended to be consistent with section 8 of the Utilities Commission Act.

Commission's immunity from liability

5.78 The Commission's legal advisers have noted that section 26 of the Act does not provide that no liability attaches to the Commission for any act or omission done in the exercise or performance or purported exercise or performance of a power or function under the Act. This is a notable omission, as the Commission is currently protected by similar immunities from liability under section 108 of the *Electricity Reform Act* and section 41 of the *Utilities Commission Act*. However, both of these provisions only operate to protect the Commission from liability in relation to the administration or enforcement of those Acts or any act or omission done in the exercise or performance or purported exercise or performance of a power or function under those Acts.

5.79 Neither of these provisions extend to protect the Commission from liability in respect of anything done under the Act or the Code unless it could be argued that such an act or omission also relates to the *Electricity Reform Act* or the *Utilities Commission Act* (which may be unlikely).

Recommendation (13) Section 26 of the Act should be amended to provide that no liability attaches to the regulator in relation to any act or omission under the Code, consistent with provisions in the Utilities Commission Act and the Electricity Reform Act.

Network provider's immunity from liability

5.80 Under section 26(2) of the Act, no liability attaches to a network provider in the absence of bad faith.

5.81 The Commission's legal advisers have noted that this is an extremely broad immunity from liability and is not consistent with the limitations of liability applying in South Australia and Victoria:

- Section 78 of the *National Electricity Law* relevantly provides that a network service provider will not incur any civil monetary liability for any partial or total failure to supply electricity unless the failure is due to an act or omission done or made by that network service provider in bad faith or through negligence.
- Section 117 of the Victorian *Electricity Industry Act 2000* relevantly provides that a network service provider is not liable to any penalty or damages:
  (a) for not supplying electricity under any contract if the failure arises through accident, drought or unavoidable cause; or
  (b) to any person for any partial or total failure to supply electricity arising through any cause that is not due to the fault of the network service provider.
- The South Australian *Electricity Act 1996* no longer contains this type of limitation of liability provision. Rather, it was considered that section 78 of the *National Electricity Law* was sufficient to protect the legitimate interests of network service providers. Transmission network service providers and distribution network service providers in South Australia are required to published standard customer connection and supply contracts. While these contracts contain a limit on liability, they do not purport to limit liability to instances of bad faith only.
- The Victorian *Electricity Distribution Code* and *Electricity Retail Code* both contain provisions dealing with the extent to which a network service provider can limit its liability for a failure of supply. These limitations are not restricted to bad faith, but rather only limit liability in the case of events of *force majeure*. In addition, Victorian network service providers are specifically required to compensate customers in certain circumstances for property damage caused by surges.

5.82 These liability provisions operating in Victoria and South Australia can be contrasted with the position in New South Wales where the government-owned network service providers are still entitled to limit their liability to the maximum extent permitted at law (and, in particular, under the TPA).

5.83 In the Commission's view, at the very least, section 26(2) of the Act should only operate to limit a network provider's liability to the maximum extent permitted under the TPA.

5.84 However, from a policy perspective, it is questionable whether it is appropriate:

- to extend the same level of protection to a network provider as is extended to an arbitrator, the Commission or a power system controller; or
- to effectively provide a very limited downside if the network provider breaches a term of an access agreement or access award or fails to perform its functions under the Code.

5.85 It is likely that this type of statutory immunity will be picked up in any access agreement and will operate to effectively exclude all rights of redress that a party to an access agreement would usually have against the network service provider for a breach of that access agreement.

Recommendation (14) Section 26(2) of the Act should be amended to only operate to limit the network provider's liability to the maximum extent permitted under the Trade Practices Act.

Recommendation (15) Section 26(2) of the Act should be amended to ensure that the network provider's immunity from liability does not exclude the rights of redress that a party to an access agreement would usually have against the network provider for a breach of any access agreement.

Application of immunity of liability to system control functions and powers

5.86 The Commission's legal advisers have noted that it is important to examine any provision of the Code that purports to impose an obligation on a person who performs a particular function, given the integrated nature of Power and Water's operation.

5.87 For example, section 26(1) of the Act should provide that no liability attaches to a person in relation to any 'system control' type of act or omission under the Code. In this way, the focus would be on the type of act or omission and not the person who performs that act or omission. This distinction is particularly important were it decided that the immunity from liability applying to a network provider should differ from that applying to a person performing a power system control function.

5.88 Were this approach adopted, it would be necessary to clearly define 'power system control functions' for the purpose of the Code so as to ensure that there is a clear delineation between the circumstances in which Power and Water can or can not claim an immunity from liability for exercising a power system control function. This approach was adopted in relation to section 77A of the *National Electricity Law* with respect to the limitation on liability applying to NEMMCO and network service providers performing system operation functions or powers.

Recommendation (16) Section 26(1) of the Act should be amended to provide that no liability attaches to a person in relation to any 'system control' type of act or omission under the Code.

Capping rather than eliminating liability

5.89 Finally, since November 1999, section 77A of the *National Electricity Law* only caps, rather than excludes, NEMMCO's and a network provider's liability in relation to system operation functions and powers. This position was adopted by the Governments of the NEM jurisdictions after a lengthy review process and reflects the policy that an exclusion from liability removes the incentive to ensure compliance with regulatory requirements.

Recommendation (17) Further consideration should be given to amending sections 26(1) and 26(2) of the Act with a view to capping, rather than excluding, the system controller's and network provider's liability for acts or omissions under the Code, consistent with recent amendments to the National Electricity Law.

CHAPTER

6

ACCESS NEGOTIATION FRAMEWORK

Introduction

6.1 Part 2 of the Code establishes the terms and conditions under which access to an electricity network is to be granted to third parties. This Part lays down the processes to be followed in negotiating and implementing access agreements and for resolving any access disputes.

Obligations of a network provider

6.2 Chapter 1 of the Code places certain obligations on a network provider on account of the monopoly power it possesses in the delivery of essential infrastructure services.

6.3 In particular, chapter 1 of the Code generally obliges a network provider to:

- use all reasonable endeavours to accommodate the requirements of those seeking access to the electricity network;
- provide information on access arrangements and requirements by developing and maintaining a package of information containing all matters of interest to access seekers regarding the arrangements and requirements for access;
- comply with good electricity industry practice when providing network access services and in planning, operating, maintaining, developing and extending the electricity network and to facilitate this by preparing and making publicly available a network technical code and network planning criteria;
- use reasonable endeavours to provide network access services of a quality and a standard specified in the Code;
- keep separate its network and other businesses as prescribed by the Commission under a ring-fencing code; and
- develop and publish a network technical code and network planning criteria.

Views in submissions

6.4 On the matter as to whether the Code was specific enough about the information to be provided by a network provider to an access seeker, Power and Water argued that the Code was sufficient is this regard, noting that:

> *"… effective competition hinges on the provision of a level playing field. The Code should ensure that non-confidential information, which assists access seekers to better understand and use the network, should be provided via a simple and practical process." (p.19)*

6.5 NT Treasury expressed the view that the information required to be provided by the network provider to access seekers was appropriate.

6.6 On the matter as to whether the nature of (internal) access arrangements between the networks business unit of Power and Water ("Power and Water Networks") on the one hand and the retail and generation business units of Power and Water ("Power and Water Retail" and "Power and Water Generation" respectively) on the other should be subject to greater prescription under the Code, Power and Water argued that:

> *"…such a move goes further down the current path of prescription and regulation of inputs rather than regulatory outcomes." (p.20)*

6.7 NT Treasury did not see a need for the nature of (internal) access arrangements between the network provider and network users within Power and Water to be subject to greater prescription, as it was felt that this was appropriately addressed through the Ring-fencing Code.

6.8 On the matter as to whether to the network technical code and planning criteria might constitute a barrier to entry, Power and Water argued that:

> *"Both the technical and planning requirements in the Code are based heavily on the equivalent Western Power documents, which in turn are derived from corresponding National Electricity Market documents. The technical and planning requirements in the Code are therefore based on sound engineering principles." (p.20)*

6.9 NT Treasury submitted that the network technical code and planning criteria were justified in the public interest as they ensure service quality and safety. NT Treasury was not aware of any evidence that these requirements have acted as a barrier to entry.

Commission's analysis and conclusions

Information provided to an access seeker

6.10 The provision of adequate information is critical to access seekers. In most cases, this information is only available from the network provider. While the level of detail can be indirectly regulated by (for example) requiring Power and Water to satisfy detailed service standards in relation to the provision of standard network access services, the Commission considers it preferable that the Code permit the Commission to require the network provider to make available additional information to access seekers as and when that appears to be necessary.

6.11 This could be achieved by including in clause 6A(2) of the Code a reference to such other information as the Commission requires from time to time.

6.12 The Commission also notes that Power and Water appears to suggest that the information disclosure requirements should be limited to non-confidential information. The Commission is not convinced that such a limitation should be adopted as it could be readily used to limit the disclosure of useful information to access seekers. In other jurisdictions, confidential information is often disclosed between suppliers and potential customers during the assessment and negotiation process. Any issues concerning the use or disclosure of that information are usually dealt with by way of a confidentiality agreement. The Commission understands that this may already have occurred in access negotiations to date. This should be adequate to protect Power and Water's interests in these circumstances.

6.13 The Commission is also of the view that clause 8 of the Code should clearly state that the power to require information under this clause is in addition to the general information gathering power conferred upon the Commission under section 25 of the *Utilities Commission Act*.

6.14 It is also unclear what is meant by the expression 'pertaining to a network access service'. The Commission could rely upon clause 8 of the Code in order to gain

access to the accounts and records referred to in clause 7 of the Code. However, clause 8 of the Code appears to limit this right of access to circumstances where the accounts and records are required for the purpose of making a determination under the Code.

Recommendation (18) Clause 6A(2) of the Code should be amended to include a reference to such other information as the regulator requires from time to time.

Recommendation (19) Clause 8 of the Code should be amended to clearly state that the power to require information under this clause is in addition to the general information gathering power conferred upon the regulator under section 25 of the Utilities Commission Act.

Access arrangements between the business units of Power and Water

6.15 With respect to the nature of internal arrangements between Power and Water's business divisions, the Code currently does not provide an effective mechanism for regulating the terms of the internal arrangements applying between Power and Water Networks and Power and Water Generation or Retail. This was implicitly recognised by the NCC when it insisted upon the inclusion of clause 7A, instituting the ring-fencing requirements, of the Code.

6.16 The Commission is of the view that achievement of the objects of the Territory's access regime would be assisted by ensuring that the internal arrangements applying between Power and Water Generation and Power and Water Networks and between Power and Water Retail and Power and Water Networks are transparent and regulated.

6.17 However, the Commission's legal advisers have noted that it may not be possible to directly regulate these internal arrangements under the Code for the following reasons:

- Part IIIA of the TPA by definition only regulates the terms upon which third parties will be granted access to the services provided by significant infrastructure facilities. Part IIIA of the TPA does not directly regulate internal arrangements between ring-fenced divisions of the entity that owns and operates the infrastructure facility.
- The same comment applies in relation to clause 6 of the CPA. Clause 6 deals with regimes for third-party access to services provided by means of a significant infrastructure facility.
- It is not possible to refer to any internal arrangement as a 'contract or agreement' because, by definition, an entity cannot enter into a contract with itself.

6.18 It follows from these consideration that the form of the internal arrangement applying between Power and Water Generation and Power and Water Networks and between Power and Water Retail and Power and Water Networks must be regulated under some other instrument (such as the *Electricity Ring-Fencing Code*).

6.19 It may be possible to assist in this process by ensuring that a number of principles are reflected in the Code. The most obvious option is by including in the Code a provision for development and approval of a default use-of-system agreement and a default connection agreement. Such agreements would not only assist third parties seeking access to the services provided by Power and Water Networks, but also provide a benchmark against which the *Electricity Ring-Fencing Code* obligations could be measured.

6.20 Experience in other jurisdictions has shown that retailers are primarily concerned to ensure that, at a basic level, they are being treated by the network provider in the same way as other retailers and, in particular, the retail arm of the network provider. It may be that this level of confidence can only be achieved by way of a regulated default use-of-system agreement.

6.21 In addition, the development of standard network access services, detailed service standards and standard reference tariffs which are consistently applied will also promote transparency and confidence among potential access seekers and provide a useful benchmark for measuring compliance with the requirements of the *Electricity Ring-Fencing Code*.

6.22 It is very unlikely that any third-party retailer or generator would be prepared to consider entering into the Territory's electricity market unless it could be assured – via a transparent and regulated process – that it would receive the same standard services on the same terms and conditions as apply between Power and Water Networks and Power and Water Generation/Retail.

