INQUIRY INTO THE NT ELECTRICITY NETWORK ACCESS CODE:

FINAL REPORT

APRIL 2003

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List of Acronyms

ACCC	Australian Competition and Consumer Commission
CPA	Competition Principles Agreement
NCC	National Competition Council
NEC	National Electricity Code
NECA	National Electricity Code Administrator
NEM	National Electricity Market
NEMMCO	National Electricity Market Management Company Limited
TPA	*Trade Practices Act 1974* (Commonwealth)

CHAPTER 1

INTRODUCTION

Terms of Reference

1.1 Third-party[1] access to the services provided by prescribed[2] electricity networks in the Northern Territory is currently 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 8(3) of the Act and section 31 of the *Utilities Commission Act 2000* – to assist the Minister in his review of the Code.

1.5 The Terms of Reference for this inquiry are reproduced in Appendix A.

The inquiry process

Issues Paper

1.6 To facilitate public consultation, the Commission published an issues paper in December 2002 identifying some of the key issues and questions which the Commission believed should be considered during its inquiry into the effectiveness of the Code. As part of the Commission's inquiry, interested parties were also invited:

- to make submissions to the Commission concerning the effectiveness of the Code; and
- to suggest related or alternative questions or issues which should be considered as part of the Commission's inquiry and report.

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.

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[1] In the context of the services provided by prescribed electricity networks, 'third parties' are generally generators or retailers (other than the generation and retailer business divisions of the network provider) but would also include consumers or end-use customers.

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

1.8 No submissions were forthcoming from NT Power Generation Pty Ltd ("NT Power") or any contestable customer.

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

Draft Report

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

1.11 The Draft Report set out the Commission's conclusions and recommendations based on its analysis of the issues and of the views put by interested parties in the submissions that were received.

1.12 The Draft Report provided a further opportunity for interested parties to make their views known. The Commission indicated its particular interest in receiving further submissions that identified errors of fact, interpretation or judgment on the Commission's part.

1.13 Submissions were again received from Power and Water and NT Treasury. These submissions can be viewed on the Electricity page of the Commission's website.

1.14 In addition, comments were also received from the Groote Eylandt Mining Company Pty Ltd ("GEMCO") and the Territory Insurance Office ("TIO").

Final Report

1.15 The Terms of Reference sought transmittal of the Commission's final report and recommendations to the Minister by 31 March 2003. However, in its Draft Report, the Commission acknowledged that it would be unreasonable to expect interested parties to respond to the matters raised in that report without a minimum consultation period. A period of ten business days was provided for further consultation, and the Minister was advised accordingly.

1.16 As required by section 34 of the *Utilities Commission Act*, the Commission is to deliver a copy of its final report to the Minister. The Minister must then table a copy of the report in the Legislative Assembly within six sitting days after receiving the report. In addition, on the earliest of either the tabling of the report in the Legislative Assembly or within 28 days after receiving the report, the Minister is to ensure that copies of the report are available for public inspection. After the Minister has made the report publicly available, the Commission will ensure that copies are available to members of the public.

CHAPTER

2

EXECUTIVE SUMMARY

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 The Commission has first reached a number of general conclusions.

- Even in the Northern Territory's circumstances, the potential benefits of providing a means whereby third parties can gain access to the services provided by electricity networks on reasonable terms warrant continuation of policy interventions aimed at facilitating third-party access to electricity networks (**recommendation 1**).
- The Code is the most appropriate policy instrument available for promoting third-party access to the services provided by electricity networks in the Northern Territory. Switching to alternative policy instruments may only increase costs without guaranteeing improved outcomes (**recommendation 2**).
- The Code's general effectiveness could be improved by reducing associated administrative and compliance costs and providing 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 could be improved by reducing the uncertainties and impediments faced by access seekers and existing network users, wherever this can be achieved without unduly impacting on the public costs associated with access regulation (**recommendation 4**).

2.3 Based on these general conclusions, the Commission's analysis results in a series of specific recommendations aimed at ensuring the continued effectiveness of the Code.

2.4 The Commission has framed all of its recommendations with a view to ensuring that the Code continues to be consistent with the principles set out in clause 6 of the Competition Principles Agreement, so as not to impact upon the Code's status as a 'certified' effective access regime under Part IIIA of the *Trade Practices Act 1974*.

2.5 In some respects, the Commission has considered it important to reaffirm the importance of certain provisions of the Code. However, in respect of some of the other provisions of the Code, the Commission has identified changes capable of either:

- reducing the costs, or increasing the certainty, facing the network provider; and/or
- increasing the benefits, and increasing the certainty, available to network users and access seekers.

Provisions requiring no change

2.6 In several important respects, the Commission recommends no change to the Code or to related provisions of the Act.

2.7 With regard to Part 1 of the Code, the Commission recommends that the generation-related provisions be retained at their present location (**recommendation 27**).

2.8 With regard to Part 3 of the Code, the Commission recommends that the following provisions be retained in their present general 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**); and
- the out-of-balance energy charging provisions in chapter 9 of the Code (**recommendation 61**).

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

- the Ministerial responsibility for determining the electricity networks covered by the Code (**recommendation 10**); and
- the enforcement provisions (**recommendation 37**).

Recommendations for change

2.10 To improve the effectiveness of the Code, the Commission has seen fit to recommend a series of changes to the Code (and associated provisions of the Act).

2.11 The recommendations for change made by the Commission are of three types:

(a) amendments to the Code, for immediate implementation;

(b) possible amendments to the Code, subject to further consideration by Code participants; and

(c) possible amendments to associated provisions of the Act, for further Ministerial consideration.

Amendments to the Code, for immediate implementation

Substantive matters

2.12 Of those recommendations involving changes to the Code for immediate implementation, the Commission would nominate the following six recommendations as being substantive or 'key' from its perspective. Without these changes, it is the Commission's considered view that the Code will be less effective than is possible in the Territory's circumstances.

2.13 The following list of these key recommendations is presented in order of importance (based upon the Commission's assessment of the associated potential for improvements to the effectiveness of the Code). The effectiveness of the Code would be materially improved by implementation of each of these recommendations.

- Provision should be made within the Code whereby an interested party may initiate consideration of amendments to the Code. The processes whereby such changes are considered by all interested parties and decided by the Minister should be along the lines proposed by the Commission (and based on the general approach followed under the National Electricity Code) (**recommendation 5**). The Commission has set out a Code review process in paragraph 4.61 of this Report based on the Code change process applying in the National Electricity Code.
- Part 3 of the Code (and associated schedules) should be amended as soon as possible to remove any doubt that the price control methodology to be used in the second and subsequent regulatory control 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**).
- Clause 63 of the Code should be amended to explicitly include in the pricing principles that regulated access prices are to 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 that regulated service or services, and includes a return on investment commensurate with the regulatory and commercial risks involved (**recommendation 47**).
- Clause 72(2)(b) of the Code should be amended (a) to include within the class of 'included services' those services provided by the network provider which in the regulator's opinion do not lend themselves to being regulated via the general price control mechanisms set out in chapters 6 and 7 of the Code; and (b) to provide that (i) a network provider should be required to provide these types of 'included services' to network users on fair and reasonable terms and (ii) the regulator may determine the fair and reasonable terms which should apply to the provision of such an 'included service' if the network user and the network provider are unable to reach agreement (**recommendation 49**).
- Provision should be made in the Code for the regulator to be authorised to develop and publish 'guidelines' and 'directions' in response to a request from the network provider, a network user or an access seeker who can demonstrate that a material uncertainty exists regarding the conduct of Code participants that would be consistent with the requirements of the Code, and provided the regulator is satisfied that a net public benefit would arise if such guidelines or directions were to affect the conduct of Code participants. The consultation process required of the regulator when developing and publishing such guidelines and directions should be the same as required of the regulator under section 24 of the *Utilities Commission Act* when developing and publishing codes and rules (**recommendation 8**).
- 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. The Code review process at recommendation 5 should apply to any exercise of this power (**recommendation 21**).

