

**NETWORKS PRICING:
2004 REGULATORY RESET**

GUIDE TO THE ISSUES

JULY 2003



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FOREWORD

The Commission has been undertaking price regulation in accordance with the Electricity Networks (Third Party Access) Code ('the Code')¹ since 1 April 2000 based on a price regulation methodology that has been constant during that time. The *first regulatory control period* is due to end on 30 June 2004.

In the lead-up to the commencement of the *second regulatory control period* (the five-year period commencing 1 July 2004), the Commission as regulator – in consultation with interested parties – is required to review the price regulation methodology being used and to modify the methodology as appropriate.

The Commission is referring to this review and consideration of the price regulation methodology as the 2004 Regulatory Reset ('the Reset').

To initiate the Reset, the Commission has released an Issues Paper. The Issues Paper is quite detailed and technical in nature and is available on the Commission's website.

Not all interested parties will wish to review the information in this form. The aim of this Guide is to provide a less technical description of the main issues identified by the Commission, the context in which they arise and the implications they may hold for network prices and the electricity market more generally.

Interested parties are invited to make submissions, comments or inquiries regarding issues raised in the Issues Paper or in this Guide. The closing date for submissions is **Friday, 22 August 2003**. Contact details for the Commission are provided on the back page.

NATURE OF THIRD-PARTY ACCESS

Granting third-party access to an electricity network involves unbundling 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 transport of electricity from generators to end-use customers).

The network provider occupies a strategic position in electricity system, since a generator or retailer can only supply electricity to its customers if it can transport this electricity via the network. For effective competition in upstream and downstream markets that have a transport requirement, all parties – irrespective of their affiliation with the network provider – must have access to the network.

¹ The Code can be viewed on the legislation page of the Commission's website (www.utilicom.nt.gov.au).

OVERVIEW: THE MAIN QUESTIONS

The Reset has two stages:

- in stage 1 the methods used to regulate prices will be reviewed and, if necessary, changed;
- in stage 2 new price controls for the second period will be calculated using the revised methods from stage 1.

The Issues Paper initiates stage 1 of the Reset. This will culminate in the Commission publishing its findings on the method of pricing regulation for the second regulatory control period. The Commission plans to publish its proposals in September, then allow two months for consultation before releasing its final decision in November. Work on applying the revised methods can then begin.

To help with identifying the issues for stage 1, the Commission has considered four main questions:

- what aspects of network regulation will be open to review and change at the Reset?
- what are the objectives and criteria that should be used in deciding how network regulation should work after the Reset?
- what has been the experience with network regulation in the first (2000-2004) period?
- what can be learned from the experience with “best practice” network regulation?

What can be changed?

The aspects of regulation that are open for review in this Reset are determined by the instructions given in the Code. The Commission must follow those instructions. To the extent that the instructions require some interpretation in order to be implemented, it is important that the Commission clarifies its position regarding the matters that it will be looking at, and those that it regards as outside the *scope of the Reset*.

The basis for making decisions

Before it can look at particular options the Commission must have a clear idea of the main aims of the Reset. This requires an appreciation of the *objectives* of network regulation, the priorities that are relevant in the NT context and, from these, the *criteria* that it should use for assessing options.

NT experience in the current period

The *experience with network regulation* in the current period forms the basis for moving forward. The Commission has its own view on the issues that come out of this experience, but it will place particular weight on feedback from network users, the network provider and other interested parties.

Best practice network regulation

The wider experience with “*best practice*” network regulation can provide useful additional information on what opportunities may exist for improving the performance of network regulation in the Territory. Whether aspects that work well in other places will also work in the Territory is also an important question. Best practice can be considered in relation to the *form of regulation* and the *structure of network prices*.

SCOPE OF THE RESET

Providing a basis for agreeing the aspects of network regulation that are open for review at this Reset is the first task that the Commission has set for the Issues Paper. The instructions for the scope of the Reset are to be found in the Code, but by its nature this is a complex document that requires careful reading and interpretation.

It seems clear that the basic institutional framework and procedures of network regulation, including the rights and obligations of the parties, are not open for review. The Code establishes three steps in the regulation of network charges:

- a control on maximum network revenues – revenues are to be subject to forward-looking CPI-X regulation applied by the Commission in which the values in the control formula are set at the start of the period;
- guiding principles for the development of individual network prices – these are developed at the start of the period by Power and Water and reviewed by the Commission, which has the power not to approve them; and
- proposed annual network charges – each year, Power and Water submits its proposed prices to the Commission, which has the power not to approve them.