Recommendation (20) The Code should be amended to provide for the regulator's approval of a default end-of-system agreement and a demand connection agreement.

Technical code and planning criteria as barriers to entry

6.23 While neither submission felt that there were of any instances where the technical code and planning criteria may have constituted a barrier to entry, the Commission notes the following points:

- Any technical requirements must be applied to Power and Water Generation and Power and Water Retail in the same manner as they are applied to a third-party access seeker.
- It is not uncommon for government-owned vertically integrated entities to develop their infrastructure to a level that exceeds a reasonable industry standard (i.e., the entity may have chosen in the past to adopt a level of duplication with respect to assets connecting a generator to the electricity network which would not necessarily be required, taking into account good electricity industry practice).

6.24 The NEC includes two separate mechanisms by which the technical obligations applying to access seekers can be modified. They are:

- clause 5.2.2 of the NEC which makes it clear that connection agreements may contain terms which are inconsistent with the obligations imposed under chapter 5 of the NEC provided the application of those inconsistent terms would not adversely affect the quality or security of network access services to other network users; and
- clause 8.4 of the NEC which establishes a mechanism whereby a code participant may apply to NECA for a derogation from one or more provisions of the NEC.

6.25 Clause 30(3) of the Code currently confers an exemption power on the network provider. The Commission is concerned that it may be inappropriate for the entity that sets the technical standards to also determine whether an exemption should be granted to a particular network user. An alternative mechanism would be to include a general approval power and a derogation or exemption power in favour of the Commission in clause 9 of the Code.

6.26 With regard to the development of the technical code and planning criteria, while clause 9(4) of the Code confers on the Commission a 'quasi' approval power, this

approval power is limited to provisions which are inconsistent with the objectives of the Code. As discussed in chapter 5, the Code currently does not contain a general objects provision. If an objects provision is included, objects necessary to support clause 9(4) of the Code should be included.

6.27 Clause 9(5) of the Code should make it clear that the Commission's approval power under clause 9(4) extends to subsequent amendments proposed by the network provider. Consideration should be given to conferring a power on the Commission to initiate amendments outside of this process, including in response to suggestions by other market participants.

6.28 Clause 9A of the Code requires the network provider to

".....use reasonable endeavours to provide network access services of a quality and a standard at least equivalent to the greater of:

(a) the levels prevailing during the year before the commencement of this Code; and

(b) the levels prevailing during the year before commencement of the access agreement."

6.29 It could be argued that this is of little assistance to most access seekers because of the lack of certainty. It would be preferable for service standards to be prescribed as part of the reference tariff (price) fixing process in a similar manner to that which now applies in relation to the ACCC's price regulation functions under chapter 6 of the NEC. This relatively recent amendment to the NEC recognises that any system for establishing a maximum price must also include a mechanism for defining the minimum service that must be provided in return for the payment of the maximum price. Access seekers want certainty and want to be assured that all network users are receiving the same standard of network access services in return for the payment of the relevant reference tariff.

Recommendation (21) Clause 9 of the Code should be amended to provide for a general approval power, and a derogation or exemption power in favour of the regulator, in relation to the network technical code and the network planning criteria.

Recommendation (22) Clause 9(5) of the Code should be amended to make it clear that the regulator's approval power under clause 9(4) extends to subsequent amendments proposed by the network provider.

Recommendation (23) Clause 9 of the Code should be amended to confer a power on the regulator to initiate amendments to the network technical code and network planning criteria, including in response to suggestions by other Code participants.

Recommendation (24) A provision should be added to clause 9A of the Code recognising that any system for establishing a maximum price must also include a mechanism for defining the minimum service which must be provided in return for the payment of the maximum price

Negotiation of access

6.30 Chapter 2 of the Code sets out the process that must be followed by all parties in negotiating and concluding access agreements.

6.31 These negotiation arrangements aim to both:

- address the perceived imbalance between the bargaining position of the network provider and access seekers; and

- avoid excessive costs where possible, given initial applications for access and the following negotiations to secure access can be costly in terms of time, money and effort of the applicant and the network provider.

6.32 The clauses in the chapter set out both the scope of information required of each party and the maximum timetables to be observed.

Views in submissions

6.33 On the matter as to whether the Code's timeframes are appropriate relating to information and responses between access seeker and network provider, Power and Water argued that the timeframes in the Code were appropriate, submitting that:

> *"In particular, for reasons of operational flexibility, the provision to allow the network provider to specify the period within which a preliminary assessment of the access application will be made, should be retained as drafted in the Code.*
>
> *This is because, in practice, different user scenarios can require widely different periods of time to process for network operators. Where a user is proposing to supply existing customer loads, the network planning phase and preparation of necessary responses can be achieved without significant complication. Network companies require a much more detailed level of analysis, and therefore greater amounts of work, to process applications for new generator customers. In some cases these studies can take several weeks to complete." (p.21)*

6.34 NT Treasury indicated that it was not aware of any problems arising from the timeframes specified in the Code.

6.35 On the matter as to whether the Code's negotiation framework was capable of accommodating likely future change in the Territory's electricity supply industry, Power and Water expressed no concerns, provided that this did not involve:

> *"…the coincident development of significant amounts of new generation capacity." (p.21)*

6.36 Power and Water argued that:

> *"The emergence of a very large generator (exceeding 500MW) would change the nature of the NT electricity market fundamentally, requiring attention far beyond the extent of this review process which is limited to the Code.*
>
> *This is for three reasons:*
>
> *1 The new generation capacity might be two to three times the size of Power and Water's current generation capacity;*
>
> *2 Large power users require spare generation capacity to insure against system failure, therefore large amounts of incremental cost power might be available for supply to the broader Northern Territory market; and*
>
> *3 That 'spare' power may be available at lower prices than that produced at Channel Island Power Station, due to the considerably larger size of the generators and low priced gas contracts with Timor Sea suppliers, compared to Power and Water's existing contracts with Central Australian producers."*

and that:

> *"Government will need to be mindful that this would represent a transfer of monopoly power rather than the introduction of competition. It is unlikely that the Code could accommodate such a change without requiring further amendment." (pp.21-22)*

6.37 NT Treasury considered that the Code's negotiation framework should be such as to anticipate future changes in the Territory's electricity supply industry.

Commission's analysis and conclusions

Code's timeframes

6.38 The current timeframes set out in chapter 2 of the Code are broadly consistent with the timeframes adopted in other jurisdictions.

6.39 If a default use-of-system agreement was not adopted in relation to retailers, it is possible that the timeframes set out in chapter 2 of the Code may not be satisfied.

The same comment applies in relation to applications for the connection of new generators. Experience in other jurisdictions has shown that the average timeframe between the lodgment of the initial connection inquiry and the finalisation and execution of the connection agreement in respect of a new generator is between six and nine months.

6.40 While not raised in submissions, the Commission is concerned that clause 11(2)(a) of the Code does not require the network provider to specify a reasonable period for the making of the preliminary assessment. It may not be appropriate for this time period to be left to the subjective assessment of the network provider, but rather that a mechanism should be in place that allows an access seeker to seek an independent adjudication of what constitutes a reasonable timeframe, where the access seeker feels that the network provider's proposed timeframe is too long.

Recommendation (25) Clause 11(2)(a) of the Code should be amended to allow an access seeker to seek the regulator's adjudication of what constitutes a reasonable timeframe for the making of the preliminary assessment, where the access seeker feels that the network provider's proposed timeframe is too long.

Adaptiveness of the Code

6.41 The Commission agrees that that the Code's negotiation framework should anticipate future changes in the Territory's electricity supply industry. Any potential inability of the negotiation framework to accommodate future changes in the Territory's electricity supply industry would be indicative of current problems with the negotiation framework as it applies now.

6.42 In other words, the negotiation framework should be able to accommodate any form of access application in a consistent manner by applying the general objectives, principles and procedures.

6.43 The Commission does not agree with Power and Water's statement that the negotiation framework may need to be amended to cope with the development of significant amounts of new generation capacity. This statement, and the reasons in support of this statement, is only relevant if Power and Water's operations are considered as a whole. In other words, this issue would not be relevant if the Territory's electricity network was operated by an entity which was separate from the incumbent generator and retailer. The same electricity network would be used to transport electricity generated by a new generator as is currently used to transport electricity generated by Power and Water Generation.

6.44 The Commission does accept, however, that changes may be required to clause 18 of the Code and the load balancing arrangement were a significant new generator was to emerge in the near future.

Recommendation (26) In time, amendments may be required to clause 18 of the Code and the load balancing arrangements if a significant new generator was to emerge in the near future.

Access terms

6.45 Chapter 3 of the Code imposes obligations regarding the technical terms and conditions to be met by network users under any access agreement.

6.46 The terms of the access agreement underpin the ongoing relationship between the network provider and the access seeker. The terms set out the rights of and obligations on each of the parties during the contractual period.

Views in submissions

6.47 On the matter as to whether the generation-related provisions of the Code should be moved to a more appropriate regulatory instrument, Power and Water expressed the view that that the current placement of the generation provisions of the Code was neither onerous nor administratively difficult to navigate.

6.48 NT Treasury also saw no reason for change.

6.49 On the matter as to whether the overlapping definitions of network 'users' should be removed, Power and Water supported their removal along with a clearer distinction being made between the different types of users. Power and Water argued that:

> *"Definitions in the Code should be made/used with greater consistency throughout the Code. To avoid interpretative difficulties and ambiguities it is necessary to use terms carefully and consistently with the definitions provided in the Code." (p.22)*

6.50 NT Treasury supported clarification in this regard to the extent that problems have emerged with existing definitions.

Commission's analysis and conclusions

Location of generation-related provisions

6.51 The Commission concedes that no strong case can be made for removing the generation-related provisions of the Code to a separate regulatory instrument, whether on the ground of:

- facilitating the NCC's approval of the operation of the generation-related provisions; and
- minimising any confusion arising from the drafting of these provisions.

6.52 The NCC has already approved the current provisions, which provide for the Commission and interested parties to evolve the arrangements without the need for further amendments to the generation provisions of the Code.

6.53 Any current confusion with the drafting of these provisions can be addressed just as easily by amending the generation-related provisions of the Code.

Recommendation (27) The generation-related provisions of the Code should be retained in their present location.

Definition of network user

6.54 The Code generally uses the term 'network user', which is defined to be a person who has been granted access to the electricity network by the network provider in order to transport electrical energy to or from a particular point. Chapter 3 of the Code, however, distinguishes between a:

- 'generator user', which means a person who has been granted access to the electricity network by the network provider and who supplies electricity into the electricity network at an entry point; and
- 'load user', which means a person who has been granted access to the electricity network by the network provider and who takes electricity from the electricity network at an exit point.

6.55 The Commission has noted that these overlapping definitions have given rise on some occasions to interpretative difficulties for affected parties.

6.56 While the Commission is of the view that the definition of 'network user' should be retained and used in the Code where a relevant provision applies in the same manner to generators, retailers, end-use customers and other categories of network users, such other categories of network users should be appropriately defined in clause 3 of the Code. In particular, the Commission notes that the term 'end-use customer' is used throughout the Code without any clear meaning.

6.57 Also, as noted by Power and Water, the current definitions for generator and load user are also incorrect and can lead to confusion when used in the Code.

Recommendation (28) Clause 3 of the Code should be amended to ensure that different categories of network users (such as generators, retailers and end-use customers, and generator and load users) are appropriately defined in clause 3 of the Code and are then subsequently used in the Code in a consistent and correct manner.

Nature of network access services provided to generators, retailers and end-use customers

6.58 More fundamentally, at issue is whether the Code should apply in the same manner to all network users. The Commission is of the view that the Code does not satisfactorily differentiate between the application of the requirements of the Code to each category of network user.

6.59 For example, the services provided to generators under the NEC differ from the services provided to retailers and end-use customers. These differences are reflected in chapters 5 and 6 of the NEC and in the terms of the connection agreements that are typically entered into with generators, retailers and end-use customers.

6.60 The NEC uses the term 'Distribution System' to define both connection assets and the distribution network supporting those connection assets. A distinction is then drawn between the services provided by the connection assets and the services provided by the distribution network. As a general rule, generators are only provided with connection (entry) services. Generators are not usually provided with distribution use-of-system services unless these are specifically requested and negotiated (because the standard transmission use-of-system charges are not payable by the generators). It follows that the entry service provided to a generator is limited to the provision of the capability of the connection assets at the relevant entry point only and does not extend to the use of the network beyond the connection assets.