Minor/technical matters

2.14 Of those recommendations involving changes to the Code for immediate implementation, the Commission considers the following to be minor or technical in nature, and perhaps less contentious than the key recommendations listed above. The Commission recommends 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 to be considered 'any other matters that the regulator considers are relevant' (**recommendation 7**);
- clause 63 of the Code be amended to include an additional paragraph referring to such other outcomes as the regulator determines are consistent with the objects of the Code (**recommendation 46**);
- the definition of 'regulatory control period' in clause 3 of the Code be amended to remove any doubt that such periods in future are to be five years in length (**recommendation 50**); and
- provided a Code review process is adopted (recommendation 5), clause 82(2A)(b) be deleted (**recommendation 62** (part)).

Possible amendments to the Code, subject to further consideration by Code participants

2.15 The Commission also flags that some issues deserve further consideration, in consultation with interested parties, than has been possible during the Commission's inquiry. The Commission believes that these issues are best dealt with via the introduction of the Code review process proposed in recommendation 5. In this way, each issue could be examined in isolation, all interested parties would be given an opportunity to input into the decision-making process and a detailed recommendation (including draft wording for implementing the recommendation) could be submitted to the Minister for final consideration, approval and implementation.

2.16 The long list of such matters means that some prioritisation will be required. It may be that some of these reviews will not be undertaken for some considerable time.

Substantive matters

2.17 Of these recommendations, some involve issues that are substantive in nature, either because they have the potential to materially improve the effectiveness of the Code or the balance between the costs and benefits associated with any changes may be contentious.

2.18 Using the Code review process at recommendation 5, the Commission recommends further consideration should be given (in order of recommendation) to:

- whether clause 6A(2) of the Code should be amended to include in the list of information to be supplied by the network provider to access applicants a reference to such other information as the regulator requires from time to time (**recommendation 18**);
- whether the Code should be amended to provide for the regulator's approval of a default use-of-system agreement and/or a default connection agreement (**recommendation 20**);
- whether 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 (**recommendation 24**);
- whether clause 11(2)(a) of the Code should be amended to allow an access seeker to request 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 (**recommendation 25**);
- 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**);

- whether clause 35 of the Code should be amended to allow any party to an access application to declare that a dispute exists by notifying the regulator (**recommendation 32**);
- whether amendments are required to the arrangements applying in clause 18 of the Code for assigning available network capacity between competing access applications (**recommendation 40**);
- whether amendments are required to clarify the rights of network users under existing access agreements as currently defined in chapter 2 of the Code (**recommendation 41**);
- whether 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) (**recommendation 42**);
- the most appropriate means by which individual contestable customers might be advised, as a matter of course, about the network component of their cost of electricity supply (**recommendation 57**);
- the role that might be played by the regulator in chapter 8 in oversighting the setting of capital contributions (including prudential requirements) (**recommendation 59A**); and
- whether changes are necessary to the methodology for estimating network energy losses contained in schedule 13 (**recommendation 62** (part)).

Minor/technical matters

2.19 The Commission has also identified a number of minor technical or drafting improvements that could be made to the Code which deserve further consideration among interested parties.

2.20 When considered separately, the impact of these various deficiencies identified by the Commission is relatively minor. However, when considered in total, these deficiencies are capable of creating a good deal of uncertainty and clearly undermine the effectiveness of the Code by confusing and diluting the policy objectives which are sought to be achieved by the Code.

2.21 The Commission has identified a number of such deficiencies, to which the following recommendations relate:

- Part 2 of the Code (**recommendations 19**, **22**, **28**, **30**, **31**, **33**, **35**, **36**, **39**, **43** and **44**); and
- Part 3 of the Code (**recommendations 48**, **52**, **53, 55**, and **60)**.

Possible amendments to associated provisions of the Act, for further Ministerial consideration

2.22 Finally, the Commission has identified aspects of the related provisions of the Act that deserve further Ministerial consideration. Without these matters being addressed, the possibility remains that the Code's effectiveness is less than it might otherwise be in the Territory circumstances.

2.23 In particular, and in order of importance (based upon the Commission's assessment of the associated potential for improvements to the effectiveness of the Code), the Commission recommends that further consideration be given within the Government to amendments to the Act being sought:

- to include a specific objects clause along the lines that the Northern Territory's third-party access regime is to promote the economically efficient operation and use of, and investment in, essential electricity network infrastructure, thereby promoting effective competition in upstream and downstream markets (**recommendation 6**);
- in relation to section 14, to delete sub-section (5) and thereby ensure that the review provisions in Part 6 of the *Utilities Commission Act* are applicable to a determination or approval made by the regulator under the Code, and to add an error of law as a ground of appeal under sub-section (3) (**recommendation 9**);
- in relation to sections 26(1) and 26(2), to cap, rather than exclude, liability for acts or omissions under the Code (**recommendation 17**);
- to include a direct right to claim compensation for a contravention of the Code (**recommendation 38**);
- in relation to section 5, to incorporate the general criteria that the Minister may take into account when determining which networks are to be covered by the Code (**recommendation 11**);
- in relation to section 26, to nominate the appropriate form of the limitation from liability applying to a 'system control' type of act or omission under the Code (**recommendation 16**);
- in relation to section 11(1), to achieve consistency with section 8 of the *Utilities Commission Act* (**recommendation 12**); and
- in relation to section 26, to achieve consistency with equivalent provisions in the *Utilities Commission Act* and the *Electricity Reform Act* (**recommendation 13**).

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 In its submission addressing the Issues Paper, 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:

- the retail business unit of Power and Water ("Power and Water Retail") and the generation business unit of Power and Water ("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/provider 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 that the Commission is entitled to inquire into matters which fall outside the Minister's 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 issue a requirement or direction to the

[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).

Commission under section 31(3) of that Act. On 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 the application of the Code since 1 April 2000 (particular given that there exists very little direct experience with the application of the Code in the Northern Territory).

3.19 However, 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 and ongoing critical review in other jurisdictions over the last 10 years, including in:

- the Hilmer Report;[4]
- the Productivity Commission's report of its review of the national access regime;[5]
- the National Competition Council's ("NCC") submission to the Productivity Commission Review;[6] and
- the continuous and ongoing development of the National Electricity Code ("NEC") by the National Electricity Code Administrator ("NECA"), the National Electricity Market Management Company ("NEMMCO"), the Australian Competition and Consumer Commission ("ACCC") and the governments of the jurisdictions participating in the National Electricity Market ("NEM").

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.

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

Coverage of the inquiry

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

"…consider and report on the Code in its entirety including:

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

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.

Commission's draft analysis and conclusions

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 the services provided by Power and Water's electricity 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 section 4(1) of 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.[8]

3.28 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.

[8] For example, TIO commented on the broader competition regime by making the following observations:

"…..regarding our experiences so far in our involvement to date with the contestability process.

1. An apparent failure to deliver primary outcome objective of lower cost to the consumer.

2. Failure to stimulate competition in the industry locally.

3.The imposition of extra costs in having to consider implications of lengthy and complex terms and conditions issues contained in service contracts we are now forced to enter into (we only want to continue to receive a utility service!)"

Views in submissions on the Draft Report

3.29 None of the parties raised concerns about inclusion of the Act in the scope of the Commission's inquiry in submissions in response to the Issues Paper.