On the Commission's reading, the aspects that are open to review and reset concern the form of CPI-X regulation, the methods used to determine values for variables in the control formula and the approach that the Commission should take to assessing Power and Water's proposed network pricing principles.

Issues for comment:

(1) Is there any disagreement with the Commission's interpretation of the matters that fall outside the scope of this reset?

(2) Is there any disagreement with the Commission's interpretation of the matters that fall within the scope of this reset?

In the Commission's view this provides considerable scope to review the performance of regulation in terms of the effectiveness of the overall revenue control, the form and structure of network charges and the cost and complexity of administration, and to respond positively to the issues raised.

The Commission urges all stakeholders to take full advantage of this opportunity, which comes around only once every five years, by considering carefully where improvements to the form of regulation and the outcomes for network prices and price structures are necessary or available.

The primary issues concern the form of CPI-X regulation and the form and structure of network charges. The Draft Methodology Report (scheduled for mid-September) will indicate the Commission's proposed position on these issues, in view of the submissions received and its own further analysis.

The Draft Methodology Report will also put forward the Commission's proposals on matters that it considers consequential to the high-level issues addressed in the Issues Paper. These include:

- the methods for determining:
 - Power and Water's cost of capital (WACC), and
 - the efficiency gains factor (X factor);
- the method used for valuing network assets;
- the method used to assess which network access services are subject to effective competition and can be excluded from regulated network access services; and
- the approaches to be used for assessing Power and Water's policy on requiring customers to make capital contributions towards the costs of connection.

OBJECTIVES OF THE RESET

Within the Code and the Commission's other legislation there are numerous references to the objectives of regulation. They contain some common central themes that can provide guidance to the Commission in the Reset. In summary, regulation should:

- be efficient and cost effective;
- prevent the network provider from exploiting its monopoly position;
- share efficiency gains fairly and allow the network provider to earn reasonable profits;
- support the development of competition across the electricity market – generation, network, retail and alternative energy services; and
- promote efficiency in all aspects of the network.

These objectives consistently emphasise the importance of efficiency, competition, protecting the interests of customers, and maintaining the financial viability of the network provider. They provide a useful basis for evaluating the overall effectiveness of the regulation of network revenues and prices.

The Commission's view is that these objectives involve a balancing of interests, namely:

- the interests of network users for tariffs that reflect efficient costs and are simple, stable and equitable;
- the interests of the network provider for incentives to maintain and invest in the network and to improve operational efficiency;
- the broader public interest in ensuring that resources are priced and allocated according to their economic value; and
- the interests of all stakeholders to ensure that regulatory costs are minimised and benefits maximised.

More specific criteria are required for the evaluation of particular forms of revenue control. The approach of other regulators illustrates the range of factors that could be taken into account.

In preparing for its 2004 reset, the NSW regulator (IPART) evaluated options for the form of revenue/price control in terms of the extent to which each option:

- minimises the overall cost of volume risk;
- provides network operators with incentives to set efficient prices;
- provides flexibility in pricing design;
- is not highly sensitive to inaccurate volume forecasts (and minimises problems associated with reconciling forecast and actual volumes of electricity distributed);
- provides incentives to reduce costs;
- is transparent; and
- requires minimal mid-period adjustments of the revenue or price caps.

The Queensland regulator (QCA) adopted the same criteria in 2001.

The Victorian regulator (ESC), in its 2001 reset, assessed price control options in terms of the extent to which each option provided an incentive to maintain and expand network services to new and existing customers, without encouraging perverse behaviour or adding to business risk. The criteria that the ESC used were:

- the impact of the form of control on the network provider's incentives for efficient behaviour;
- the extent to which the controls ensure that total revenues track total costs; and
- the implications of the form of control for risk allocation.

The fact that these criteria have been applied in practice provides a level of confidence. A key question is whether the circumstances in the NT electricity market suggest that a particular weighting would be appropriate or amendment required.

Network operations in the NT have some distinguishing features:

- supply is provided through a single, relatively small, integrated generator, distributor and retailer;
- the system contains one distinct high voltage transmission link (DKTL);
- otherwise the regulated system is an integrated transmission/distribution network organised around three regions: Darwin/Katherine, Tennant Creek and Alice Springs; and
- loads are small, but relatively dispersed resulting in relatively high network costs per unit.