6.61 As a result, retailers or end-use customers in the NEM enter into connection agreements with network providers under which both connection (exit) services and use-of-system services are provided (i.e., the service of transporting electricity from the entry points with generators through the electricity network to the connection point for a particular end-use customer or retailer).

6.62 The current wording of the Code raises questions concerning whether it was intended that each category of network users be dealt with in the same manner (i.e., should a small end-use customer wishing to connect to the electricity network be dealt with in the same way as a large retailer or generator?).

6.63 The services being provided by a network provider to a retailer will, in general terms, differ from those being provided to an end-use customer.

6.64 A retailer will usually only contract for the provision of use of network access services because the retailer is not the owner of the assets which are being physically connected to the electricity network at the exit point. These assets are

usually owned by the end-use customer and in South Australia, Victoria and New South Wales a stand-alone connection agreement is established between a network provider and the end-use customer in relation to the provision of exit services.

6.65 In each of these jurisdictions at the distribution network level, a form of default connection agreement approved by the regulator is required to be established. In other words, customers connecting to the distribution networks in South Australia, New South Wales and Victoria are entitled to receive a standard form connection agreement unless they choose to negotiate a different form of connection agreement with the relevant network provider.

6.66 This reduces costs and promotes certainty with respect to a customer's right to be connected to the distribution network.

6.67 The arrangements applying to the provision of use-of-system services differ between New South Wales and Victoria on the one hand and South Australia on the other.

6.68 In New South Wales and Victoria, the regulatory arrangements establish what is known as a 'straight line' relationship between the network provider, the retailer and the customer.

6.69 In general terms, under the straight line arrangement an agreement dealing with the provision of exit services only is created between the network provider and the customer. In both New South Wales and Victoria a network provider is required to offer a standard form connection agreement.

6.70 The regulatory arrangements also grant a right to retailers to access the use-of-system services provided by network providers. Originally, in both jurisdictions the contents of the use-of-system agreements were indirectly regulated in a manner similar to the Code (i.e., the terms were required to be fair and reasonable with a right to refer any dispute to the regulator for resolution). However, both New South Wales and Victoria have now adopted a default form of use-of-system agreement to apply between retailers and network providers in the absence of any agreed alternative use-of-system agreement.

6.71 The net result of this contractual structure is as follows:

- The network provider has a connection agreement with the customer for the provision of exit services only. That connection agreement provides that any costs associated with the provision of exit services are to be recovered via the use-of-system charges imposed upon the customer's retailer.
- The network provider has a use-of-system agreement with each retailer covering the provision of those services required to transport electricity from entry points with generators to exit points with the retailer's customers. The retailer is required to pay all charges relating to the provision of exit services and use-of-system services with respect to the electricity delivered to its customers. The network provider is responsible to the retailer for quality of supply and continuity of supply issues.
- The retailer has a contract with the end-use customer for the sale and supply of electricity to the end-use customer at its premises.

6.72 The contractual framework applying in South Australia is known as a triangular relationship.

6.73 Under this framework:

- the network provider has a regulated customer connection and supply contract with each end-use customer which governs both the connection of the end-use customer's premises to the electricity network and the transportation of electricity through the electricity network to that end-use customer; and

- the retailer has a contract with the end-use customer for the sale of electricity only (and the recovery of the amounts owing to the network provider under the terms of its contract).

6.74 Determination of the contractual framework that should apply between the generator and the network provider and between the retailer, end-use customer and network provider is a pivotal issue for any network access regime.

6.75 In the Commission's view, the Code is unclear whether:

- any particular contractual framework is to be preferred; or
- the contractual framework should be left to the network provider and the relevant network user.

6.76 For example, it appears that a generator may have an access agreement with a network provider for the acceptance of electricity at an entry point and the delivery of that electricity to an exit point. This type of access agreement would not occur under the NEC or the access regimes operating in Victoria and South Australia.

6.77 This type of access agreement, and the associated contractual framework, may reflects the fact that electricity is sold and purchased by way of direct contracts in the Northern Territory electricity supply industry. It is, however, contrary to the licensing regime in the Territory under which only retailers (and not generators) may contract for the direct delivery of electricity to end-use customers. This contradiction should be removed from the Code.

Recommendation (29) Further consideration should be given to whether the contractual framework to apply between the generator and the network provider and between the retailer, end-use customer and network provider under the Code should be in the form of the 'straight-line' arrangement as applying in New South Wales and Victoria or the 'triangular' arrangement as in South Australia.

Recommendation (30) The Code should be amended to remove references to the possibility that no generators may contract for the direct delivery of electricity to end-use customers.

Associated definitions

6.78 To assist in clarifying the contractual framework to be adopted in the Territory, the Commission's legal advisers have noted that a number of amendments are required to the definitions and the Code in general. For example:

- The definition of 'connection services' refers to the establishment and maintenance of a connection point. The Commission's legal advisers suggest that this is incorrect. The connection point is simply the point of physical connection between Power and Water's electricity network and the electrical equipment belonging to the access seeker. Rather, connection services should mean the establishment and maintenance of the connection assets for a particular connection point (or more particularly, the provision of a level of capability determined with reference to the 'contract maximum demand' or the 'declared sent out capacity').
- The term 'electricity network' covers both connection assets and network system assets used to transport electricity from generators to a transfer point or to consumers of electricity. The Commission's legal advisers have noted two problems with this definition.
  - First, the definition of 'network system assets' does not specifically exclude connection assets.

- Secondly, the Code does not define a 'consumer of electricity'. This is highlighted by the distinction between the services provided to a retailer and an end-use customer referred to below.

Recommendation (31) Clause 3 of the Code should be amended to ensure appropriate definitions are included for 'connection services', 'electricity network' and a 'consumer of electricity'.

Access disputes

6.79 Chapter 4 of the Code sets out the procedures to be followed in the event of an access dispute. The dispute resolution process can be invoked by either party requesting that the Commission refer the dispute to arbitration.

6.80 Clause 35 of the Code provides that an access dispute exists if:

- the network provider or an affected network user refuses or fails to enter into good faith negotiations with the access seeker within 10 days;
- the access seeker and the network provider fail (within 30 days of the receipt of the access application) to reach agreement on the access application after making reasonable attempts to do so; or
- the parties agree that there is no reasonable prospect of reaching agreement.

6.81 On receiving the request, under clause 38 of the Code the Commission must either:

- if the parties to the dispute agree, attempt to settle the dispute by conciliation; or
- if the parties do not agree, or they agree but the Commission fails to settle the dispute by conciliation after having made reasonable attempts to do so, appoint an arbitrator and refer the dispute to them.

6.82 The Code is not designed to replace commercial negotiations. The intention is that the applicant should first seek to negotiate with the network provider, with the Code only coming into play if a dispute arises. Underpinning this 'light-handed' approach is concern to avoid the costs of more intrusive regulation.

Views in submissions

6.83 On the matter as to whether there is sufficient certainty as to the conditions to be met before an access dispute can be declared, Power and Water argued that the existing arrangements regarding the process for dealing with access disputes are appropriate.

6.84 On the other hand, NT Treasury supported some change to the Code in this regard, providing the following comment:

> *"Provisions of the Code essentially state that an access dispute arises where commercial negotiations fail, or are overly protracted. The applicant is able to notify the regulator that they do not wish the dispute to proceed to arbitration. Some uncertainty exists over what "good faith negotiations" entail. Recent court decisions have interpreted the meaning of "good faith" in a way that conflicts with commercial objectives. On this basis, these words should be deleted. Similarly the regulator's assessment of a "reasonable prospect of reaching agreement" and the applicant's "reasonable attempts to reach agreement" are vague. However, further prescription of these terms may impose unnecessary restraints in negotiations without any foreseeable benefits" (p.4)*

6.85 On the matter as to whether the Commission should be given a more explicit role in the dispute resolution process, Power and Water argued for a pragmatic approach to regulation, opining that the 'problem' that access regulation is designed to

address is best served by an approach characterised by minimal intervention in commercial processes.

6.86 Power and Water argued that:

> *"as currently drafted, the dispute resolution provisions of the Code strike an appropriate balance between the requirements of both the network access applicant and the respondent (the network operator or owner).*
>
> *….Processing access applications is not a simple matter. The access application respondent must assess each application carefully against a number of technical and commercial criteria, which are necessary to ensure that technical and financial issues have been appropriately dealt with, while avoiding barriers to access applicants. Power and Water submits that network technical issues are best resolved by the parties rather than via a dispute resolution body.*
>
> *The Regulator and other arbitrators should have a formal role in dispute resolution, with this role as a last resort and only if there is no prospect of a commercially negotiated outcome. Once a third party becomes involved in the review of the technical and commercial aspects of access negotiations, the time and costs of the access negotiation, ultimately borne by all parties, substantially increase." (p.23)*

6.87 Finally, Power and Water expressed the view that, to date, the Commission had taken a constructive approach to access and other negotiations, and that Power and Water saw little benefit in additional prescription in the dispute resolution processes.

6.88 NT Treasury did not support a more explicit role for the Commission in the dispute resolution processes under the Code, arguing that the role of the regulator in the dispute resolution process is already currently quite intrusive and is adequately provided for in the Code.

Commission's analysis and conclusions

6.89 The provisions of clauses 35 and 36 of the Code seem sufficiently certain as to the conditions which must be met before an access seeker or a network user can request the Commission to refer an access dispute to arbitration.

6.90 However, they differ somewhat from the dispute definitions set out in clause 8.2.1 of the NEC. To remove this difference, clause 35 of the Code could be amended to allow any party to an access application to declare that a dispute exists by notifying the Commission. The provisions of clause 38(2) could then be used by the Commission to delay the commencement of conciliation or referral to arbitration if the Commission believes that the party who is proposing to declare a dispute has not negotiated in good faith or complied with its obligations under the Code.

6.91 In that regard, the Commission also considers that clause 38(2) of the Code should be amended to refer not only to the applicant, but also the respondents.

6.92 Clause 42(2) of the Code refers to the expansion or extension of the electricity network. This may give rise to confusion given that the definition of extension already covers expansions of the electricity network.

6.93 Clause 42(2) of the Code requires the arbitrator to determine the economic feasibility of an extension of an electricity network in a manner which appears to be different from the procedure applied by the Commission under chapter 8 of the Code. If an access dispute relates to whether or not an access seeker should pay a capital contribution, or to the amount of that capital contribution, such questions should be resolved in accordance with clause 31 and chapter 8 of the Code.

6.94 Clause 52(2)(e) of the Code suggests that an arbitrator can make an award which will operate to override an earlier award or access agreement (presumably with another network user). However, clause 52(6) states than an award takes effect as a contract between the network user and network provider. As a result, the terms of the

award could not bind a person other than the relevant access seeker and network provider. However, clause 56(1) goes on to provide that an award is binding on all of the parties to the arbitration in respect of which the award was made. These two provisions should be reconciled in order to ensure that an award which overrides an earlier award or access agreement with another party is clearly binding on that other party. It is likely that the party to the earlier award or access agreement would argue strongly against its rights being varied by the new award.

Recommendation (32) Clause 35 of the Code could be amended to allow any party to an access application to declare that a dispute exists by notifying the regulator (consistent with the process in the National Electricity Code).

Recommendation (33) Clause 38(2) of the Code should be amended to refer not only to the applicant, but also respondents.

Recommendation (34) Clause 42(2) of the Code should be amended to remove reference to expansions of the electricity network in the definition of 'extension of an electricity network'.

Recommendation (35) Clause 42(2) of the Code should be amended to ensure that an arbitrator will determine the economic feasibility of an extension of an electricity network in a manner that accords with the procedure applied by the regulator under chapter 8 of the Code.

Recommendation (36) Clause 52(1) and 52(6) of the Code should be reconciled in order to ensure that an award which overrides an earlier award or access agreement with another party is clearly binding on that other party.

Related provisions of the Act

6.95 The Code establishes certain rights and responsibilities for network providers, access seekers and network users (together referred to as "Code participants"). To ensure that these rights are upheld and responsibilities are adhered to, the Act contains provisions for legal enforcement of the Code.

6.96 In particular:

- section 19 of the Act empowers the Commission to seek injunctive remedies by application to the Supreme Court;
- section 22 of the Act makes provision for Code participants as well as the Commission to initiate court proceedings against one another in certain circumstances; and
- sections 23-25 of the Act empower the Commission to demand (and enforce) civil penalties for breach of the Code.