3.30 However, in response to the Draft Report, NT Treasury raised concerns regarding the Commission's inclusion of consideration of the relevant provisions of the Act within the scope of this Review, arguing that:

> *"…several recommendations contained in the [Draft] report address problems identified within the Electricity Networks (Third Party Access) Act and therefore appear to be outside of the Commission's terms of reference for this review. …it seems appropriate that they be provided separately, outside of the current review." (covering letter)*

3.31 Likewise, in its response to the Draft Report, Power and Water argued that:

> *"Many of the recommendations are for changes to the Electricity Networks (Third Party Access) Act, not the Code. Neither the terms of reference for the Inquiry nor the Issues Paper anticipated consideration of specific legislative amendments." (p.3)*

Commission's final position

3.32 The Commission acknowledges the concerns that arose after the Draft Report regarding whether the Commission was appropriate in canvassing changes to the Act as well as the Code.

3.33 The Commission does not dismiss these concerns out of hand. However, it was not in the end prepared to restrict its considerations to the Code only as suggested by NT Treasury, on the following grounds:

- the Code's effectiveness is directly related to provisions contained in both the Code and the Act – just where a particular provision has been located (whether in the Act or in the Code) relates mainly to whether or not the provision requires explicit backing in law; and
- the Commission's findings are in the nature of recommendations, rather than a determination or a decision, with the Commission preferring to canvass those issues it considers appropriate to address the Terms of Reference and then to leave it to the Minister (as the final decision maker) to decide on the extent to which the Commission's views are appropriate or acceptable for the task at hand.

3.34 Nevertheless, the Commission has endeavoured to make a careful distinction between those of its recommendations that might impact on the Act as opposed to the Code, and to frame its recommendations accordingly. In particular, where consideration of changes to the Act are involved, the Commission has opted to formulate its final recommendations in terms of the Minister undertaking consideration or further consideration of the issue at hand.

Role of recertification

3.35 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."*

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

3.37 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 the services provided by the relevant infrastructure under the Part IIIA provisions, and means that the

access regime established by the Code represents the sole legal mechanism for third-party access to the services provided by the prescribed electricity networks in the Northern Territory.[9]

3.38 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 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."*[10]

3.39 In general, as the desired policy outcomes of the Code are consistent with the CPA's clause 6 principles *and* the matters that the Commission is obliged to take into account in the performance of all its function by section 6(2) of the *Utilities Commission Act* are consistent with the CPA's clause 6 principles, the Commission considers that any recommendations it makes aimed at improving the effectiveness of the Code necessarily will be *in principle* consistent with the CPA.

3.40 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. 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

3.41 In its submission on the Issues Paper, 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

3.42 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.

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[9] 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 undertaking to the ACCC. Acceptance of an undertaking provides an equivalent outcome to certification – services covered by that regime are made immune from declaration.

[10] 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 the services provided by 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 on behalf of the end-use customer or its retailer via network infrastructure or facilities, being the system of poles and wires operated for this purpose).

4.5 The provision of the network infrastructure used to transport 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 electricity supply chain, since a generator or retailer can only supply electricity to its customers if it can transport this electricity via the network infrastructure. 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 transportation and other services provided by the network infrastructure.

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

- access to these services is essential to permit effective competition in upstream or downstream activities; and
- the granting of this 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 relating to the provision of network access services that are fair and reasonable.

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, the regulatory framework also aims to address any imbalance between the bargaining position of the network provider and third parties seeking access.

Views in submissions on the Issues Paper

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 regimes are designed to curb the market power that attaches to the owner of network infrastructure. Electricity networks are generally regarded as 'natural monopolies'; i.e., 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 the services provided by 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 made by the Commission below are intended to improve the scope for potential benefits.

4.18 Accordingly, it was the Commission's draft recommendation that the benefits possible warrant continuation of policy interventions aimed at facilitating third-party access to electricity networks, even in the Territory's circumstances (draft recommendation (1)).

4.19 No objections were raised to this recommendation in submissions in response to the Draft Report.

> ***Recommendation 1 Even in the Northern Territory's circumstances, the potential benefits of providing a means whereby third parties can gain access to the services provided by electricity networks on reasonable terms warrant continuation of policy interventions aimed at facilitating third-party access to electricity networks.***

Policy alternatives to access regulation

4.20 Access regimes are only one of several policy interventions (i.e., policy instruments) available for addressing monopoly power in the delivery of essential infrastructure services. Other possible policy instruments include:

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

4.21 Structural separation to address the essential services 'problem' was strongly advocated in the Hilmer Report.[11] 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.

4.22 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.

4.23 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 on the Issues Paper

4.24 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.

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

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

"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

4.26 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
- there may be cost savings from overcoming information imbalances that can make contracting and contract enforcement difficult under separated provision.

4.27 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 circumstances 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.

4.28 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.

4.29 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.

4.30 Accordingly, it was the Commission's draft recommendation that 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 (draft recommendation (2)).

4.31 No objections were raised to this recommendation in submissions in response to the Draft Report.

Recommendation 2 The Code is the most appropriate policy instrument available for promoting third-party access to the services provided by electricity networks in the Northern Territory. Switching to alternative policy instruments may only increase costs without guaranteeing improved outcomes.

The costs of access regulation

4.32 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.

4.33 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.

4.34 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.

Views in submissions on the Issues Paper

4.35 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)*

4.36 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

4.37 The Commission considers 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 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 third-party access.
- Finally, many of these regulatory requirements are designed to ensure that there exist no barriers to 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.

4.38 None of this denies that refinement of the Code could not reduce costs. Some of the recommendations made by the Commission below are intended to reduce the scope for unnecessary costs.

4.39 Accordingly, it was the Commission's draft recommendation that the Code's general effectiveness could be improved by efforts to reduce associated administrative

and compliance costs and to provide greater certainty to the network provider, wherever this were achieved without unduly impacting on the public benefits possible from access regulation (draft recommendation (3)).

4.40 No objections were raised to this recommendation in submissions in response to the Draft Report.

> ***Recommendation 3 The Code's general effectiveness could be improved by reducing associated administrative and compliance costs and providing 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

4.41 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 on the Issues Paper

4.42 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.

4.43 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)*

Commission's analysis and conclusions

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

4.45 In line with the Productivity Commission Review's conclusion regarding the national access regime, the Commission considered that it would be inappropriate to abandon access regulation in such circumstances. A preferable strategy would be to continue to monitor the effects of the Code (as modified to reflect the outcome of this inquiry and the Minister's review) and to review it again when there has been further experience with third-party access in the Northern Territory or to reflect the development of the NEC and the electricity access regimes operating in other Australian jurisdictions.

4.46 Accordingly, it was the Commission's draft recommendation that the Code's general effectiveness could 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 (draft recommendation (4)).

4.47 No objections were raised to this recommendation in submissions in response to the Draft Report, although NT Treasury noted that:

> *"…due care is required that such interventions do not inappropriately disadvantage the incumbent network provider." (p.1)*

Recommendation 4 The Code's general effectiveness could be improved by reducing the uncertainties and impediments faced by access seekers and existing network users, wherever this can be achieved without unduly impacting on the public costs associated with access regulation.

Fine-tuning costs against benefits

4.48 The Commission's recommendations 3 and 4 involve a recognition that scope exists, at the margin, to improve the Code's benefits and reduce its costs. To achieve such 'fine-tuning' requires a review mechanism, possibly in addition to that provided under sections 8(1) and 6 of the Act which respectively provide that the Minister may review and amend the Code at any time.

Views in submissions on the Issues Paper

4.49 NT Treasury supported reviews of the Code prior to the commencement of each regulatory control period. No special provision was considered necessary, however, as section 8(1) of the Act already allows for review at any time.

4.50 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.

4.51 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)*

4.52 Power and Water noted that, while section 6 of the Act allows the Minister to amend the Code and section 8 of the Act 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 and any person might submit a Code change proposal to the body charged with the ongoing review and development of the Code.

Commission's draft analysis and conclusions

4.53 The Commission agreed with Power and Water's comment that the Code should include a procedure whereby interested parties can initiate consideration of amendments to the Code at any time. 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 NEC can only be amended after extensive consultation with interested parties and the completion of separate reviews by a code change panel and NECA.