The Commission's view is that the reset needs to give particular focus to:

- the absence of effective competition in the NT electricity market- at this stage there is no sign of a competitor to Power and Water that would require (third party) access to the network;
- the implications of the close integration between Power and Water's network, retail and generation operations;
- the opportunities available for making NT regulation 'simple' and low-cost when compared with larger markets with high levels of third-party access; and
- the scope for reducing regulatory uncertainty (and giving increased emphasis to regulatory stability and predictability).

Issues for comment:

(3) What criteria should be used to assess options and alternatives for the form of regulation? What should be the relative importance attached to the various criteria?

(4) How should the assessment criteria be amended or qualified to reflect the circumstances expected in the NT electricity market during the second regulatory control period?

EXPERIENCE IN THE CURRENT PERIOD

Over the last three years network users and the network provider (and the Commission) have had their first experience of network regulation in practice. Some aspects may have worked well, and others not so well. Lessons learned from the first period should form the starting point for ideas on how to improve performance in the next period.

The Commission has divided its issues into those concerning revenue regulation and those concerning the form and structure of network prices.

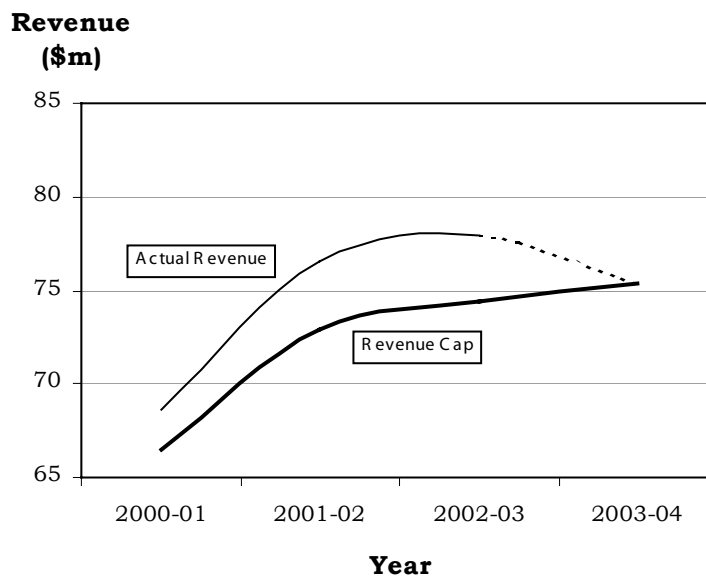
Experience with revenue regulation

The application of revenue caps in the first period has left the Commission with some serious reservations about the methods adopted and the level of compliance achieved.

A continuing problem has been the over-recovery of revenues from customers. In effect, customers have paid too much. Excess revenue has been returned from the network to retailers, but the distribution of this to customers may not have been satisfactory.

Chart 1 below illustrates the actual revenue collected versus the determined revenue cap during the first regulatory control period. It also shows the forecast versus actual volumes of energy sales, as this has been a key determinant of revenue over-recovery.

Chart 1



Note: Revenue data for 2002-03 is Power and Water's revised estimate as at March 2003. It is expected that actual revenue in 2003-04 will be in line with the determined revenue cap.

This experience raises important questions about:

- the validity of the annual revenue cap formula applied by the Commission;
- the adequacy of Power and Water's forecasting techniques; and
- the adequacy of the Commission's processes in annually approving the network tariff schedules that have given rise to consistent over-recovery of revenues.

A second concern is the cost of developing and administering the revenue control. Compared to the National Electricity Market (NEM) and markets overseas, the NT system is small, and in a small system overhead costs are a significant issue.

The revenue control used in the first period was based on a detailed analysis of Power and Water’s costs (called a building block analysis), which is thorough but expensive to conduct.

Administration of the revenue control has also proven expensive and complex. Forecasts of sales are required, and adjustments necessary if actual sales vary from forecast. Additional costs are borne by both the Commission and Power and Water. Ultimately, these costs are passed through to customers.

In a large system, these overhead costs may be acceptable because they can be spread over a larger volume of sales, but in the NT system they are a significant concern.

Issues for comment:

(5) What are the main deficiencies revealed by experience with the application of annual revenue caps in the first regulatory control period?

