22 August 2012

Dr Patrick Walsh
Utilities Commissioner
NT Utilities Commission
GPO Box 915
DARWIN NT 0801

Dear Dr Walsh

2014 NETWORK PRICE DETERMINATION
FRAMEWORK AND APPROACH CONSULTATION PAPER

Thank you for the invitation to comment on the proposed approach to the 2014 revenue rest review for Power and Water's electricity network. We apologise for responding later than your requested time and we trust that the later response does not cause you significant difficulties.

To assist us in responding to your invitation, we have utilised the resources and knowledge of the National Electricity Market Rules (NER) of our affiliate Major Energy Users (MEU) which has considerable experience in operating as a consumer advocate in the National Electricity Market (NEM).

As a general observation the Northern Territory Major Energy Users (NTMEU) agrees that the alignment of the NT regulatory approach to the revenue reset of Power and Water (PWC) electricity network with the NER is supported for the reasons outlined in your consultation paper. The NTMEU is aware that the Rule changes proposed by the AER and which are under review at this time, are designed to ensure that regulation provides a more efficient outcome for consumers than is achieved under the current Rules. To use the current Rules as the basis for regulating PWC Networks will result in a less efficient outcome for consumers than under the current NT Access Code.

Having stated this, the NTMEU is also aware that the NER are designed to regulate services provided by both private and government firms. Because of this, there are aspects of the NER which provide a clear benefit to government owned network service providers. As PWC is government owned, the NTMEU considers that the rules applying regulation to it should reflect this reality, and not provide PWC with unearned and unnecessary income which provides it with the benefit of reducing pressures to be efficient.

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The NTMEU has one significant problem with the proposal in that, as stated above, the NER are about to undergo significant change, not so much in the general structure of the approach, but in the detail of the application of the rules. The MEU advises us that the changes being proposed by the Australian Energy Regulator (AER) are a result of significant concern with the operation of the NER in relation to network revenue resets and which have resulted in electricity networks (and gas networks) receiving considerably more revenue than is warranted for the service s provided.

As the NER are likely to change considerably in the coming months, the NTMEU queries whether now is the time for the UC to vary its approach to the PWC revenue reset. If the proposal only addresses the structure of how the revenue reset is to be managed, the NTMEU does not have a significant problem with the proposal, as we understand that the structure of the NER revenue resets will be unchanged as a result of the current review of the Rules. If, however, the UC is proposing to use the detail of how the various elements are to be established, the NTMEU has quite significant concerns.

For example, the NTMEU does not agree with the current processes required in the NER in relation to:

- Automatic roll into the RAB of actual capex. The NTMEU is of the view that all capex to be added to the RAB must be demonstrably prudent. This has the flow on effect to establishing the RAB for use in the future.
- The NTMEU does not agree with the basis of the NER which is based on the propose/respond model. The NTMNEU considers that the UC should continue to apply the consider/determine approach that applied under the National Electricity Code (NEC) and is implicit in the NT Access Code. This approach affects both the setting of opex and capex at levels that are probably not as efficient as applied under the consider/determine model used effectively under the NEC. In particular, the propose/respond model allows the NSP to determine which elements of the opex will be based on the outcomes of an Efficiency Benefit Sharing Scheme (EBSS) and which will be set based on a "bottom up" approach. This means large parts of the opex are not being driven by the incentive to reduce opex.
- The NTMEU does not consider that the current AER approach (which we understand is likely to change) to setting the debt risk premium, as it results in costs to consumers that are not incurred by PWC. In this regard we consider that the approach used by the WA's ERA in setting the WACC for Western Power in the recent draft decision, is much more appropriate for setting a five year forward looking cost of capital.
- The NTMEU queries the use of the pre- and post-tax models for regulation in the case of PWC. As a government owned corporation, PWC pays no tax so the tax that is allowed in the revenue stream (designed to reflect the tax that a privately owned NSP has to pay) just adds to the return the government receives from PWC and effectively imposes indirect taxation on electricity consumers. The NTMEU notes that using a post-tax revenue model reduces the amount of tax included in the revenue stream and therefore prefers this model to a pre-tax model.

- The NTMEU is aware that the application of the automatic roll in of actual capex has provided an unnecessary incentive to underspend in early years of a regulatory period and overspend in later years, and in many cases overspend allowances. The discipline provided by an ex post prudency review of all capex should not be removed. We understand that one of the changes the current review of the NER is likely to introduce will be to impose more discipline in this area.
- The NTMEU is concerned that the approach to setting opex under the NER results in considerably more opex being granted than is efficient. The AER has noted that there has been a distinct trend to "game" the setting of future opex as a result of the current rules.
- The MEU has advised us that the complexity in making allowances for future real cost increases in both opex and capex by the AER has resulted in consumers incurring significant additional costs that were not warranted when actual cost changes were identified.
- The costs incurred by network service providers, regulators and consumers in the regulatory process as a result of the introduction of the current Rules have increased massively. As regulatory costs are added to the allowed revenue for NSPs, consumers are effectively paying for NSPs to involve many consultants to "prove" the need for increased costs, putting consumers in the invidious position of paying NSPs to justify higher tariffs which consumers then have to pay.
- The NTMEU agrees that an incentive to increase service levels and efficiency in opex and capex, are desirable. What the NTMEU is concerned about, is that the current NER are not providing the outcomes that such incentive schemes are designed to deliver. In this regard, we note there is no incentive scheme to make capex more efficient (in fact, as noted above, the current NER incentivises less efficient capex), the EBSS is resulting in payments for supposed improved efficiency yet opex costs are rising faster than ever and gaming is more prevalent, and the AER is currently revising its current Service Target Performance Incentive Scheme (STPIS)

As can be seen, the NTMEU has significant problems with the application of the current NER (with all its anomalies) and as they are likely to be significantly changed, the NTMEU queries the sense in converting to Rules that are likely to be changed and, based on the extent of the AER proposals, to a significant degree. It is because of these extensive changes that the NTMEU agrees that perhaps the structure of the NER could be applied to the PWC review but without using the detailed elements that the AER is proposing need change.

Should you wish to discuss in more detail any of the issues we have raised above, please do not hesitate to contact me.

Yours sincerely

Michael Williams
Chair