Views in submissions

6.97 Both NT Treasury and Power and Water considered the enforcement provisions of the Act appropriate.

6.98 Power and Water added, however, that it was unlikely that the enforcement provisions under the Act would ever be used.

Commission's analysis and conclusions

6.99 Parts 5 and 6 of the Act make it clear that the requirements of the Code can only be enforced in the manner set out in those Parts. These provisions are broadly consistent with the corresponding provisions of the *National Electricity Law*.

6.100 The main difference is that the *National Electricity Law* does not specifically confer on NECA, NEMMCO or the National Electricity Tribunal the right to apply to a Court for an injunction. Rather, the National Electricity Tribunal is entitled under section 44(2) of the *National Electricity Law* to make an order requiring a code participant to cease the relevant act, activity or practice which constitutes a breach of the NEC.

6.101 The National Electricity Tribunal is also able to make a range of other orders under section 44(2) of the *National Electricity Law*. These orders broadly reflect the types of injunctions referred to in section 19(1) of the Act. However, the National Electricity Tribunal can only impose a monetary penalty (as compared to applying for an injunction) if a code participant contravenes an order of the National Electricity Tribunal.

6.102 In the Commission's view, the powers granted by section 19 of the Act provide a more effective mechanism for enforcing compliance with the Code (as compared to the enforcement provisions under the *National Electricity Law*) and should be retained.

Recommendation (37) The enforcement provisions in section 19 of the Act should be retained in their present form.

Should there be a right to claim compensation?

6.103 There may be an omission in the remedies available under the Act. Under section 36 of the *National Gas Code*, a person is able to apply for compensation in certain circumstances. In particular, a person who suffers loss or damage as a result of a contravention of a 'conduct provision' can recover the amount of that loss or damage from the person who was involved in that contravention. An example of a 'conduct provision' is section 13 of the *National Gas Code* that prohibits a person from engaging in conduct for the purpose of preventing or hindering access to a relevant service.

6.104 The Commission considers that it would be it appropriate for the Act to incorporate a direct right to claim compensation for a contravention of the Code in certain circumstances.

Recommendation (38) The Act should be amended to allow, in certain circumstances, a direct right to claim compensation for a contravention of the Code, consistent with provisions of the National Gas Code.

Other issues

Flexibility to develop ring-fencing obligations outside of the Code

6.105 In relation to clause 7A of the Code, the Commission's legal advisers have note the following specific points:

- Consideration should be given to further defining the phrase 'business of operating the electricity network' to ensure that the provision of system control services can be separately ring fenced if that is required. For example, given the role of the power system controller under the Code and the *Electricity*

Reform Act, it may be appropriate to impose a higher level of ring fencing in respect of these functions.

- Clause 7A(ii) seeks to impose obligations upon an entity but does not link those obligations to a specified function. For example, clause 7A(ii)(a) states that only employees etc of the network provider are to have access to commercially sensitive information. In this case, the network provider is Power and Water. On the face of this clause, all employees of Power and Water would have access to sensitive information. While this may not have been the intention, it is the effect of these words.

Recommendation (39) Clause 7A of the Code should be revised to remove any anomalies with the Regulation under the Utilities Commission Act which authorises the Electricity Ring Fencing Code.

Network capacity limits

6.106 Clause of the Code 18 deals with the situation where:

- two or more access seekers wish to gain access to network access services; and
- there is insufficient spare network capacity to provide the full level of requested network access services to both access seekers.

6.107 Clause 18(1) of the Code provides that, in these circumstances, the network provider may assign the available capacity to the first access seeker who enters into an access agreement with the network provider. This may not be an appropriate way of dealing with this issue, for two reasons.

- This requirement will operate to encourage access seekers to agree to a network provider's access offer without negotiation in order to secure the available capacity ahead of another access seeker. In the absence of a mandated form of default access agreement, this may result in access agreements which are overly favourable to the network provider. It also exposes the network provider to potential claims of bias where negotiations are occurring with two or more access seekers at the same time.
- Clause 18(1) of the Code applies to all access seekers in the same way. This ignores the issues raised above concerning the nature of the network access services provided to generators, end-use customers, retailers and other network providers.

6.108 Clause 18 of the Code also raises issues concerning what is generally known as 'firm capacity' rights. For example, under the NEC, a generator is usually only provided with entry services (i.e., the capability of the connection assets at the entry point to receive electricity from the generator). In addition, a generator is entitled to negotiate for the provision of generator access services and/or generator transmission use-of-system services.

6.109 In both cases, the network provider is required to negotiate in good faith concerning the terms upon which these additional services may be provided. These terms would usually include an agreement relating to the augmentation or extension of the relevant network in order to provide the generator with the required level of access to the network.

6.110 In addition, the network provider would usually require any generator seeking firm access to the network to agree to compensate any other generator who is unable to gain access to the network as a result of the provision of that level of firm access.

6.111 In other words, generators usually do not have firm access rights and those that do have firm access rights are required to compensate those generators who are unable to access the network as a result of those firm access rights.

6.112 The Commission is unaware of any situation under the NEM where a generator has requested a level of generator access or generator network use-of-system services. Rather, generators simply contract for the provision of entry services on the basis that there is sufficient spare network capacity in the network to allow them to export up to their declared sent out capacity in most circumstances.

6.113 In the NEM, if a 100MW generator was connected to a 100MW radial line and another 100MW generator wanted to also establish a connection to that 100MW line, in the absence of any firm access arrangements with respect to the existing generator, the network provider could not refuse to connect the new generator under the NEC.

6.114 If both generators were connected, the limit on the capacity of the radial line would be taken into account by NEMMCO in calculating its constraint equations for that portion of the network. These constraint equations would then be factored into the dispatch process so that the generators would be dispatched in accordance with their bids up the level of the constraint (i.e., if one generator was to bid in its full 100MW at a lower price that the other generator it would be dispatched ahead of that other generator).

6.115 Different arrangements would apply in relation to retailers and end-use customers. For example, use-of-system agreements with retailers do not usually deal with issues relating to spare network capacity. Rather, any limitation on the capacity of the network will be taken into account either via the normal network planning process (i.e., the obligation to design the electricity network in order to accommodate forecasted increases in demand) or by way of a requirement imposed upon the end-use customer to extend or augment the electricity network (and make an appropriate capital contribution towards that augmentation or extension).

6.116 The Commission acknowledges that is a very complex issue, one that continues to be the subject of a great deal of debate within the NEM. This report is not the place to go into all the associated details. However, what is certain is that clause 18(1) of the Code adopts a simplistic approach to this issue which is not reflected in the NEC. In addition, it is unclear what is meant by the wording of clause 18(2) (particularly in view of the fact that the terms 'capacity', 'contestable loads' and 'associated end-use customer' are not defined in clause 3 of the Code).

6.117 This issue is critical to new entrants, and combined with the issues concerning existing contractual entitlements referred to below, could provide a significant barrier to entry.

Recommendation (40) Further consideration should be given to the arrangement applying in clause 18 of the Code for assigning available network capacity between competing access applications.

Existing contractual entitlements

6.118 The rights of network users under existing access agreements or awards are dealt with in a number of different clauses of the Code.

Nature of Power and Water Generation's and Power and Water Retail's existing rights

6.119 Chapter 2 of the Code only applies to access rights granted to third parties (and not to any access rights granted to Power and Water Generation or Power and Water Retail by Power and Water Network).

6.120 As a result, Power and Water Generation and Power and Water Retail cannot be respondents to an access application for the purpose of clause 10(6) of the Code. Among other things, this raises the question as to whether Power and Water Networks is entitled to notify Power and Water Retail or Power and Water Generation that it has received an access application (in view of the fact that neither of these business units

has existing access agreements which could be affected by the implementation of an access application).

6.121 If Power and Water Retail and Power and Water Generation do not have any rights under an existing access agreement (which must currently be the case), it is difficult to see how their use of the current network access services provided by Power and Water Networks will be taken into account in the negotiation process, and, in particular, under clause 18(1) of the Code.

Existing rights under the NEC and effective access regimes

6.122 Subject to the jurisdiction-specific derogations set out in chapter 9 of the NEC, the provisions of chapter 5 and chapter 6 of the NEC do not confer any special rights upon existing network users as compared to future network users (other than the limited firm access rights applying to generators and market network providers under the NEC).

6.123 This is consistent with the NEM arrangements that balance supply and demand using the spot market and dispatch processes. In other words, in the absence of firm access rights (and associated compensation obligations), existing network users have no guaranteed firm access rights to use the transmission or distribution network.

6.124 Network users are entitled to exclusive access to connection assets for which they are paying 100% of the associated costs. However, it is not possible to 'book up' the entire available capacity of a particular network without using that full capacity and compensating other network users who are unable to use that network capacity.

6.125 This can be contrasted to the specific requirements of clause 6 of the CPA (and repeated in clauses 2(2)(d) and (e) of the Code). In particular, clause 6(4)(i), (iv) and (v) of the CPA specifically refer to the 'interests of persons holding contracts for the use of facility' and 'firm and binding contractual obligations of the owner or other persons already using the facility'.

6.126 While it is appropriate that the rights under existing access agreements are grandfathered in order to avoid the situation where Power and Water could be in breach of an existing access agreement as a result of having to grant access in accordance with the Code to an access seeker in the future, the Commission considers that the preservation of existing rights beyond the grandfathered date (and the granting of firm access rights in the future) without an associated compensation obligation could operate to 'lock out' new generators and retailers.

6.127 The Commission notes that this issue could be avoided if a network provider did not enter into an access agreement which conferred firm access rights on a network user without an associated compensation provision or a specific right to modify those firm access rights to accommodate subsequent network users. This concept is reflected in part in clauses 52(3)(e) and 56(1) of the Code.

Clause 12(2)

6.128 This clause refers to not only a respondent's existing rights of access, but also 'prospective rights of access'. This differs from the wording used in clauses 10(5)(a)(ii), 10(6)(b) and 17 of the Code. A concern arises if this was interpreted to suggest that an existing network user could be granted a pre-emptive right to use future spare network capacity (thereby denying a new entrant the opportunity to use that spare network capacity).

Recommendation (41) Further consideration should be given to clarifying the rights of network users under existing access agreements as currently defined in chapter 2 of the Code.

Financial guarantees

6.129 The requirement in clause 19(3)(c) of the Code to provide a financial guarantee, while consistent with the NEC and the requirements applying in Victoria with respect to the default use-of-system agreement, raises competitive neutrality issues. That is, an access seeker will be required to provide a financial guarantee and pay the costs of providing and maintaining that financial guarantee, whereas Power and Water Generation and Power and Water Retail will not be required to provide a financial guarantee or incur these costs because they are part of the same entity.

6.130 This issue was considered at length with respect to the Victorian default use-of-system agreement. In the end, the Essential Services Commission concluded that the requirement to provide a financial guarantee should apply.

6.131 However, the Commission considers it appropriate that it have some input into the circumstances in which a financial guarantee should be applied (and the terms relating to the provision of that financial guarantee) in order to ensure that this does not create an unnecessary barrier to entry for new retailers and generators.

Recommendation (42) Clause 19(3) of the Code should be amended to provide for the regulator to have a role in establishing the circumstances in which a financial guarantee should be applied (and the terms relating to the provision of that financial guarantee).

Definitions

6.132 The Commission's legal advisers have identified a number of other deficiencies in relation to the definitions set out in clause 3 of the Code as they relate to Part 2.

6.133 While some of these deficiencies reflect problems with the corresponding operative provisions of the Code, and are therefore more appropriately dealt with in discussion of those operative provisions, some of the more general deficiencies are highlighted in the following paragraphs.

6.134 While the Territory's access regime cannot and should not directly mirror the NEC, the Commission acknowledges that definitions used in the Code should be consistent with the definitions used in the NEC where that is reasonably possible. Unlike the Code, the NEC is constantly being applied by network providers and network users within the NEM jurisdictions. In addition, the access provisions of the NEC are under constant review and are regularly updated to reflect the outcomes of that review process and the experience gained within the NEM. The process of applying and interpreting the Code will be made easier if the Code adopts consistent definitions and procedures in areas where the particular requirements of the Territory's electricity supply industry do not require alternative definitions or procedures.

No definition section in the Act

6.135 There is currently no definition section in the Act. In particular, while the Act refers to the Code, it does not contain a provision to the effect that words and expressions used in the Act will have the same meaning when used in the Code.

All definitions should appear in the same place

6.136 For example, the definition currently contained in clause 1(4) of the Code should be moved to clause 3 of the Code.

Access to services not networks

6.137 The definition of 'Access Agreement' refers to the provision of network access services. This is correct and reflects the fact that Part IIIA of the TPA and clause 6 of

the CPA deal with access to services provided by facilities rather than to the facilities themselves.