4.54 Clause 8.3 of the NEC sets out an elaborate procedure by which code changes are to be suggested, considered and recommended, including:

- the establishment of an independent, expert code change panel (sub-clause 3.2);
- how the NEC may be changed (sub-clause 3.3);

- how matters may be referred to the code change panel (sub-clause 3.4);
- the processes to be followed by the code change panel when considering and recommending code changes (sub-clause 3.5);
- the processes to be followed by NECA in considering and deciding upon recommendations for change made by the code change panel (sub-clause 3.6);
- the processes to be followed by the ACCC in considering whether any code change accepted by NECA affect authorisations granted under the TPA (sub-clause 3.7); and
- the processes to be followed by NECA in implementing and publishing code changes (sub-clauses 3.8 to 3.11).

4.55 The Commission supported a version of this process as being appropriate for inclusion in the Code and the Act. However, given the size of the Northern Territory's electricity supply industry, the Commission considered that a separately-constituted code change panel may not be cost-effective. Rather, the Commission suggested that it be charged with overseeing any Code amendment, review and consultation process.

4.56 Accordingly, it was the Commission's draft recommendation 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 NEC (draft recommendation (5)).

Views in submissions on the Draft Report

4.57 Power and Water supported draft recommendation (5).

4.58 By contrast, NT Treasury expressed some scepticism arguing that:

> *"At present there do not appear to be any legislative impediments for interested parties to initiate amendments to the Code." (p.1)*

Commission's final position

4.59 In the Commission's view, the NT Treasury comment misses the point. What is available to Code participants under the NEM is an effective and inclusive review mechanism that can be activated in a timely manner, and which results in a clear recommendation for change. It is difficult to see why parties to the Territory's access regime should be denied an equivalent review process.

4.60 However, the Commission recognises that its Draft Report did not detail the 'truncated version' of the NEC review process that might be appropriate in the Northern Territory.

4.61 Based on clause 8.3 of the NEC, the Commission considers that a *Code review process* that might be appropriate to the Territory's circumstances and suitable for incorporating into the Code is as follows:

- any interested party (whether that be the network provider, an access seeker, or a network user) may make a written submission to the regulator nominating a provision of the Code to which they consider a change may be necessary or desirable;
- the regulator must consider the proposed change and, within five business days after the submission, give notice to the person who made the submission as to whether or not the proposed change is, in the regulator's opinion, of such a nature that further consideration is warranted;
- if the regulator considers that the proposed change is of such a nature that further consideration is warranted or if the regulator wishes to initiate consideration of a Code change itself, it must give notice to the Minister and to

all interested parties giving particulars of the proposed change and inviting written submissions concerning the proposal;

- the regulator must allow interested parties a minimum of 30 business days to prepare and lodge such submissions;
- the regulator must consider all valid submissions within a further 20 business days, by which time it should publish its recommendations or findings in draft form which should include, if an amendment to the Code is recommended, the proposed text of the amendment;
- in formulating any recommendations or findings, the regulator must take into consideration the objects of the Code (and the Act), and must seek to give maximum effect to market (as opposed to regulatory) mechanisms where possible;
- the regulator must allow interested parties a minimum of 30 business days to prepare and lodge submissions on its draft recommendations or findings;
- the regulator must consider all valid submissions made in response to its draft findings within a further 20 business days, by which time it should submit a report to the Minister containing its final recommendations or findings along with its reasons and – if an amendment to the Code is recommended – the proposed text of the amendment;
- the Minister should then consider whether or not to favour or reject the adoption and implementation of all or any of the recommendations contained in the regulator's report;
- the Minister should only accept a Code change recommended by the regulator if he considers the change would further the objects of the Code (and the Act); and
- within a prescribed period, the Minister should notify all interested parties of his decision concerning the regulator's recommendations and, if the Minister decides to reject some or all of the regulator's recommendations, the Minister's reasons for that decision.

4.62 In addition, as with the NEC, the Commission considers this Code review process could be added to the Code itself, rather than to the Act.

4.63 Effectively, the process proposed would establish a transparent and cost-effective mechanism by which advice is formulated for the Minister as a basis for the exercise of his powers under section 6 of the Act.

4.64 The Commission considers its recommendation for a Code review process to be one of its key recommendations.

Recommendation 5 Provision should be made within the Code whereby an interested party may initiate consideration of amendments to the Code. The processes whereby such changes are considered by all interested parties and decided by the Minister should be along the lines proposed by the Commission (and based on the general approach followed under the National Electricity Code).

CHAPTER

5

PART 1: OBJECTS AND DISCRETIONS

Introduction

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

5.2 Part 1 of the Code provides background and some general provisions. In this context, the Commission found it necessary and useful to consider relevant provisions of the Act itself (specifically Parts 2 to 6 of the Act) in conjunction with Part 1.

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 The unstated 'objects' of the Code appear to be the same as those of Part IIIA of the TPA and clause 6 of the CPA.

5.7 However, these objects must be imputed from those of clause 6 of the CPA and of Part IIIA of the TPA, as they are not separately and specifically identified in the Act or the Code. Moreover, how satisfactory these objects are for the purposes of the Act and the Code depends upon how relevant the current objects of clause 6 of the CPA and of Part IIIA of the TPA are to the Code. For example, clause 6(4)(i) of the CPA sets out various matters which need to be taken into account when resolving any access dispute. The Code extends to cover a broader range of issues which may involve the consideration of different principles and objectives.

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."*[12]

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."*[13]

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…"*

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[12] NCC Submission, p.8.

[13] Productivity Commission Review, p.126.

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…"[14]

Views in submissions on the Issues Paper

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[15] 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.

[14] Productivity Commission Review, p.130.

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

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. Any amendment to 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.

5.24 However, 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 overall administration of the Code as it applies to matters other than terms and conditions for access. Therefore, a separate objects clause could be developed which picks up only those aspects of clause 2(2) of the Code which are relevant and appropriate to the overall administration of the Code.

5.25 It would also be useful to have regard to the structure of the *Utilities Commission Act* and the *Electricity Reform Act*. Section 3 of the *Electricity Reform Act* sets out the broad objects of that Act. Some of these objects are equally relevant to the Act and the Code.

5.26 Section 2 of the *Utilities Commission Act* sets out the broad objects of that Act. Section 6 of the *Utilities Commission Act* goes on to provide that the Commission has certain functions and that the Commission must have regard to certain matters when performing the Commission's functions.

5.27 The Commission believes that the Act and the Code should be amended to adopt this type of structure. For example, clause 2(2) of the Code should be amended to provide that the regulator (in addition to the matters set out in section 6(2) of the *Utilities Commission Act*) take into account or consider the various matters listed in clause 2(2) of the Code when deciding upon the terms and conditions for access.

5.28 The Commission agrees that the use of the word 'must' in place of 'should' in clause 2(2) of the Code would clarify the mandatory nature of this requirement. However, the Commission also believes that:

- the regulator or an arbitrator should also be entitled to take into account any other relevant matters when making a decision; and
- clause 2(2) of the Code should also make it clear that the regulator or an arbitrator is only required to demonstrate that it has considered each of these issues when making its decision.