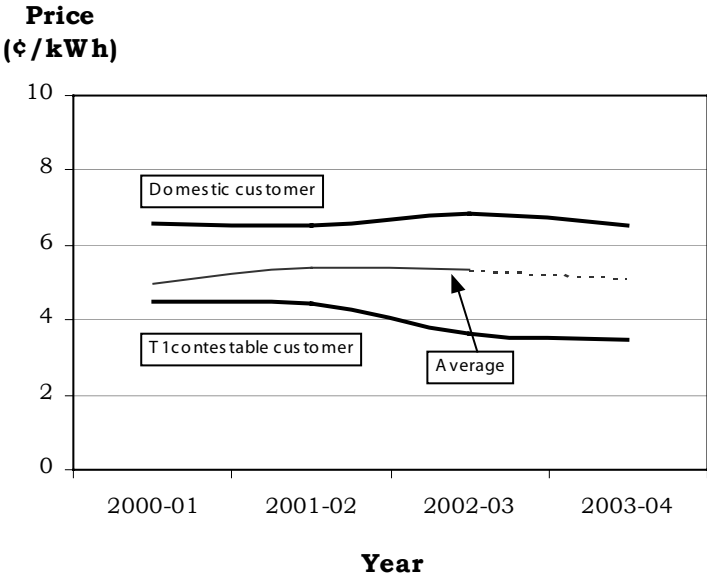
(6) Are there matters additional to those listed by the Commission arising from experience with the revenue cap arrangements during the first regulatory control period that should be considered during this reset?

Experience with network prices

In the first regulatory control period, larger contestable customers (Tranche 1 to 3) typically saw a decline in their network prices, whereas smaller contestable customers (Tranche 4) and non-contestable customers typically experienced increases in some years.

Chart 2 below illustrates the range of network prices paid by customers in the Darwin-Katherine region over the first regulatory control period.

Chart 2



In the Commission’s view, there are clearly shortcomings in the current pricing arrangements. But there are also clearly limitations imposed by complexity and information requirements, and tension with stability and transparency objectives that are important to customers.

Some features of the network pricing arrangements during the first regulatory control period noted by the Commission are:

- current network tariffs are not ‘unbundled’ from energy charges and retail margins for any customers, contestable or non-contestable. Customers cannot gain information on the network component of their bundled electricity price;

- common pricing principles apply to each network region, but tariff levels vary with costs. Each region has its own revenue cap;
- multi-part (fixed, demand, energy) declining block network tariffs are applied to contestable load, while two-part network tariffs (fixed plus energy) are applied to non-contestable load;
- no connection or network usage charges have been applied to supply customers (i.e., generators). Network costs are recovered entirely from end-use customers (load customers);
- within each region and each customer category, uniform charges are applied. No customers, either supply or load, face locational or congestion-related network price signals;
- for the DKTL, uniform energy-based charges are levied on all demand customers in the Darwin/Katherine region; and
- there is no information available to customers on the standard of service they can expect to receive in return for the regulated prices they pay.

From the Commission's perspective, the main issues that arise from the experience with network pricing over the first regulatory control period are:

- the reluctance of Power and Water to provide unbundled network charge data to large contestable customers on request;
- the absence of tariff categories for network services provided to and by embedded generators;
- the unequal treatment of supply customers (generators) and load customers (end users) in the application of network charges, and the potential for unequal treatment of new supply customers relative to existing supply customers;
- the relevance of tariff component weights to economic cost drivers in each of the three price regions;
- the absence of a pricing policy governing capital contributions by customers to connection costs;
- the basis for maintaining a separate energy-based usage charge for the DKTL; and
- the absence of documented standards of service as a basis for determining whether customers are receiving the service they have paid for, whether in relation to reference tariffs or negotiated tariffs.

Issues for comment:

(7) What are the main deficiencies revealed by experience with the type and structure of network tariffs in the first regulatory control period?

(8) Are there matters additional to those listed by the Commission arising from experience with the type and structure of network prices during the first regulatory control period that should be considered during this reset?

THE FORM OF CPI-X REGULATION: IMPLICATIONS OF BEST PRACTICE

For a small system, the cost effectiveness of regulation is a key consideration in assessing 'best practice'. Cost effectiveness does not mean minimum cost, but a balancing of costs and benefits.

The Code directs that regulation is of the forward-looking CPI-X style. There are different forms within this style, and a variety of forms are in use around the world.

The elements common to each form are that a CPI-X formula is used to limit the annual increase in either revenues or prices, and that the value of X is set at the start of the period.