6.138 However, this concept is not consistently applied throughout the Code. For example:

- clause 1(1) of the Code states that the Code deals with 'access to those electricity networks in the Territory as are prescribed under section 5 of the Act'.
- the term 'network provider' rather than the NEC term 'network service provider' is used in the Code.

6.139 This distinction can be critical in determining the scope of an access seeker's rights with respect to the network provider's electricity network. For example, a right to gain access to the services provided by an electricity network would not entitle the access seeker to gain physical access to the electricity network for the purposes of installing its own equipment within that electricity network.

6.140 The Code should not deal with access to electricity networks. Rather, it should deal with access to the services provided by those electricity networks.

Definitions should be consistently applied

6.141 In general terms, the Code does not use the defined terms in a consistent manner. This leads to ambiguity and confusion in a number of areas. In a number of clauses, conflicting terms or non-defined terms are used when defined terms exist under clause 3 of the Code.

Incorrect definitions used in clause 10(3)

6.142 The term 'network infrastructure facilities' used in clause 10(3) of the Code is not defined. The term 'network system assets' should be used.

6.143 In addition, the term 'connection assets' should be used instead of 'connection point' because a connection point is simply the point at which the electricity network physically connects to someone else's electricity infrastructure.

Schedule 2 issues

6.144 Schedule 2 to the Code requires certain information to be included in an access application. However:

- there is no reference to the capacity of the network system assets in paragraph (c);
- the term 'maximum demand' used in paragraph (h) is not defined – presumably this should be a reference to 'contract maximum demand';
- it is unclear what is meant by paragraph (j), as this information will already be covered by paragraphs (g) and (h); and
- paragraph (n) refers to any 'disturbing load', which is not defined in clause 3 of the Code.

Recommendation (43) Clause 3 (and associated clauses) of the Code should be amended to address the definitional anomalies identified by the Commission's legal advisers.

Drafting anomalies in chapter 2 of the Code

6.145 The Commission's legal advisers have identified a number of deficiencies in relation to the drafting of chapter 2 of the Code.

6.146 Clause 11(1) of the Code requires the network provider to comply with different time periods with respect to existing end-use customers and new end-use customers. This clause does not specify a time period for access applications by retailers, generators or new network providers.

6.147 Clause 14 of the Code should apply in a reciprocal manner to the network provider and any respondent.

6.148 Clause 16(1) of the Code does not identify a date from which the 30 day period will commence to run.

6.149 Clause 16(2) of the Code should include a general obligation on the network provider to ensure that the access offer is fair and reasonable. This is the approach adopted under the NEC and the Victorian regulatory arrangements.

6.150 Clause 16(2) of the Code should not be an exclusive list of the matters required to be covered in an access offer. For example, the terms of the preliminary assessment issued under clause 15 may need to be incorporated within an access offer. Alternatively, clause 16(2)(a) may not be relevant to all access applications.

6.151 There are also a number of definitional problems with clause 16(2) of the Code (e.g., which 'technical code'?, what is an 'inter-network access request'?, what is meant by the obligation in clause 16(2)(g)).

6.152 Clause 16(3) of the Code is strangely worded. It is difficult to see how negotiations can be completed without an agreement being entered into.

6.153 The conditions precedent set out in clause 19(3) of the Code should form part of any access offer or access agreement.

6.154 Clause 20 of the Code should also apply to access seekers. The test set out in clause 21(3) is fairly imprecise.

6.155 While the requirement in clause 22 of the Code appears reasonable, it will result in access seekers incurring a cost in excess of the costs incurred by Power and Water Generation and Power and Water Retail.

Recommendation (44) Part 2 of the Code should be amended to address the drafting anomalies identified by the Commission's legal advisers.

CHAPTER

7

ACCESS PRICE REGULATION

Introduction

7.1 Part 3 of the Code specifies the price control framework to be observed by the Commission and by providers of both network access services and out-of-balance energy when setting the prices to be paid by network users for the conveyance of electricity through the electricity network.

Why regulate access prices?

7.2 The Hilmer Report urged the avoidance, where possible, of 'conventional' price controls:

> *"Since price control never solves the underlying problem it should be seen as a 'last resort'."*[19]

7.3 Conceptually, 'conventional' price controls can take various forms, including price or revenue caps applying to baskets of items, or controls on the price of individual services. They can be related directly to production costs or, alternatively, linked to some sort of productivity benchmark.

7.4 As a practical matter, the pricing of regulated access is perhaps the most contentious issue in the area of access regulation. As the NCC has argued:

> *"The Australian experience with price control … [highlights that] the control of utility prices to final consumers is inherently a highly politicised process, which is rarely likely to lead to outcomes consistent with efficiency principles. Additionally, the approach seems to seriously under-estimate the difficulties inherent in going from a given final price, even if efficiently set, to the determination of appropriate charges for the supply of the intermediate inputs (such as access)."* [20]

7.5 In an access context, price controls can lessen the scope for a network provider and access seekers to negotiate a price for access. Indeed, at the extreme, where the price of an individual access service is set ("posted"), all scope for negotiation on price (as distinct from conditions) is removed.

7.6 While some sort of access rule or obligation to supply will almost always be required to complement a conventional price control approach, some have argued that a negotiate-arbitrate approach does not necessarily require price regulation.

Views in submissions

7.7 Power and Water argued in support of existing arrangements, stating that:

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[19] Hilmer Report, p.271.

[20] NCC Submission, p.26.

" the regulatory framework presently in place provides a more rigorous and transparent approach to balancing the public and Power and Water's legitimate business interests than would be applied simply by shareholder intervention. Accordingly, Power and Water support the continuation of the existing price monitoring, determination and approval framework." (p.24)

7.8 NT Treasury argued that:

"Government ownership should not be a consideration. Arms length price control is supported. An obligation to provide access in the absence of price controls leaves the network provider to operate above appropriate levels. The reference tariff and revenue cap should be high enough to allow the network provider to achieve appropriate return." (pp.4-5)

Commission's analysis and conclusions

7.9 The Commission agrees with the submitted views that the current regulatory framework provides a more rigorous and transparent method for determining prices than direct government intervention (particularly in view of the history of the development of prices in the Territory prior to the commencement of the Code), as well as being consistent with other jurisdictions.

Recommendation (45) The network price control framework provided for in Part 3 of the Code – involving an independent regulator – should be retained.

Pricing principles

7.10 Chapter 5 of the Code sets out broad pricing principles to be followed by the Commission and by service providers when setting access prices.

7.11 Essentially, the Code provides that the prices that network providers charge retailers, generators or individual contestable customers for use of the network are to be regulated by:

- determining an annual cap or limit on total revenue, sufficient to enable an efficient supplier of regulated services to raise sufficient revenue to meet its operating costs, to finance necessary new investment and to provide an adequate return on past investment efficiently undertaken; and
- within limits imposed by the revenue cap, ensuring that (maximum) network tariffs are structured so as to be cost-reflective and non-discriminatory.

7.12 Clause 63 of the Code states that access price regulation must be administered to achieve the following outcomes:

"(a) efficient costs of supply;

(b) prevention of monopoly rent extraction by the network provider;

(c) promotion of competition in upstream and downstream markets and promotion of competition in the provision of network services where economically feasible;

(d) an efficient and cost-effective regulatory environment;

(e) regulatory accountability through transparency and public disclosure of regulatory processes and the basis of regulatory decisions;

(f) reasonable certainty and consistency over time of the outcomes of regulatory processes; and

(g) an acceptable balancing of the interests of the network provider, network users and the public interest."

7.13 These criteria involve a balancing of interests.

7.14 The difficulties associated with access pricing were recognised in the Hilmer Report:

> *"Neither the application of economic theory nor general notions of fairness provide a clear answer as to the appropriate access fee in all circumstances. Policy judgments are involved as to where to strike the balance between the owner's interest in receiving a high price, including monopoly rents that might otherwise be obtainable, and the user's interest in paying a low price, perhaps limited to the marginal costs associated with providing access. Appropriate access prices may depend on factors such as the extent the facility's existing capacity is being used, firmly planned future utilisation and the extent to which the capital costs of producing the facility have already been recovered. Decisions in this area also need to take account of the impact of prices on the incentives to produce and maintain facilities and the important signalling effect of higher returns in encouraging technical innovation. For example, relatively low access prices might contribute to an efficient allocation of resources in the short term, but in the longer term the reduced profit incentives might impede technical innovation."* [21]

7.15 The Hilmer Report considered two possible responses for regulating access pricing:

> *"*
> - *the entrusting of a broad discretion to an independent regulator, leaving the regulator to decide where the balance should be drawn in particular circumstances, perhaps guided by broad and general guidelines as to the factors to be taken into account; or*
> - *requiring the relevant Minister to stipulate more specific pricing principles in the context of declaring a right of access to particular facilities. Such principles would guide commercial negotiations and, if either party could not agree on an access price, the opportunity for arbitration could be provided."*[22]

7.16 The Hilmer Report favoured the second approach:

> *"... under which the key policy issues relating to pricing principles are more transparent*
>
> *... Once principles are in place the parties have a greater degree of certainty over their respective rights and obligations. This approach is also less interventionist than regulated outcomes and should facilitate the evolution of more market-oriented solutions over time."*[23]

7.17 For its part, the Productivity Commission Review more recently concluded that:

> *"... a key role of pricing principles is not so much to prescribe what should happen in a particular situation, but to rule out approaches and methodologies which would be inappropriate. More generally, even pricing principles which signal that a particular outcome could fall within a wide band provide, at least tacitly, some discipline on regulators to justify the outcome of a particular determination. For example, transparent pricing principles might allay concerns that a regulator will simply bring its own values to bear when setting the terms and conditions of access."*[24]

7.18 Clearly articulated pricing objectives can reduce the scope for ambiguity and regulatory error, ensure consistency in regulatory decisions and assist regulators to reach outcomes consistent with the government's policy goals.

7.19 Counter-balancing these views is the possibility that objectives which are too restrictive may inhibit a regulator's ability to adapt to changing circumstances and to take account of continued improvements in regulatory best practice. Regulators also need a degree of flexibility to enable them to make appropriate decisions when issues arise that may not have been foreseen in the policy and design stages of setting up the regulatory regime.

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[21] Hilmer Report, p.253.

[22] Hilmer Report, p.255.

[23] Hilmer Report, p.255.

[24] Productivity Commission Review, p.142.

Views in submissions

7.20 On the matter as to whether the objectives of price regulation set out in the Code are appropriate, Power and Water argued that these objectives were broadly appropriate.

7.21 Power and Water's concern mainly was with the interpretation of these objectives. Power and Water noted the need for careful interpretation, arguing that:

> *"Unfortunately, a number of regulators have taken sections (a) and (b) in particular to mean that their task is to try to ensure that prices are consistent with those that would be found in a perfectly competitive market.*
>
> *This has led to an approach to regulation that focuses on the elimination of perceived monopoly rents and an inevitably intrusive approach to regulation. A more realistic objective would be to try to mimic the outcomes or incentives that could be expected in a workably competitive market." (p.25)*

7.22 Power and Water further argued that references to efficient cost, competitive markets and prevention of monopoly rents should be judged by reference to a workably competitive market, rather than by reference to a perfectly competitive market, quoting from an acknowledged expert in the area as follows:

> *"The hallmark of a workably competitive market is flexibility and independence in decision making, with no coercion, and freedom to choose on the part of both producers and consumers. This should be the implicit goal in theory of any regulatory scheme, but it is one that has in practice been subverted by a misguided application of perfect competition theory in the search for computational specificity and regulatory objectivity."*[25]

7.23 NT Treasury drew on the Commonwealth Government's response to the Productivity Commission Review, supporting similar modifications to the pricing principles in the Code to explicitly take long-run costs of providing access into account. NT Treasury advised that these are:

> *"(a) that regulated access prices should:*
>
> *(i) be set so as to generate expected revenue for a regulated service or services that is at least sufficient to meet the efficient* ***long-run*** *costs of providing access to the regulated service or services; and include a return on investment commensurate with the regulatory and commercial risks involved.*
>
> *(b) that the access price structures should:*
>
> *(i) allow multi-part pricing and price discrimination when it aids efficiency; and*
>
> *(ii) not allow a vertically integrated access provider to set terms and conditions that discriminate in favour of its downstream operations, except to the extent that the cost of providing access to other operators is higher.*
>
> *(c) that access pricing regimes should provide incentives to reduce costs or otherwise improve productivity." (p.5)*

7.24 On the matter as to whether the Code's pricing principles should provide guidance as to the relative weights to be accorded to what can often be conflicting objectives, both Power and Water and NT Treasury supported leaving the balancing of conflicting objectives to the regulator.