5.29 While Power and Water refers to section 2.24 of the National Third Party Access Code for Natural Gas Pipeline Systems ("National Gas Code"), which is a schedule to the *Gas Pipelines Access (South Australia) Act 1997* ("Gas Access Act"), 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 clause were expressed as a mandatory obligation. The exact wording of section 2.24(g) of the National Gas Code is set out below for ease of reference:

> *"The Relevant Regulator may approve a proposed Access Arrangement only if it is satisfied the proposed Access Arrangement contains the elements and satisfies the principles set out in sections 3.1 to 3.20. The Relevant Regulator must not refuse to approve a proposed Access Arrangement solely for the reason that the proposed Access Arrangement does not address a matter that sections 3.1 to 3.20 do not require an Access Arrangement to address. In assessing a proposed Access Arrangement, the Relevant Regulator must take the following into account:*
>
> *(i) the Service Provider's legitimate business interests and investment in the Covered Pipeline;*
>
> *(ii) firm and binding contractual obligations of the Service Provider or other persons (or both) already using the Covered Pipeline;*

(iii) the operational and technical requirements necessary for the safe and reliable operation of the Covered Pipeline;

(iv) the public interest, including the public interest in having competition in markets (whether or not in Australia);

(v) the interests of Users and Prospective Users;

(vi) any other matters that the Relevant Regulator considers are relevant."

5.30 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 regulator must only take into account the matters listed in that clause when undertaking a function assigned to the regulator 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*.

5.31 As supported by both parties who made submissions, it was the Commission's draft recommendation 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 TPA (draft recommendation (6)); and
- 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 (draft recommendation (7))

5.32 No objections were raised to these recommendations in submissions in response to the Draft Report.

5.33 The Commission recognises that the object clause could be placed in the Act itself (which currently has no objects clause), leaving clause 2 to state the specific objectives of the Code.

Recommendation 6 The Minister should give consideration to an amendment to the Act being sought aimed at including a specific objects clause along the lines that the Northern Territory's third-party access regime is to promote the economically efficient operation and use of, and investment in, essential electricity network infrastructure, thereby promoting effective competition in upstream and downstream markets.

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 to be considered 'any other matters that the regulator considers are relevant'.

Extent of regulatory discretion

5.34 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.

5.35 Notably, section 11(2) of the Act expressly prohibits the Minister from directing the regulator to suppress or vary determinations or approvals made by the regulator 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.

5.36 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 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]

5.37 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.

5.38 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 on the Issues Paper

5.39 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.*

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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.

> *…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)*

5.40 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 draft analysis and conclusions

5.41 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.

5.42 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).

5.43 Distribution network providers were required to grant access to the services of their distribution networks to retailers on fair and reasonable terms. If a retailer and distribution 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.

5.44 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.

5.45 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.

5.46 Experience has also 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.

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

5.48 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.

5.49 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 a timely Code review process as proposed in recommendation 5.

5.50 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 were being provided. This situation would have continued if a form of default use-of-system agreement had not been introduced.

5.51 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 potential issues. Rather, the Commission considers that it would be preferable if the Code authorised the regulator to develop and publish – in consultation with interested parties – detailed 'guidelines' and 'directions' as and when those guidelines and directions are required and following processes similar to those required for the development and publication of codes and rules under the *Utilities Commission Act*.

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

5.53 Accordingly, it was the Commission's draft recommendation 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 (draft recommendation (8)).

Views in submissions on the Draft Report

5.54 NT Treasury argued that:

> *"The Commission has not adequately justified its recommendation to make the Code generally more prescriptive. Other review mechanisms (that exist and are recommended, including a default access agreement) as well as the regulator's current discretionary powers appear sufficient to deal with uncertainties as they arise. It is unclear that there is a need to provide the regulator with broader and largely unspecified regulatory powers." (pp.1-2)*

5.55 By contrast, Power and Water did not object to this draft recommendation.

Commission's final position

5.56 Contrary to NT Treasury's suggestion, the Commission does not currently have any discretionary powers that would enable it to deal with uncertainties as they arise. It could seek legislative amendment or Regulations to authorise it to make 'codes' and 'rules' consistent with section 24 of the *Utilities Commission Act*, but in the

Commission's experience this process is unlikely to be timely and can only result in regulatory prescription rather than guidance.

5.57 However, to offset concerns that a regulator could unilaterally use the proposed powers in the pursuit of some imagined agenda of its own, the draft recommendation deserves to be changed to make clear that only interested parties (be they the network provider, network users or access seekers) – rather than the regulator – could initiate development of 'guidelines' or 'directions' in response to identified uncertainties about the application of the Code in circumstances which may have arisen.

5.58 The processes to be followed should be similar to those suggested with regard to the Code review process in recommendation 5 (except that Ministerial approval would not be appropriate or warranted), namely:

- any interested party (whether that be the network provider, an access seeker, or a network user) may make a written submission to the regulator nominating a provision of the Code which, in that party's view, requires clarification and guidance;
- the regulator must consider such a request for clarification or guidance, within five business days after the submission, give notice to the person who made the request as to whether or not the clarification or guidance being sought is, in the regulator's opinion, of such a nature that further consideration is warranted;
- if the regulator considers that the proposed clarification or guidance is of such a nature that further consideration is warranted, it must give notice to all interested parties giving particulars of the clarification or guidance being sought and inviting written submissions concerning the proposal;
- the regulator must allow interested parties a minimum of 30 business days to prepare and lodge such submissions;
- the regulator must consider all valid submissions within a further 20 business days, by which time it should publish its clarification or guidance ('guidelines') in draft form;
- in developing any guidelines, the regulator must take into consideration the objects of the Code and must seek to give maximum effect to market (as opposed to regulatory) mechanisms where possible;
- the regulator must allow interested parties a minimum of 30 business days to prepare and lodge submissions on its draft guidelines; and
- the regulator must consider all valid submissions made in response to its draft findings within a further 20 business days, by which time it should publish its final guidelines along with supporting rationale.

5.59 To enable the Minister to retain oversight of this process (given his power to amend the Code), the enabling provisions are best placed in the Code rather than, as in the draft recommendation, in the Act.

5.60 The Commission considers its recommendation for a standing guidelines development power to be one of its key recommendations.

Recommendation 8 Provision should be made in the Code for the regulator to be authorised to develop and publish 'guidelines' and 'directions' in response to a request from the network provider, a network user or an access seeker who can demonstrate that a material uncertainty exists regarding the conduct of Code participants that would be consistent with the requirements of the Code, and provided the regulator is satisfied that a net public benefit would arise if such guidelines or directions were to affect the conduct of Code participants. The consultation process required of the regulator when developing and publishing such guidelines and directions should be the same as required of the regulator under section 24 of the Utilities Commission Act when developing and publishing codes and rules.

Review and appeal

5.61 Section 14(1) of the Act provides that the determinations and approvals made by the regulator under Part 3 of the Code are final. Section 14(5) provides that the review provisions in Part 6 of the *Utilities Commission Act* do not apply in respect of a determination or approval of the regulator made under the Code. Together, these provisions have the effect of eliminating any review of decisions made by the regulator (including by the Commission under section 27 of the *Utilities Commission Act).*

5.62 While appeals against a determination or approval of the regulator under the Code under section 28 of the *Utilities Commission Act* are prevented by section 14(5) the Act, section 14(2) provides the right of appeal. However, section 14(3) limits the grounds for such an appeal to questions of bias or misinterpretation of facts.

5.63 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]

Views in submissions on the Issues Paper

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

5.65 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*

[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).

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)

5.66 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)

5.67 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 draft analysis and conclusions

5.68 The Commission understands that the reason for the regulator's determinations or approvals under the pricing provisions (Part 3) of the Code being final are akin to those associated with the denial of review of the merits of an arbitrator's decisions. The regulator's role in Part 3 is that of the pricing arbitrator. This is clearly provided for in clause 41 of the Code.

5.69 With respect to Power and Water's suggestion to establish a separate expert panel to deal with questions of fact associated with an appeal, the Commission expressed the view that there is ample opportunity for the opinions of experts to be taken into account during the decision and that the establishment of an expert panel may not be warranted given the small size of the Territory's electricity supply market.

5.70 As to the appropriate grounds for subsequent appeal to the courts against the regulator's decisions or determinations, the Commission noted that access seekers generally prefer limits on the scope of appeal 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.

5.71 The Commission acknowledged that, 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.

5.72 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 regulator 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.