The main differences are whether the value of X is derived from a detailed analysis of projected network costs over the period or based on expected general improvements in efficiency (an external benchmark), and whether revenues are the focus of control (revenue cap) or prices (price cap).

The current form is a cost-based revenue cap. For the next period the Commission considers that the primary choice is between continuing with the current form or moving to a price cap where X is based on a general efficiency measure, or external benchmark.

There are also other choices to be made about the particular type of revenue or price cap to be used and how the benefits of any efficiency improvements that have been made by the end of the second period are treated in the third period.

A final and potentially quite important choice is whether the approach taken to regulating revenues or prices in the first year of the period should be subject to special scrutiny because the resulting values will form the base for values in the following years.

Cost-based controls

Under the cost-based approach, the network provider's main cost elements are projected for each year. Since revenues must cover costs (including an allowance for reasonable profits), the cost elements (called cost building blocks) can be added together to provide an estimate of the required revenues for each year.

The cost-base generally includes a return on capital, depreciation and operating expenses. To obtain these values, information is required on the network asset base, expected capital expenditure, the weighted average cost of capital for the network and efficient operating and maintenance costs. Forecasts of each of these elements are required as well as forecasts of sales and inflation.

Usually a regulator asks the network provider to provide this information and then makes its own assessment of likely demand and reasonable capital and operating costs. When the regulator is satisfied that the projections represent an achievable efficiency target for the network provider, the resulting revenues are used to set the value of X.

Cost-based controls are information-intensive. Their preparation adds to costs for both the regulator and the network provider.

Their strength is the account they take of the particular cost, demand and operating characteristics of the individual network. This does not remove the uncertainty involved in projections of future conditions, but it provides an increased level of confidence that the network provider will recover its costs if it performs efficiently, and that customers will not pay too much.

Externally benchmarked controls

Critics of the cost-based approach argue that its advantages are over-stated. The regulator's ability to project network costs over a five year period is in reality quite limited, and any increased confidence in the outcomes is misplaced.

The detailed examination of network costs is said to be highly intrusive, and risks drawing the network provider into strategic behaviour directed at gaining a more favourable outcome from the regulator.

The better alternative they argue is to accept that there will always be some uncertainty about the precise relationship between revenues and efficient costs, and instead focus on simple methods for keeping the possible divergence within reasonable bounds.

The method they propose is to allow prices (or revenues) to rise in line with inflation *less* a general efficiency improvement (or productivity) factor. The measure preferred by regulators that use this method is total factor productivity (TFP), which measures all the inputs required per unit of output.

As an example, if productivity was increasing each year 2% faster than on average in the rest of the economy, and annual inflation was expected to be 3%, prices (or revenues) would be allowed to increase by a maximum of 1% each year.

Supporters argue that this prevents prices from moving too far out of line with costs, creates a clear incentive for network providers to keep their costs down *and* outperform the target (the 2% pa efficiency improvement in the example above) because they keep the extra profits for the rest of the period, and is easy to apply.

Critics argue that without looking at the network provider's costs the risks of either excessive profits or losses emerging during the period are too great for either the regulator or the network provider to accept.

External benchmarks are normally, although not exclusively, used in conjunction with price caps. Where they are used with revenue caps special attention must be paid to the implications of variations in future sales volumes.

Revenues and prices in the first year

The level of revenues and prices in the first year of a regulatory control period provide the base from which revenues and prices in succeeding years are developed. They have a large bearing on outcomes over the following years, particularly if costs and revenues are not re-examined. If the level of profits in the first year is too high or too low, or if the structure of individual prices does not reflect underlying costs, the gap between costs and revenues will widen over the period under an externally benchmarked approach.

For the externally benchmarked approach a key question is whether revenues and prices in the first year should be determined by a cost-based building block analysis to ensure that efficiency criteria are met and a sound foundation for the subsequent CPI-X indexation of prices provided.

Revenue caps

The current form of control is a cap on annual revenue. Prices are set by the network provider to be consistent with the revenue cap. Since this involves a forecast of sales for the year, revenue caps have the added complexity of requiring a method for adjusting actual revenues at the year's end.

Revenue caps may either be fixed at the start of the period or include a formula intended to allow revenues to track costs more closely. Fixed revenue caps expose the network provider to changes in sales volumes. For the same reason they reduce the incentive for the network provider to promote sales, which may have demand management benefits.

The flip-side is that network providers may actually have an interest in reducing sales (perhaps below customer requirements), because their revenue is unaffected yet costs may fall.