7.25 NT Treasury slightly qualified this support by suggesting that the regulator should be required to provide justification for any adopted weightings.

7.26 Power and Water also noted the difficulty involved in balancing the competing interests of all the parties involved in the access process, advocating a pragmatic approach and submitting that:

> *"In particular, the choice between highly prescriptive and inflexible principles and an element of regulatory judgement is important considering the relative immaturity of the competitive NT electricity market and the NT access regime.*

[25] Professor David Round, "Commentary on proposed price-service offering approach to regulation by Energex", 20 December 2002, p.2.

Regulatory flexibility is crucial to the development of an evolving regulatory framework. In this context, greater prescription in relation to pricing principles may solve 'problems' that have not yet arisen and may never arise." (p.26)

Commission's analysis and conclusions

Clause 63 pricing principles

7.27 Clause 63 of the Code currently sets out an exclusive list of the outcomes which must be achieved when exercising the Commission's price regulation power. In the Commission's view (consistent with the extension of the rights of appeal), consideration should be given to including an additional paragraph referring to such other outcomes as the Commission determines are consistent with the general objects.

7.28 The Commission accepts that clause 63 should also be amended to explicitly take long-run costs of providing access into account along lines similar to that proposed in the Commonwealth Government's response to the Productivity Commission Review.

Recommendation (46) Clause 63 of the Code should be amended to include an additional paragraph referring to such other outcomes as the regulator determines are consistent with the general objects of the Code.

Recommendation (47) Clause 63 of the Code should be amended to explicitly include in the pricing principles that long-run costs of providing access should be taken into account, consistent with the Commonwealth Government's response to the Productivity Commission Review.

Definitional issues

7.29 The Commission's legal advisers have noted some possible deficiencies in the drafting of chapter 5 of the Code.

7.30 Clause 60(1) of the Code suggests that the principles set out in Part 3 only relate to the setting of regulated prices for the conveyance of electricity through an electricity network covered by the Code. The term 'regulated price' is not defined in clause 3 of the Code. Rather, the term 'regulated network access services' is defined. It would be preferable for this term to be used in clause 60(1) because it covers all types of network access services supplied by a network provider (and is not limited to the conveyance of electricity through an electricity network).

7.31 Another source of this confusion may be clause 61(2)(b) of the Code that refers to a network. The term 'network' is not defined in clause 3 of the Code. This is particularly relevant given the distinction between network system assets and connection assets and the use of the term 'electricity network' to refer to both connection assets and network system assets operated by the same network provider.

Recommendation (48) Chapter 5 of the Code should be amended to address the definitional anomalies identified by the Commission's legal advisers.

Network revenue caps

7.32 Chapter 6 of the Code sets out the approach that the Commission is to use to determine the network provider's annual network revenue cap.

7.33 A 'revenue cap' establishes the maximum allowed revenue determined by the Commission to be raised during a financial year, or nominated part of a year, from included network access services by the network provider.

7.34 Essentially, clause 69 of the Code provides for the revenue cap in the first year of a regulatory period to be set by the Commission in order:

> *"…to provide a fair and reasonable risk-adjusted rate of return to the network provider on efficient investment given efficient operating and maintenance practices on the part of the network provider..."*

In this respect, schedules 6 and 8 to the Code provide important guidance to the Commission, where:

- Schedule 6 provides that an accrual 'building blocks approach' be used, being a summation of a return on capital, return of capital (depreciation) and a return of efficient non-capital costs; and
- Schedule 8 specifies the methodology to be used to determine the weighted average cost of capital ("WACC") to be applied in calculating the return on capital.

7.35 Clause 70 of the Code requires the Commission to roll forward the annual revenue cap over the second and remaining years of a regulatory control period using a 'CPI-X' adjustment, where:

- Schedule 9 details the manner in which revenue caps for subsequent years of the regulatory period are to be established (by escalating the preceding year in line with CPI less an efficiency gains ("X") factor); and
- Schedule 10 specifies the factors to be taken into account and the methodology to be used in determining the X factor.

7.36 Clause 72 of the Code makes reference to 'excluded services', being those services for which the associated costs and revenue are to be excluded from the revenue cap. In particular, clause 72(2) states that:

> *"Excluded network access services relate to services –*
>
> *(a) the supply of which, in the assessment of the regulator, is subject to effective competition; and*
>
> *(b) the cost of which, in the assessment of the regulator, can be satisfactorily excluded from the cost base (including all asset-related costs) used for the purpose of calculating the revenue cap applying to regulated network access services."*

Scope of the revenue cap

7.37 Essentially, Power and Water's network business provides services that can be grouped into three broad categories:

- services which are subject to the revenue cap;
- services which may be subject to regulation, but are not included in the revenue cap; and
- non-regulated services.

7.38 By contrast, the Code (especially clause 72) only recognises two groups of services. In some senses, the Code may not distinguish sufficiently between services that deserve to be regulated by means other than a revenue cap and services which need not be regulated at all.

Views in submissions

7.39 Neither Power and Water nor NT Treasury advocated any change to the Code with respect to excluded services.

7.40 Power and Water argued that:

> *"Clause 72 provides that excluded services are services which the Regulator assesses to be subject to effective competition. This is less information than is provided in the NEC, which lists examples of services that could be 'excluded', however this is considered appropriate on the basis that workable competition in the NT market needs to be assessed on a case by case basis." (p.26)*

Commission's analysis and conclusions

7.41 The Commission is aware that there has been a great deal of confusion in the NEM in relation to which network access services are prescribed services as compared to excluded services. This lack of clarity is critical to access seekers because the classification of network access services as prescribed or excluded determines the form of price regulation applying to those services.

7.42 The same confusion exists in clauses 67 and 72 of the Code. In general terms, regulated network access services should include all services provided by a network provider other than those that are specifically excluded by the Commission pursuant to clause 72.

7.43 In turn, a distinction should be made between:

- those regulated network access services which are capable of being regulated via the general price controls provided for in chapters 6 and 7 of the Code; and
- those regulated network access services which, in the regulator's opinion, do not lend themselves to be regulated via the general price controls provided for in chapters 6 and 7 of the Code, but for which the requirement must be for a network provider to provide such network access services to access seekers on fair and reasonable terms.

7.44 Network providers are able to provide a number of ancillary services that are critical to access seekers but which are not subject to effective competition. In these circumstances, the same 'monopoly service provider' concerns arise as apply to regulated network access services.

Recommendation (49) Clause 72(2)(b) of the Code should be amended to provide for a class of 'excluded services' that, because in the regulator's opinion such services are both not subject to effective competition and do not lend themselves to be regulated via the general price controls provided for in chapters 6 and 7 of the Code, are to be provided to network users on fair and reasonable terms as approved by the regulator.

Length of regulatory periods

7.45 Under clause 3 of the Code, the 'regulatory control period' is defined to mean the period between major price reviews during which time the methodology used in setting prices is held constant. Specifically, the first regulatory control period is the period between commencement of the Code and 30 June 2003 and the second regulatory control period is "expected to be" the period between 1 July 2003 and 30 June 2008.

7.46 The Commission intends to seek Ministerial agreement to extend the first regulatory period through to 30 June 2004, on the grounds that this will enable the Ministerial review of the Code to be completed and any changes to the Code put into effect in advance of the regulatory processes that need to take place prior to a new regulatory period. The way the Code stands at the moment, there is a prospect that any changes to the Code as a result of the Ministerial review may either not have effect until the third regulatory period or result in the truncation of the second regulatory period. A one year's delay in the second regulatory period seems more sensible all around.

7.47 The presumption in the Code is that, in future, regulatory periods should be five years in length. This is the term typical in other jurisdictions.

Views in submissions

7.48 Neither Power and Water nor NT Treasury advocated any change to the five-year regulatory control periods currently specified in the Code, with Power and Water pointing out that this was consistent with current practice in other jurisdictions and industries.

7.49 Power and Water also argued in support of the Commission's stated intention to seek an extension of the first regulatory control period to 30 June 2004, submitting that:

> *"While the need to extend the revenue control period is supported, Power and Water notes that there is significant preparatory work and cost required in a revenue reset. Many staff are required to be taken 'off line' and engaged full-time in the engineering, planning, modelling and price setting. In order to ensure that the revenue reset process operates smoothly, and that full consideration can be given to all aspects of the review submission, Power and Water will require at least 6 months to prepare the submission following the finalisation of the Code." (p.27)*

Commission's analysis and conclusions

7.50 In the absence of any opposing views from the respondents, and in view of the fact that a five year regulatory control period has been adopted in relation to most network pricing orders in other jurisdictions to date, the Commission agrees that this remains appropriate for the Territory access regime.

Recommendation (50) The definition of 'regulatory control period' in clause 3 of the Code should be amended to remove any doubt that such periods in future are to be five years in length.

What approach for the second regulatory period?

7.51 Schedules 6, 8 and 9 to the Code allow methodologies in subsequent regulatory periods to be determined by the Commission, taking into account measurement and definitional conventions generally accepted at that time.

Building blocks approach

7.52 The revenue cap is based on the so-called building blocks approach, where the revenue that a firm may earn is directly related to the costs it can be expected to incur in providing its services in an efficient manner.

7.53 The capped amount for each year is set by building up the cost-base for the facility from its individual components. The cost-base generally includes: return on capital, depreciation and operating expenses. To obtain these values, the Commission requires information on the asset base of the facility, expected capital expenditure, the weighted average cost of capital for the business and efficient operating and maintenance costs. Since caps are set for future years, forecasts of each of these elements are required as well as forecasts of likely inflation.

7.54 The advantage of the building blocks approach is that the necessary information is readily available (being based on the network provider's actual capital base and estimates of future capital expenditure and operating costs extrapolated from historical data), and is seen to be objective and transparent.

7.55 The main areas of criticism of the building block methodology are:

- it is considered information intensive and intrusive; and
- the need to forecast future costs and validate proposed capital expenditure can lead to a regulator having significant influence over the running of the business.

Industry-wide efficiency gains approach

7.56 An alternative approach is to allow prices or revenue to rise by CPI less an efficiency gains (or productivity) factor determined by reference to the industry or economy as a whole, rather than the individual firm. Under this approach, if a firm performs better than the 'average' for the industry, it retains some or all of the gains, whereas if its costs are higher than average it will be penalised. This can provide powerful incentives for firms to improve their performance.

7.57 The measure generally used is the total factor productivity (TFP) for the industry, although measures can also be derived from data envelop analysis (DEA) or based on best-practice benchmarking.

7.58 In exploring these alternatives to the building blocks approach, the Productivity Commission Review has noted the following:

> *"Yet, while productivity-based approaches are clearly feasible, like all forms of price control, they are far from perfect:*
>
> - *developing robust productivity benchmarks is not costless;*
> - *there will always be scope for dispute as to whether the results of a TFP or benchmarking exercise are applicable in a given situation; and*
> - *they appear to be less precise than cost-based approaches and, in the short-term, may not align prices as closely with costs."*[26]

7.59 In light of these issues, the Utility Regulators' Forum commissioned a study to examine the relative merits of building blocks and productivity-based approaches to regulation of monopoly prices. The study concluded that:

- there is no single best approach, with the choice of approach to regulation depending on environmental factors and objectives;
- if priority objectives are to promote productive and dynamic efficiency by mimicking competition and to reduce regulatory costs, then further consideration of a TFP-based approach is warranted; and
- if the priority is static efficiency and reduction in risks, a building blocks approach may be best.[27]

Views in submissions

7.60 Power and Water argued for a relaxation of the Code to allow alternative approaches to be considered, although evincing some doubt as to whether the Code truly 'locked in' the building blocks approach.

> *"The building block approach has been widely adopted by regulators to assess revenue requirements in the Australian gas and electricity industry. However, the building block approach is a highly intrusive form of regulation. It focuses more on returning investors the cost of their outlays than providing incentives for investment and the cost efficient delivery of improved customer outcomes.*
>
> *This notwithstanding, Power and Water would not support a new approach so close to the next regulatory price reset. With no competition in the market, and an established model already in use by Power and Water and the Regulator, it would be difficult to demonstrate significant benefits from change." (pp.27-28)*

7.61 Power and Water also argued that adoption of any alternative methodology should be determined among the parties concerned in light of further analysis of the costs and benefits of the available approaches in the Territory context.