5.73 In relation to section 14 of the Act, the Commission considers that limiting the grounds for appeal to bias or material errors of fact should be sufficient *provided* errors of law are also added as a ground of appeal.

5.74 It was the Commission's draft recommendations that the review and appeal provisions of the Act be retained in their present form (draft recommendation (9)).

Views in submissions on the Draft Report

5.75 NT Treasury agreed with the draft recommendation.

5.76 By contrast, Power and Water strongly opposed this draft recommendation.

> *"The Regulator has dismissed calls for an appeals provision, out of hand. This is despite both calls by the Productivity Commission for appeal processes to be introduced and principles promoted in Best Practice Utility Regulation by the Utility Regulators' Forum."*

5.77 Power and Water disagreed with the suggestion that the issuing of regulatory decisions in draft form prior to a final decision being made allowed parties to identify issues such as bias and errors of fact or interpretation. Power and Water argued that:

> *"…review mechanisms increase investor confidence, through lessening perceptions of possible regulatory risk. This is because regulation involves implementation of instruments with a range of possible interpretations, with each interpretation of material financial effect for investors in regulated utilities. Investors have little choice but to factor in the risk of disadvantageous regulatory decisions in deciding whether to invest in either assets or systems.*
>
> *...Regulatory risk is therefore mitigated through reducing the possibility of interpretative error. Review procedures lessen interpretive error by ensuring that decisions are tailored towards meeting the objectives set under the regulatory instrument, and provide necessary quality assurance of decision making processes.*
>
> *There are negative impacts in avoiding review or appeal procedures. National Economic Research Associates noted in their submission to the PC Review that "a regulatory regime that lacks a clear path of reliable appeal to an independent judiciary will fail to gain investor trust". There is a link between the integrity of a regulatory system, and the level of regulatory risk inherent in that system, with the willingness of investors to provide capital.*
>
> *Most importantly, however, review mechanisms provide Regulator's with an ongoing check on the effectiveness of the regime." (pp.5-6)*

5.78 Further, Power and Water cited both the NCC and the Utility Regulators Forum in support of their conclusion that:

> *"The need for an appeals mechanism is supported by Power and Water, by the PC Review, and by other Regulatory bodies. This supports a more extensive review of the need for an appeals mechanism in the Northern Territory than provided by the Regulator." (p.6)*

Commission's final position

5.79 Submissions generally failed to make a clear enough distinction between 'reviews' and 'appeals':

- a review process is administrative in nature and deals with the merits of the decision in question; and
- an appeals process is judicial in nature, and depends on the allowed grounds of appeal.

5.80 As to review processes under the Code, the Commission recognises that any determination or approval of the regulator under the Code is currently not subject to the review processes set out in section 27 of the *Utilities Commission Act*, in contrast to any other of the Commission's determinations and approvals. While there may be grounds for this distinction given the regulator's role as a pricing arbitrator, the Commission acknowledges that permitting reviews by the Commission in accordance with section 27 of the *Utilities Commission Act* would not be inconsistent with the Commission's determination or approval as a pricing arbitrator being final. Such a review process would increase the Commission's accountability by requiring greater articulation of the Commission's processes of consideration and reasoning, thereby

potentially adding to the evidence that would be available were an appeal subsequently launched.

5.81 The Commission accepts that it cannot escape accountability for its decisions, even when it is performing the role of a pricing arbitrator and its decisions are final. It has never sought to do so. After further consideration, the Commission sees merit in section 14(5) being deleted, thereby providing affected parties with access to the review provisions in section 27 of the *Utilities Commission Act*.

> ***Recommendation 9 The Minister should give consideration to an amendment to section 14 of the Act being sought aimed at (a) deleting sub-section (5) and thereby ensuring that the review provisions in Part 6 of the Utilities Commission Act are applicable to a determination or approval made by the regulator under the Code, and (b) adding an error of law as a ground of appeal under sub-section (3).***

Coverage of the Code

5.82 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."

5.83 The electricity networks prescribed by the Minister are currently:

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

5.84 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 on the Issues Paper

5.85 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.

5.86 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)

5.87 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)*

5.88 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.

5.89 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 grounds 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.

5.90 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 draft analysis and conclusions

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

5.92 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.

5.93 Accordingly, it was the Commission's draft recommendation that:

- Ministerial discretion in determining the Code's coverage of networks remain (draft recommendation (10)); and
- consideration 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 (draft recommendation (11))

Views in submissions on the Draft Report

5.94 NT Treasury agreed with the draft recommendations, noting that:

"Specific criteria would reduce the uncertainty surrounding Ministerial discretion." (p.2)

5.95 Power and Water also supported the draft recommendations, adding that:

"Power and Water accepts that public policy decisions will always contain a level of discretion. It is suggested that, in forming the framework, the potential scope of discretion is balanced carefully against requirements for regulatory certainty.

Power and Water would support something akin to the National Gas Code, which sets out a clear and transparent test for coverage, assessed by an independent body (the National Competition Council) and including a right of appeal to the Australian Competition Tribunal." (p.6)

5.96 As the Code applies only to regulated networks, GEMCO noted that they are not subject to and have had no real experience with the Code. However, as the operator of a network in a remote location, GEMCO expressed the following preliminary views in relation to the coverage of the Code:

"1. Subject to point 2, there is some merit in specifying appropriate criteria that the Minister must take into account in exercising his or her discretion to prescribe a network as a regulated network, so that a current or prospective network operator has some basis for assessing the scope of regulation to which it may be subject.

2. The decision to prescribe a network as a regulated network should be made only after taking into account the Territory's relatively new regulatory environment and considering whether increased efficiency is a realistic outcome of that regulation.

3. If a smaller network in a remote location is prescribed as a regulatory network, there are grounds for considering appropriate modifications to the obligations imposed on the network provider under the Code." (p.1)

Commission's final position

5.97 In view of the support expressed for the draft recommendations, the Commission has not changed its position on these matters.

Recommendation 10 Ministerial responsibility for determining the Code's coverage of networks should remain.

Recommendation 11 The Minister should give consideration to an amendment to section 5 of the Act being sought aimed at incorporating the general criteria that the Minister may take into account when determining which networks are to be covered by the Code.

Other issues

Section 11 of the Act – Ministerial direction

Commission's draft analysis and conclusions

5.98 The Commission's legal advisers 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.

5.99 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.

5.100 Section 11(1) of the Act provides that the regulator is subject to the direction of the Minister with regard to general policies to be followed by the regulator 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'.

5.101 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 regulator. 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).

5.102 Finally, the Commission's legal advisers 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 and is an example of the drafting problems with the Act and Code. As section 11(2) of the Act only prohibits the Minister from issuing a direction which *directly* affects conditions of access, it would appear that it is permissible for a direction from the Minister that *indirectly* affects access terms and conditions.

5.103 Accordingly, it was the Commission's draft recommendation that section 11(1) of the Act be amended to be consistent with section 8 of the *Utilities Commission Act* (draft recommendation (12)).

Views in submissions on the Draft Report

5.104 Both NT Treasury and Power and Water neither supported nor opposed the draft recommendation.

5.105 NT Treasury noted that:

> *"It is unclear whether any inconsistencies exist, although some definitional issues are apparent."*

5.106 Power and Water noted that:

> *"Power and Water supports the concept of an independent regulator.*
>
> *To this end, legislative changes may be necessary to provide certainty to the Regulator and Government that this is the case. Power and Water has not sought advice on whether the Regulator's proposed amendments to the Act provide such certainty."*

Commission's final position

5.107 While the Commission intends to consider the provisions in the *Utilities Commission Act* regarding regulatory independence as being primary, and as in effect over-riding any inconsistent provisions in relevant industry regulations Acts, its legal advice is that there are inconsistencies between the two Acts. Accordingly, the Commission considers that it is prudent if further policy consideration is given to this issue.