Revenue caps are also criticised for their poor incentives for the network provider to price efficiently - that is, to structure prices so they reflect underlying costs.

Price caps

The most common form of price cap is a “tariff basket”.² All the network provider’s prices are included in the tariff basket, weighted according to their contribution to total revenue. Because the price cap is applied as a limit on the increase in the tariff basket, individual prices can move by more or less than this amount.

Supporters of price caps argue that they are easier to apply and enforce since they do not rely on sales forecasts or require year-end revenue adjustments.

Theory also suggests that they provide stronger incentives for network providers to structure their prices to reflect underlying costs.

The strongest criticism of price caps is that they create incentives for network providers to increase sales, and that this can lead to the suppression of economically efficient alternatives to expanded network services (such as embedded generation, demand management and energy efficiency).

Issues for comment:

(9) Should the Commission’s reliance on the building block approach be relaxed, and if so in what way? In the NT context, where cost and complexity are important considerations, do the benefits of placing greater emphasis on the use of price caps and external benchmarks during the second regulatory control period outweigh the costs and risks?

(10) Should year 1 prices or revenues be based on a building block cost analysis, irrespective of the approach taken in years 2 to 5?

(11) If a cost-based revenue cap is to be used, what is the most appropriate form of that cap in the NT context?

(12) Should the X factor used by the Commission continue to be based on smoothing of the building block-based annual allowed revenues, or should greater emphasis be given to an external productivity-based approach?

Beyond the second regulatory control period

A key feature of CPI-X regulation is the incentive for the network provider to out-perform X, since this will increase profits. The incentive may be reduced if the improved return is automatically reset to its target level at the end of the period. Towards the end of the period the network provider may instead have an incentive to postpone possible efficiency improvements until after the next reset.

A feature of incentive regulation is that customers share in any benefit of superior performance. Questions therefore arise regarding:

- the extent to which efficiency out-performance should be shared with customers;
- the period over which benefits are shared with customers; and
- the profile of the sharing arrangements.

Issue for comment:

(13) Should there be an efficiency carry-over mechanism at the end of the second regulatory control period, and if so what form should it take?

² Under a tariff basket, the limit on allowed price increases is expressed in terms of a weighted average of the prices of a basket of services, rather than on an average revenue.

NETWORK PRICE STRUCTURES: IMPLICATIONS OF BEST PRACTICE

Network prices have two main functions:

- they signal to customers the costs imposed by their use of the network; and
- they allow the costs of providing and operating the network to be recovered as revenue.

Prices that signal costs allow consumption and investment decisions to reflect the economic value of the services provided and the cost of the resources consumed. This is a requirement for *economic efficiency*.

Revenue that covers total cost is a necessary condition for *financial viability*.

Transmission and distribution prices

Electricity networks are a transport system; they link sources of generation to points of consumption (or load). Generation may be provided by large dedicated power stations, smaller distributed generators that are linked to other activities (such as cogeneration plants using recycled boiler steam) or locally available energy (such as methane gas from landfills).

Traditionally most electricity has been generated in a few large power stations. In the future, factors such as improved technology may see the share of generation from distributed sources increase.

Load is more widely dispersed, determined by the spread of population and industry. Customers make decisions about where to locate based on a range of factors, one of which is the availability and cost of electricity at that location. Once located, the level of electricity consumption and its pattern (the hourly, weekly and seasonal profile) will depend on the customer's requirements, the value placed on consumption and the cost.

Electricity networks are usually divided into a high voltage transmission component used for transporting bulk power from large generators to regional delivery points, and a lower voltage distribution network, which takes power from the regional delivery points and distributes it to final customers.

Pricing methods reflect this functional difference; transmission prices are usually considered as an extension of the bulk electricity market price.

In the NT, the network (with the exception of the DKTL) is treated as a single system.

Issue for comment:

(14) Should regulated networks in the NT be functionally separated into a transmission and distribution component, with separate network prices reflecting the different services provided?

Improving network cost signals

A key input to choices on both the demand and supply sides is cost – if costs are not known or are under- or over-stated then the choices made may be wasteful, using resources that could be better used elsewhere. Electricity usage and transport (network) prices that reflect all relevant costs allow unbiased comparisons to be made between alternative ways of meeting customers' energy service requirements.

The critical cost signalling role of prices is the influence they have on the future behaviour of network providers and users. Therefore, efficient prices are those which, in a forward-looking sense, encourage efficient use of, operation of, and investment in the network.