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[26] Productivity Commission Review, p.344.

[27] Farrier Swier Consulting, *Comparison of Building Blocks and Index-based Approaches*, Utility Regulators' Forum, June 2002. Available on the ACCC website (www.accc.gov.au/utipubreg/pubreg.htm).

7.62 NT Treasury argued that:

> *"…it seems more appropriate that the regulator determine the relative importance and form of various efficiency and productivity measures that are used in the regulation of network prices*
>
> *…Consideration of a total factor productivity measure appears appropriate in addition to regulation based on the building blocks approach based on the objectives of mimicking competition and reduction in regulatory costs." (pp.5,6)*

Commission's analysis and conclusions

7.63 While Power and Water may be right in that under a strict interpretation the Code does not 'lock in' a building blocks approach, the Commission is concerned that aspects of the drafting of Part 3 of the Code (and associated Schedules) may unintentionally have this effect.

7.64 At the very least, schedule 10 needs to be amended to include the same clause 1A that is in schedules 6 and 9, allowing:

> *"The methodology for determining revenue caps in subsequent regulatory control periods is to be determined by the regulator, taking into account measurement and definitional conventions generally accepted at the time"*

7.65 In addition, it seems a bit pointless to leave schedules in the Code that refer to what must be done in the first regulatory control period, when to all intents and purposes the first regulatory control period is over, unless of course they are intended to in some way bind the regulator in subsequent periods.

Recommendation (51) Part 3 of the Code (and associated Schedules) should be amended where applicable to remove any doubt that the price control methodology to be used in the second and subsequent regulatory periods is to be determined by the regulator, in consultation with interested parties, in accordance with generally accepted regulatory best practice current at the time.

Recommendation (52) Consideration should be given to deleting – at the appropriate time – those sections of Part 3 of the Code that refer exclusively to the price control methodology to be used in the first regulatory period.

A definitional anomalies

7.66 The definition of 'regulated network access services' currently covers all network access services other than those specified under clause 72 of the Code (i.e., this definition extends to cover both connection services and use of network services). The Commission's legal advisers have noted that, given this fact, it is uncertain why clause 67(2) of the Code appears to further limit what is covered by the term 'regulated network access services'. In particular, the matters listed in paragraphs (a) – (c) do not appear to cover connection services or the more general use of network services usually covered by the definition of 'common services' under the NEC. Hence, there may be grounds for deleting clause 67(2).

Recommendation (53) Clause 67(2) of the Code should be deleted to address the definitional anomalies identified by the Commission's legal advisers.

Network tariffs

7.67 Chapter 7 of the Code regulates the structure and level of individual network tariffs within the revenue cap established under chapter 6.

7.68 Clause 73 of the Code provides that regulated tariffs are to be 'reference tariffs', which specify the *maximum* tariff to apply in a particular year with respect to a specific individual standard network access service. 'Standard network access services' mean the network access services for which reference tariffs are published in respect of a financial year.

Objectives of network tariffs

7.69 Clause 74 of the Code sets out the objectives of network tariffs as follows:

> *"The reference tariffs are –*
>
> *(a) to reflect efficient costs of supply;*
>
> *(b) to involve a common approach for all network users, with the actual tariff with respect to a particular network access service only differing between users because of –*
>
> *(i) the user's geographical and electrical location;*
>
> *(ii) the quantities in which the relevant network access service is to be supplied or is supplied;*
>
> *(iii) the pattern of network usage;*
>
> *(iv) the technical characteristics or requirements of the user's load or generation;*
>
> *(v) the nature of the plant or equipment required to provide the network access service; and*
>
> *(vi) the periods for which the network access service is expected to be supplied;*
>
> *(c) to be transparent and published in order to provide pricing signals to network users;*
>
> *(d) to promote price stability; and*
>
> *(e) to reflect a balancing of the quest for detail against the administrative costs of doing so which would be passed through to end-use customers."*

Views in submissions

7.70 Power and Water argued that it was unaware of any conflicts between the clause 74 objectives and the chapter 5 pricing principles.

7.71 NT Treasury argued that:

> *"The differences reflect the objectives to be followed by the regulator and network provider and do not appear to be inconsistent." (p.6)*

Commission's analysis and conclusions

7.72 Clause 73(1) of the Code requires that the reference tariffs for standard network access services be determined and published annually by the network provider in accordance with the principles set out in chapter 7 of the Code.

7.73 This process is overseen by the Commission in the manner set out in clause 75(6) of the Code (i.e., the Commission is required to approve the statement of principles and methods to be used for defining the individual standard network access services to be supplied by the network provider and for establishing the reference tariff to apply those services if in the Commission's opinion that statement is consistent with the principles set out in clause 74).

7.74 On the other hand, chapter 5 of Part 3 of the Code imposes a general obligation upon the Commission to administer Part 3 so as to achieve the nominated outcomes.

7.75 It is possible for a conflict to arise between these two obligations imposed upon the Commission. For example, the Commission must approve a statement if it is consistent with the principles set out in clause 74 of the Code. However, the Commission is also required when exercising its power under clause 75(6) to seek to achieve the outcomes set out in clause 63.

7.76 In the event of any conflict, the Commission considers that clause 63 of the Code would prevail over clause 74.

Recommendation (54) The objectives of network pricing stated in clause 74 of the Code should be retained in their present form.

Recommendation (55) Clause 74 of the Code should be amended to provide that, in the event of any conflict with the clause 63 pricing principles, the clause 63 principles will prevail.

Structure of regulated network prices

7.77 Clause 75(2) of the Code sets out the categories by which the network provider may distinguish tariffs and charges for standard network access services:

(a) entry services that include the asset-related costs and services provided to serve a generator user at its connection point;

(b) exit services that include the asset-related costs and services provided to serve a load user at its connection point;

(c) common services that include the asset-related costs and services that ensure the integrity of the network and benefit all network users and cannot be allocated on the basis of voltage levels or location; and

(d) use of network services that include the network shared by generator users and load users, but exclude entry services, exit services and common services.

7.78 However, in the network tariff schedules approved for use in the first regulatory period, Power and Water effectively only has one bundled tariff for regulated network access services which is calculated by summing a daily standing charge, an energy based charge (which has peak and off-peak rates) and a demand base charge (which also has peak and off-peak rates), levied based on the requirements of the end-use customer.

7.79 Charges associated with standard connection and disconnection, metering and other services related to the transportation of electricity (e.g., normal meter reading, billing services) are implicitly bundled into these tariffs. There were no network reference tariffs applicable to generators submitted or approved for the first regulatory period.

Views in submissions

7.80 Power and Water argued that the Code is adequate in its present form.

7.81 NT Treasury also expressed the view that the flexibility currently allowed in the Code is appropriate.

7.82 On the matter as to whether the network charges should be unbundled from generation and retail charges in bills sent to customers by the retailer, Power and Water argued that:

"Power and Water does not consider that the size of the Northern Territory customer base currently warrants an unbundling of charges to any greater extent than presently exists.

Clause 74 of the Code provides that reference tariffs are to reflect a balancing of the quest for detail against the administrative costs of doing so which would be passed through to end-use customers. The regulatory costs of approving cost allocations, causality and associated matters, especially given the lack of access seekers in the NT market, are likely to outweigh the negligible benefits from requiring unbundled tariffs." (p.28)

Commission's analysis and conclusions

7.83 The Commission agrees that the network pricing structure provisions in clause 75 of the Code are adequate in their present form.

7.84 However, the Commission does not consider that Power and Water has provided a case for not amending chapter 7 of the Code to require that the network provider make arrangements with the retailer to include the network component of a customer's bill in the statement of charges provided to each customer. This

requirement could be restricted to those customers (contestable customers) not subject to retail price control by the Government.

7.85 Price is the main determining factor from a customer's point of view. Unbundled tariffs provide better signals to customers because they enable a customer to simply compare the energy charge offered by one retailer against the energy charge offered by another retailer. Bundled tariffs remove this level of transparency and make it easier for the incumbent retailer to compete with new entrants.

Recommendation (56) The network pricing structure provisions in clause 75 of the Code should be retained in their present form.

Recommendation (57) Chapter 7 of the Code should be amended to require that the network provider make arrangements with the retailer to include the network component of a contestable customer's bill in the statement of charges provided to each contestable customer.

Pricing principles statement

7.86 Clause 75(5) of the Code provides that, prior to the commencement of each regulatory period, the network provider is to submit for the Commission's approval a draft statement setting out details of principles and methods to be used for defining the individual standard network access services to be supplied by the network provider and for establishing the reference tariffs to apply to those services.

7.87 The Commission may only withhold its approval of the pricing principles statement if the statement is not consistent with the principles in clause 74 of the Code.

Views in submissions

7.88 On the matter as to whether the pricing principles statement approved by the Commission in the first regulatory control period was sufficient, Power and Water argued that any Pricing Principles Statements complying with clause 74 of the Code should be capable of providing a satisfactory level of flexibility to enable unexpected market situations, such as new dominant generators, co-generation or stand-by supply.

> *"The provisions strike an appropriate balance between disclosure of the underpinnings of Power and Water's reference tariffs and the amount of work and cost required to complete and publish the required documents." (p.29)*

7.89 NT Treasury argued that:

> *"The statement approved by the Commission appears to adequately list broad pricing principles and structures that would be expected of a network provider in setting reference tariffs, including margins for investment returns as allowed under the revenue cap. The information in the statement appears to exceed the provider's obligation under clause 74." (p.6)*

Commission's analysis and conclusions

7.90 The Commission agrees that the requirement for the network provider to develop and publish, subject to the regulator's approval, a pricing principles statement at the commencement of each regulatory control period is appropriate in its present form.

Recommendation (58) The pricing principles statement provision in clause 78(1) of the Code should be retained in its present form.

Capital contributions

7.91 Chapter 8 of the Code provides for regulatory oversight of capital contributions expected of network users.

7.92 'Capital contributions' involve a financial contribution made by a network user towards the capital investment associated with designing, constructing, installing and commissioning the electricity network assets of a network provider.

7.93 The main provisions of chapter 8 of the Code are as follows:

- clause 80(2) of the Code provides that an access seeker or network user may be required to make a capital contribution towards the extension of connection equipment or network system assets only if the network provider can demonstrate that the extension is not 'commercially viable' without that capital contribution;
- clause 80(3) of the Code defines the conditions to be met for an extension to be commercially viable, which includes definitions for this purpose relating to:
  - a reasonable rate of return on the capital investment associated with the proposed extension,
  - a reasonable time within which the costs, the capital investment and a reasonable rate of return on the capital investment in respect of a proposed extension must be recovered, and
  - reasonable terms and conditions upon which funding is to be obtained to finance the proposed extension; and
- clause 81(2) of the Code requires the network provider to submit for the Commission's approval details of principles and methods for establishing capital contributions.

Views in submissions

7.94 Power and Water argued that there was no need for the provisions relating to capital contributions to be made more prescriptive. Power and Water also submitted that their forthcoming capital contributions framework would provide an appropriate mechanism to monitor its behaviour in this regard.

7.95 NT Treasury argued that the provisions relating to capital contributions appear adequate, noting that:

> *"There is sufficient provision for capital costs not only to be recovered from the access seeker, but also to apportion them to various other parties according to expected benefits from the additional network investment. Calculation of contributions to be paid by an access seeker will depend on specific nature of the network investment and its future usage and the provisions should be accordingly flexible to account for these specifics." (p.6)*

Commission's analysis and conclusions

7.96 The Commission agrees that the current provisions appear adequate, provided the principles and methods for establishing capital contributions developed by the network provider and approved by the Commission pursuant to clause 81 of the Code contain sufficient information to enable access seekers to assess the reasonableness of the requirement to pay a capital contribution and the amount of that capital contribution.

7.97 Lack of clarity and certainty in this area has caused problems in other jurisdictions. As a result, South Australia, Victoria and New South Wales have all developed detailed principles and procedures dealing with capital contributions in relation to extensions or augmentations of the distribution system.

7.98 However, most access seekers are still confused concerning the practical application of these principles and procedures and are often left with little recourse but to accept the interpretation of these principles and procedures proposed by the network provider.

7.99 In that regard, the Commission will rely on the proposed powers to issue directions to address any concerns arising during the access application process with respect to this issue.

Recommendation (59) The capital contributions provisions in chapter 8 of the Code should be retained in their present general form.

Some definitional and drafting anomalies

7.100 The Commission's legal advisers have proposed that some minor amendments would improve the effectiveness of the provisions of chapter 8 of the Code.