> ***Recommendation 12 The Minister should give consideration to an amendment to section 11(1) of the Act being sought aimed at achieving consistency with section 8 of the Utilities Commission Act.***

Commission's immunity from liability

Commission's draft analysis and conclusions

5.108 The Commission's legal advisers noted that section 26 of the Act does not currently 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.

5.109 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).

5.110 Accordingly, it was the Commission's draft recommendation that section 26 of the Act 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* (draft recommendation (13)).

Views in submissions on the Draft Report

5.111 NT Treasury agreed with the draft recommendation.

5.112 Power and Water agreed that such an indemnity provision was currently absent from the Act but did not support the draft recommendation, expressing the view that such an amendment was neither necessary nor desirable.

> *"It is unnecessary because Section 41 of the Utilities Commission Act as drafted seems to sufficiently indemnify the Regulator.*
>
> *It is not desirable because the amendment appears to go further than the current provisions of the Utilities Commission Act and Electricity Reform Act by indemnifying the Regulator even where acts or omissions have occurred in bad faith. This does not appear to be consistent with interstate provisions which, Power and Water's initial review indicates, indemnify Regulators only for acts or omissions made in 'good faith'."(p.7)*

Commission's final position

5.113 The Commission's view continues to be that there are inconsistencies between the regulator's immunity from liability across the relevant Acts which deserve to be addressed.

> ***Recommendation 13 The Minister should give consideration to an amendment to section 26 of the Act being sought aimed at achieving consistency with equivalent provisions in the Utilities Commission Act and the Electricity Reform Act.***

Network provider's immunity from liability

Commission's draft analysis and conclusions

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

5.115 The Commission's legal advisers 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. For example:

- 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:
  - for not supplying electricity under any contract if the failure arises through accident, drought or unavoidable cause; or
  - 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* previously contained a limitation of liability provision which was similar to the Victorian provision. However, the South Australian *Electricity Act 1996* was amended to remove this provision as it was considered that section 78 of the National Electricity Law was sufficient to protect the legitimate interests of network service providers.
- In addition, distribution network service providers in South Australia are required to published a standard customer connection and supply contract. While this contract contains a limitation on liability, it does 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 and a retailer 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*.

- Victorian network service providers are also specifically required to compensate customers in certain circumstances for property damage caused by surges.

5.116 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).

5.117 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.

5.118 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.

5.119 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.

5.120 Accordingly, it was the Commission's draft recommendation that:

- section 26(2) of the Act be amended to only operate to limit the network provider's liability to the maximum extent permitted under the TPA (draft recommendation (14)); and
- section 26(2) of the Act 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 (draft recommendation (15))

Views in submissions on the Draft Report

5.121 On draft recommendation (14), NT Treasury supported the recommendation noting that:

> *"If the TPA does not already override section 26(2), an amendment to this effect would be appropriate." (p.2)*

5.122 Power and Water expressed the view that such an amendment appeared unnecessary, stating that:

> *"It is clear that the Territory Legislative Assembly, as a subordinate legislature to the Commonwealth, has no legislative power to pass laws inconsistent with Commonwealth laws .*
>
> *Therefore, any limitation of liability in a Northern Territory statute such as that contained in section 26 of the Electricity Networks (Third Party Access) Act must be subject to the Trade Practices Act in any event." (p.8)*

5.123 On draft recommendation (15), NT Treasury supported the recommendation, noting that:

> *"Ensuring possible liability for breaching an access agreement would encourage compliance." (p.2)*

5.124 Power and Water argued that the draft recommendation was supported with insufficient information on which to form a view. However, Power and Water noted that:

> *"Section 26(2) is not limited in its terms to the relationship between the network provider and the other party to an access agreement. Given that the network provider does not*

have any contractual relationship with end use customers, it is to be expected that the limitation of liability in section 26(2) should govern and limit the network provider's liability to end use customers of electricity.

Power and Water is concerned that, if specific reference is made in section 26(2) to the rights of redress a party to an access agreement has under an access agreement, this may support an argument that section 26(2) is only intended to limit the liability of a network provider to the other party to an access agreement.

Accordingly, if section 26(2) is to be amended to make specific reference to the preservation of a party's rights under an access agreement, Power and Water asks that, at the same time, the section should also be amended to make it clear that section 26(2) also extends to limit a network provider's liability to third parties such as end use customers. This could be done by the insertion of the words "to a Code participant or any third party" into section 26(2) after the opening words "No liability".

As to the substance of the recommended amendment, Power and Water has not had sufficient opportunity to either consider the merits of the arguments advanced by the Commission in its draft report, or any available arguments in response. Power and Water suggests that, as the Commission has recommended in relation to the proposal to cap liability under section 26, this proposed amendment be the subject of further consideration and consultation.

If the amendment is to proceed, Power and Water suggest that it be couched in terms similar to those used in section 107(3) of the Electricity Reform Act, but substituting "access agreement" for "agreement" where it first appears, and deleting the words "with a person". Power and Water would also like the opportunity to review the wording of any amendment proposed to give effect to this recommendation." (pp.8-9)

Commission's final position

5.125 The Commission has opted to leave consideration of the relationship between the network provider's liability in the Act and that permitted under the TPA to others.

5.126 Moreover, as there is a close relationship between draft recommendations (15) and (17), the Commission has decided to address the issues as part of recommendation 17 below.

5.127 In doing so, the Commission accepts the reasoning behind the proposed drafting amendments to section 26(2) proposed by Power and Water.

5.128 Hence, the Commission makes no final recommendations in these regards.

Recommendation 14	***Withdrawn***
Recommendation 15	***Withdrawn***

Application of immunity of liability to system control functions and powers

Commission's analysis and conclusions

5.129 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.

5.130 For example, section 26(1) of the Act provides that no liability attaches to a person in relation to any 'system control' type of act or omission under the Code. This is the correct approach because it focuses on the type of act or omission and not the person who performs that act or omission. This should be contrasted to clause 7A of the Code (see the Commission's comments at paragraph 6.164 of this Report).

5.131 This distinction is particularly important if it was 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.

5.132 If this approach was adopted, the Commission believes it would be necessary to further 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.

5.133 Accordingly, it was the Commission's draft recommendation that section 26(1) of the Act 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 (draft recommendation (16)).

5.134 No objections were raised to this recommendation in submissions in response to the Draft Report, although Power and Water noted that it expected to be consulted on the proposed wording of any amendment.

> ***Recommendation 16 The Minister should give consideration to an amendment to section 26 of the Act being sought aimed at nominating the appropriate form of the limitation from liability applying to a 'system control' type of act or omission under the Code.***

Capping rather than eliminating liability

Commission's draft analysis and conclusions

5.135 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.

5.136 Accordingly, it was the Commission's draft recommendation that further consideration 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 (draft recommendation (17)).

Views in submissions on the Draft Report

5.137 NT Treasury agreed with the draft recommendation, noting that:

> *"Capping rather than excluding liability would, to some extent, discourage non-compliance with the Code." (p.2)*

5.138 Power and Water expressed the view that there had been insufficient opportunity to consider this draft recommendation, noting that:

> *"…the capping of liability provided for under section 77A of the National Electricity Law was agreed to after 'a lengthy review process'." (p.9)*

5.139 Power and Water urged further consideration of this proposal, in consultation with interested parties, arguing that:

> *"…a review process should be undertaken which provides Power and Water with a reasonable opportunity to consider:*
>
> - *the merits of, and make submissions in relation to, any recommendation of this type; and*
> - *the ramifications or any amendment of this type on Power and Water's business, and the increased risks and exposure associated with the amendment." (p.9)*

Commission's final position

5.140 The Commission has not changed its recommendation, which was all along limited to a further consideration of the issues. The subject is one of significant complexity, deserving of due consideration by and consultation with affected parties.