Electricity consumption varies considerably during the day. Peak demand usually occurs in the mornings and evenings. Network capacity must be capable of meeting these peaks, even though this means that a large proportion remains unused for the rest of the time.

As demand increases at peak times, network elements become congested. To reduce congestion, either demand must be reduced or the network element expanded through investment.

Network prices that signal the cost of congestion (the cost of the investment in additional capacity required to relieve the congestion) can play a key role in bringing forward the least cost supply or demand response.

Capacity constraints may occur at different levels of the network and at different locations. The constraint may be within the transmission network, at the sub-transmission level or at a particular distribution element. In addition, variations in terrain, customer density, distance from points of generation and other factors can all lead to differences in costs across the network.

Ideally, network usage charges will signal locational variations in costs. In practice there is significant complexity in accurately representing locational and time-specific costs.

Issues for comment:

(15) To what extent should network prices in the NT be reflective of the economic costs of network use and access?

(16) Is one declining block tariff for regulated network services (as applied in the first regulatory control period) sufficient to provide appropriate price signals to the market? Should separate charges be mandated?

(17) What approach should be taken to the pricing of network services provided to, and by, embedded generation to ensure that economic projects are not disadvantaged?

Setting priorities and balancing objectives

The pricing of network services is a practical exercise that takes place with limited cost information, technical complexity and uncertainty. Prices have a broader function than signalling economic costs; they also recover the revenue necessary for financial viability and allocate sunk network costs between customers. Price changes may also impose adjustment costs on customers that are not taken into account when considering pricing efficiency.

No single set of prices can equally satisfy the commonly agreed objectives for network pricing. There are clearly tensions between the objectives. In settling on a particular pricing structure and cost allocation, a balancing of objectives is arrived at, either explicitly or implicitly.

In the lead up to a new five year regulatory control period, it is important that the relative weights given to the objectives, as expressed in the current structure of network charges, should be reviewed for their suitability to conditions across the network and the market more generally.

On one view, current network charges unduly favour the recovery of accounting costs over the cost signalling role of efficient prices. Signals regarding the variation in the cost of network use by time, location and level of asset utilisation are generally weak.

If this view is valid, it may be that opportunities for more economic means of meeting customers' energy needs are being missed, leading to increased costs and wasted resources. The risk is that Power and Water, as the integrated monopoly supplier, will continue practices that may create barriers to the entry of efficient alternative suppliers.

The NT market is relatively small and competition has not yet taken hold. More efficient network prices take effort to develop and add to costs in the short term. A key question is whether more efficient network prices are feasible in the small NT system.

This issue goes beyond price alone. It also concerns the basis on which network planning and investment takes place and the public disclosure of information as a means of bringing forward economic alternatives to network investment.

Over the next five years, as increased supplies of gas become available, there may be increased opportunities for distributed generation of varying sizes. Such projects may have the potential to defer the need for network augmentations as well as allowing customers that are supplied direct from local generation sources to avoid network charges.

Similarly, demand management service providers are gaining a foothold in the NEM by providing benefits to customers and networks, and it may only a matter of time before they become more active in the NT market.

The approach to network pricing will be an important influence on potential market developments such as these – a key question is whether, and how, the door could be opened a little wider.

Issues for comment:

(18) What changes to network charges and structures are necessary to ensure that customers will benefit from economic opportunities in the provision of energy services that may occur during the second regulatory control period?

(19) In a small network, are there cost effective ways to provide the appropriate signals (price or otherwise) for efficient use and investment (having regard to capacity and location) and to ensure that customers and competing service providers are not unreasonably discriminated against?

Consultation process and timetable

The timetable that will be guiding the Commission's consultation process during Stage 1 is as follows:

Target	Event
22 August 2003	Submissions on the Issues Paper due
mid September 2003	Publication of the Commission's Draft Report on the price regulation methodology to apply in the second regulatory control period
mid October 2003	Submissions on the Draft Report due
mid November 2003	Publication of the Commission's Final Report on the price regulation methodology to apply in the second regulatory control period, including the data requirements for applying the revised methodology

Submissions

Submissions, comments or inquiries regarding issues raised in the Issues Paper or in this Guide 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

The closing date for submissions is **Friday, 22 August 2003**.

Confidentiality

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

Subject to the above, submissions will be made available for public inspection at the office of the Commission, and on its website (www.utilicom.nt.gov.au).