7.101 The definition of capital contribution in clause 3 of the Code and the provisions of clause 31 and chapter 8 should be amended to remove the current level of duplication. For example, the definition of capital contribution refers to both a financial contribution and an equivalent contribution in the form of assets contributed by a network user towards certain capital investments. However, the extended definition of capital contribution is repeated in clause 31 and chapter 8 of the Code with a slight variation. This causes confusion and may cause unattended results.

7.102 The definition of capital contribution also refers to a 'formal access agreement'. There is no definition of formal access agreement in clause 3 of the Code. This wording suggests that a formal access agreement must be different from an ordinary access agreement.

7.103 Clause 31(1) of the Code does not clearly state that this question (as to whether the granting of an access application would necessitate the extension of connection equipment or network system assets) will be determined in accordance with the procedures set out in chapter 8 of the Code.

7.104 In addition, clause 31(1) of the Code suggests that the network provider should have some discretion as to whether or not to request a capital contribution in a particular circumstance. This discretion should be regulated by the principles and procedures referred to in chapter 8 of the Code so as to ensure that all network users are treated in an equitable manner. Chapter 8 then repeats most of the information already appearing in clause 31 but in a slightly different form.

7.105 While clause 81(1) of the Code states that the broad application of the capital contribution principles will be overseen by the Commission, the only power granted to the Commission under chapter 8 of the Code is to review the statement of principles and methods for establishing capital contributions prepared by the network provider for consistency with the requirements of chapter 8. In the Commission's view, the role of the Commission should be expanded by:

- granting to the Commission a specific right to require amendments to the statement of principles and methods for establishing capital contribution from time to time; and
- allowing the Commission to provide preliminary advice to access seekers concerning the application of these principles and methods and any requirement to make a capital contribution set out in an access offer.

7.106 Finally, clause 79(5) of the Code provides that prudential requirements are not regulated by the Code and are a matter to be negotiated between the network provider and network user. The Commission notes that this exposes third-party

network users to potentially onerous requirements without any form of redress and could potentially prevent a new retailer or generator from entering the market.

Recommendation (60) Chapter 8 of the Code should be amended where applicable to address the definitional and drafting anomalies identified by the Commission's legal advisers.

Charges for out-of-balance energy services

7.107 Chapter 9 of the Code provides for regulatory oversight of the setting of out-of-balance energy prices.

7.108 Out-of-balance energy means the supply of electrical energy to a load user by a generator other than the generator user who is party to the access agreement when there is a mismatch between the transfer of electrical energy into and out of the electricity network by the parties to the access agreement.

7.109 These provisions were substantially modified as a result of the amendments which took effect on 1 July 2001. The economic dispatch arrangements that gave effect to the pricing principles in this chapter became operational on 1 July 2002.

System imbalance pricing

7.110 Clause 85 of the Code provides that, when determining guidelines or dispatch arrangements which may affect the prices for any out-of-balance energy services, the Commission and the power system controller must ensure that these guidelines and arrangements result in prices which best promote:

"(a) the efficient provision of out-of-balance capacity and energy; and

(b) the efficient operation and ongoing development of the power system as a whole."

7.111 Clause 85A of the Code provides that settlement of out-of-balance energy services is to involves both:

- a system imbalance *energy* price, defined by reference to the marginal operating costs of generation units instructed by the power system controller to deviate from their expected level of output; and
- a system imbalance *capacity* price, defined by reference to the incremental capital cost of generation units instructed by the power system controller to commence output.

7.112 Clause 87(3) of the Code provides, among other things, that the Commission is to review the economic dispatch arrangements giving effect to the provisions of chapter 9 of the Code by 30 June 2003 and that, in conducting the review, the Commission must assess the extent to which the arrangements are meeting the requirements of clause 85.

Views in submissions

7.113 Neither Power and Water nor NT Treasury saw any need for the Code to be modified in relation to system imbalance pricing, or for the generation-related provisions of the Code to be removed.

7.114 Power and Water argued that:

"Review of the regulation of system imbalancing, or out-of-balance, pricing has been ongoing since 1999. Under Chapter 9 of the Code, Power and Water Generation determines prices while ensuring that incentives for generation are not skewed. In practice, Power and Water has submitted a framework for calculating system imbalancing prices for approval by the Regulator each year.

…Power and Water has contributed vigorously to the ongoing consideration of effective system imbalancing pricing mechanisms, having made several submissions to the

Regulator on this issue since 2000. Power and Water had assumed that the ongoing debate over the effectiveness of system imbalancing charges was no longer necessary due to the following:

- *System imbalance in the NT market has proven to be financially immaterial and does not warrant detailed investigation or prices oversight; and*
- *That in any event, the current lack of competitive generation or retail markets in the Northern Territory renders detailed assessment of system imbalance pricing at this point in time unnecessary and certainly not cost effective. (p.30)*

7.115 Power and Water also argued that, while recognising the need for a theoretical framework to take account of possible misuse of market power, price exploitation was not possible in the absence of any competitors in the current market environment, and that any review of system imbalance charging was best left until a new generator/retailer enters the market.

Commission's analysis and conclusions

7.116 The Commission agrees that, while complex, the provisions of chapter 9 of the Code provide ample scope for the Commission and interested parties to evolve the arrangements without the need for further amendments to this chapter of the Code.

Recommendation (61) The out-of-balance energy charging provisions of chapter 9 of the Code should be retained in their present form.

Energy loss factor formula

7.117 Clause 82(2A) of the Code provides that:

"The power system controller's assessment of the out-of-balance energy supplied or demanded by a generator must take full account of network energy losses where such energy losses are:

(a) estimated in accordance with Schedule 13; or

(b) as otherwise determined from time to time by the regulator."

7.118 'Network energy loss' means the energy loss incurred in the transportation of electricity from an entry or transfer point to an exit point or another transfer point on an electricity network.

7.119 Schedule 13 of the Code, which deals with calculation of loss factors, appears ambiguous in a number of areas. It does, however, appear to be prescribing the calculation of loss factors on the basis of stand-alone losses. As this loss factor calculation is neither on the basis of marginal losses (which would ensure allocative efficiency), nor on a basis (such as average losses) which ensures there is no surplus or deficit, and as this surplus (the fixed loss element of the stand-alone losses makes it almost certain to be a surplus) will accrue to the network provider, it may be neither allocatively efficient nor competitively neutral.

Views in submissions

7.120 Power and Water raised two issues in relation to loss factor calculations, which they believe require a level of pragmatism to resolve, particularly in relation to relative costs and benefits:

- *Schedule 13 of the Code currently requires Power and Water to measure individual entry/exit point loss factors for all contestable customers. This is becoming increasingly impractical as the number of these customers increases; and*
- *The term "measurement" as applied to setting energy loss factors is not suitable given the mathematical and technical issues. Power and Water believe that the Code requires cosmetic amendments to reflect the "determination" of loss factors rather than "measurement". (p.31)*

7.121 While noting that some preliminary discussions had been held with the regulator with regard to addressing these issues, Power and Water foreshadowed their intention to formalise this with the Commission shortly.

7.122 NT Treasury supported the current calculation of energy loss factors on a marginal loss basis.

Commission's analysis and conclusions

7.123 The Commission is current exploring alternative methodologies for allowing for network energy losses for out-of-balance settlement purposes.

7.124 Given the power granted to the Commission to undertake such a revision, the Commission sees no need to amend clause 82(2A)(b) of the Code.

Recommendation (62) The provision for the regulator's determination of the methodology for estimating network energy losses in clause 82(2A)(b) of the Code should be retained in its present form.

APPENDIX

A

TERMS OF REFERENCE

Pursuant to section 8(2) of the *Electricity Networks (Third Party Access) Act* and section 31 of the *Utilities Commission Act*, the Utilities Commission is to inquire into and report on the effectiveness of the Network Access Code in:

- facilitating competition and the use of networks by electricity generators and retailers; and
- preventing the exercise of market power by the owners/operators of electricity networks;

including in light of experience with application of the Code since 1 April 2000.

The Commission is to consider and report on the Code in its entirety including:

- the access framework (covering negotiations, agreements and disputes); and
- the access pricing provisions (covering pricing principles, revenue caps and tariff approvals).

As any changes to the Code are likely to require recertification by the relevant Commonwealth Minister, in making its recommendations the Commission is to take into account the requirements for certification under clause 6 of the CPA and Part IIIA of the TPA.

In undertaking the inquiry, the Commission is to:

- consult with key interest groups and affected parties;
- release an issues paper and draft report to facilitate consultation; and
- provide its final report by 31 March 2003.

TREASURER
12 December 2002

APPENDIX

B

EFFECTIVE ACCESS REGIMES

The criteria for assessing the effectiveness of a State or Territory access regime are set out in clauses 6(2) to 6(4) of the Competition Principles Agreement and specified below:

6(2) The regime to be established by Commonwealth legislation is not intended to cover a service provided by means of a facility where the State or Territory Party in whose jurisdiction the facility is situated has in place an access regime which covers the facility and conforms to the principles set out in this clause unless:

(a) the Council determines that the regime is ineffective having regard to the influence of the facility beyond the jurisdictional boundary of the State or Territory; or

(b) substantial difficulties arise from the facility being situated in more than one jurisdiction.

6(3) For a State or Territory access regime to conform to the principles set out in this clause, it should:

(a) apply to services provided by means of significant infrastructure facilities where:

(i) it would not be economically feasible to duplicate the facility;

(ii) access to the service is necessary in order to permit effective competition in a downstream or upstream market; and

(iii) the safe use of the facility by the person seeking access can be ensured at an economically feasible cost and, if there is a safety requirement, appropriate regulatory arrangements exist; and

(b) incorporate the principles referred to in subclause (4).

6(4) A State or Territory access regime should incorporate the following principles:

(a) Wherever possible third party access to a service provided by means of a facility should be on the basis of terms and conditions agreed between the owner of the facility and the person seeking access.

(b) Where such agreement cannot be reached, governments should establish a right for persons to negotiate access to a service provided by means of a facility.

(c) Any right to negotiate access should provide for an enforcement process.

(d) Any right to negotiate access should include a date after which the right would lapse unless reviewed and subsequently extended; however, existing contractual rights and obligations should not be automatically revoked.

(e) The owner of a facility that is used to provide a service should use all reasonable endeavours to accommodate the requirements of persons seeking access.

(f) Access to a service for persons seeking access need not be on exactly the same terms and conditions.

(g) Where the owner and a person seeking access cannot agree on terms and conditions for access to the service, they should be required to appoint and fund an independent body to resolve the dispute, if they have not already done so.

(h) The decisions of the dispute resolution body should bind the parties; however, rights of appeal under existing legislative provisions should be preserved.

(i) In deciding on the terms and conditions for access, the dispute resolution body should take into account:

(i) the owner's legitimate business interests and investment in the facility;

(ii) the costs to the owner of providing access, including any costs of extending the facility but not costs associated with losses arising from increased competition in upstream or downstream markets;

(iii) the economic value to the owner of any additional investment that the person seeking access or the owner has agreed to undertake;

(iv) the interests of all persons holding contracts for use of the facility;

(v) firm and binding contractual obligations of the owner or other persons (or both) already using the facility;

(vi) the operational and technical requirements necessary for the safe and reliable operation of the facility;

(vii) the economically efficient operation of the facility; and

(viii) the benefit to the public from having competitive markets.

(j) The owner may be required to extend, or to permit extension of, the facility that is used to provide a service if necessary but this would be subject to:

(i) such extension being technically and economically feasible and consistent with the safe and reliable operation of the facility;

(ii) the owner's legitimate business interests in the facility being protected; and

(iii) the terms of access for the third party taking into account the costs borne by the parties for the extension and the economic benefits to the parties resulting from the extension.

(k) If there has been a material change in circumstances, the parties should be able to apply for a revocation or modification of the access arrangement which was made at the conclusion of the dispute resolution process.

(l) The dispute resolution body should only impede the existing right of a person to use a facility where the dispute resolution body has considered whether there is a case for compensation of that person and, if appropriate, determined such compensation.

(m) The owner or user of a service shall not engage in conduct for the purpose of hindering access to that service by another person.

(n) Separate accounting arrangements should be required for the elements of a business which are covered by the access regime.

(o) The dispute resolution body, or relevant authority where provided for under specific legislation, should have access to financial statements and other accounting information pertaining to a service.

(p) Where more than one State or Territory regime applies to a service, those regimes should be consistent and, by means of vested jurisdiction or other co-operative legislative scheme, provide for a single process for persons to seek access to the service, a single body to resolve disputes about any aspect of access and a single forum for enforcement of access arrangements.