> ***Recommendation 17 The Minister should give consideration to amendments to sections 26(1) and 26(2) of the Act being sought aimed at capping, rather than excluding, liability for acts or omissions under the Code.***

CHAPTER

6

PART 2: 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 regulator under a ring-fencing code; and
- develop and publish a network technical code and network planning criteria.

Information provided to an access seeker

Views in submissions on the Issues Paper

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.

Commission's draft analysis and conclusions

6.6 The provision of adequate information is critical to access seekers. In most cases, this information is only available from the network provider.

6.7 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 considered it preferable that the Code permit the regulator to require the network provider to make available additional information to access seekers as and when that appears to be necessary. This could be achieved by including in clause 6A(2) of the Code a reference to such other information as the regulator requires from time to time.

6.8 The Commission also noted that Power and Water appeared to suggest that the information disclosure requirements should be limited to non-confidential information. The Commission was 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 understood 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.

6.9 The Commission was 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*. This is currently not clear from the wording of clause 8 of the Code.

6.10 It is also unclear what is meant by the expression 'pertaining to a network access service'. The regulator 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. The Commission considered that the Code should contain a broader power for the regulator to require parties to provide information to the regulator which may be relevant to the operation of the Code or the performance of any of the regulator's functions under the Code.

6.11 Accordingly, it was the Commission's draft recommendation that:

- clause 6A(2) of the Code be amended to include a reference to such other information as the regulator requires from time to time (draft recommendation (18)); and
- clause 8 of the Code 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* (draft recommendation (19)).

Views in submissions on the Draft Report

6.12 With respect to draft recommendation (18), NT Treasury agreed with the recommendations, noting that:

> *"While the current wording is sufficiently broad to allow for additional information, it seems unlikely that the network provider would supply this without some explicit regulatory requirement." (p.3)*

6.13 Conversely, Power and Water did not support this recommendation, which Power and Water considered to be a significant move away from the current provisions of the Code. Specifically, Power and Water argued that:

> *"…the thrust of the Regulator's recommendation is to amend clause 6A(2) of the Code in a way that allows the Regulator the power to prescribe and control the information provided by the network provider to access seekers.*
>
> *This is a significant move from the current provisions in the Code, which currently allow the network provider to determine information to be included in the package of information to be provided to access seekers.*
>
> *Power and Water, as network provider, and access seekers engage in commercial negotiations in relation to the terms of access to Power and Water's networks. While those negotiations occur against a background of regulation, they have in the past been commercial in nature and have produced commercially acceptable outcome. This recommendation is therefore unreasonably heavy handed and invasive in that it aims to resolve a theoretical rather than actual problem through increased regulation." (p.10)*

6.14 With respect to draft recommendation (19), NT Treasury expressed the view that it was unclear why such an amendment was necessary.

6.15 Power and Water noted that:

> *"Notwithstanding [its] opposition to the Regulator's recommendation (18), if it was adopted, this [draft recommendation (19)] may be a necessary consequential amendment." (p.10)*

Commission's final position

6.16 The Commission considers the issues raised in draft recommendation (18) deserve further consideration by the parties involved. It is therefore a matter that should be subject to the Code review process proposed in recommendation 5.

Recommendation 18 Using the Code review process at recommendation 5, further consideration should be given to whether clause 6A(2) of the Code should be amended to include in the list of information to be supplied by the network provider to access applications 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

Views in submissions on the Issues Paper

6.17 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 Power and Water Retail and Power and Water Generation 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)*

6.18 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 Electricity Ring-fencing Code.

Commission's draft analysis and conclusions

6.19 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.

6.20 The Commission was 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.

6.21 However, the Commission's legal advisers noted that it may not be possible to directly regulate these internal arrangements under the Code as it currently stands 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.

6.22 It follows from these considerations 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).

6.23 However, the Commission suggested that it may be possible to assist in this process by ensuring that a number of relevant 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.

6.24 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.

6.25 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.

6.26 In the Commission's view, it is 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 access services on the same terms and conditions as apply between Power and Water Networks and Power and Water Generation/Retail.

6.27 Accordingly, it was the Commission's draft recommendation that the Code be amended to provide for the regulator's approval of a default use-of-system agreement and a default connection agreement (draft recommendation (20)).

Views in submissions on the Draft Report

6.28 NT Treasury agreed with the draft recommendation.

6.29 Power and Water did not support this draft recommendation, expressing the view that it would be both unworkable and expensive.

> *"It is unworkable because each agreement for each party at each location will be different in the prices and terms/conditions offered. Conditions such as prices will be negotiated commercially depending on each entity's needs and offering. Given the possibility for the default agreement to act as a 'backstop' for failed negotiations with an access seeker, the agreements would need to be drafted to reflect a number of possibilities. This would be counterproductive and would result in significant legal and interpretive effort.*
>
> *…It is expensive because regulators are not able to pass a view on much of the commercial content of use of system or connection agreements without significant use of consulting engineers and advisors. The Regulator's approval of commercial conditions such as terms and conditions of access to land and buildings, frequency of payment intervals, dispute mechanisms, and definitions sections, for example, would inappropriately extend regulation into competitive business activities." (p.11)*

Commission's final position

6.30 The Commission considers the issues raised in draft recommendation (20) deserve further consideration by the parties involved. It is therefore a matter that should be subject to the Code review process proposed in recommendation 5.

> ***Recommendation 20 Using the Code review process at recommendation 5, further consideration should be given to whether the Code should be amended to provide for the regulator's approval of a default use-of-system agreement and/or a default connection agreement.***

Technical code and planning criteria as barriers to entry

Views in submissions on the Issues Paper

6.31 On the matter as to whether 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)*

6.32 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 draft analysis and conclusions

6.33 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 noted 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; and
- 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).

6.34 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.

6.35 Clause 30(3) of the Code currently confers an exemption power on the network provider. The Commission was 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, derogation or exemption power in favour of the regulator in clause 9 of the Code.

6.36 With regard to the development of the technical code and planning criteria, while clause 9(4) of the Code confers on the regulator 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.

6.37 It was also the Commission's view that clause 9(5) of the Code should make it clear that the regulator's approval power under clause 9(4) extends to subsequent amendments proposed by the network provider. The Commission also raised the possibility that consideration be given to conferring a power on the regulator to initiate amendments outside of this process, including in response to suggestions by other market participants.

6.38 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."

6.39 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.

6.40 Accordingly, it was the Commission's draft recommendation 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 (draft recommendation (21));

- clause 9(5) of the Code 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 (draft recommendation (22));
- 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 (draft recommendation (23)); and
- a provision 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 (draft recommendation (24)).

Views in submissions on the Draft Report

6.41 NT Treasury agreed with draft recommendations (21) and (22), noting that:

> *"…the discretion allowed by clause 30(3) may be excessive. Any derogation from the technical code should involve an application from the network provider and approval by the regulator." (p.3)*

6.42 However, NT Treasury did not agree with draft recommendation (23), arguing that:

> *"The Commission has provided little justification for extending the regulator's current powers beyond influencing the development of, as well as approving, the technical code and planning criteria." (p.3)*

6.43 Power and Water did not support draft recommendations (21) to (23), arguing that:

> *"The proposal that the Regulator have a substantial role in determining network technical and planning issues, rather than continuing its current role, involves more regulatory involvement in technical issues than seems either efficient or practical. The Code is structured to give the network provider responsibility for developing and implementing a network technical code and network planning criteria subject to consultation with the Regulator. Changes to the network technical code or planning criteria are subject to a consultation process." (p.11)*

6.44 On draft recommendation (24), NT Treasury agreed with the recommendation stating that:

> *"…some minimum service standard should be formulated and applied in conjunction with the determination of reference tariffs." (p.3)*

6.45 In contrast, Power and Water suggested there was not enough information on which it could form a view. It did, however, argue that:

> *"Broadly, Power and Water encourages the development of a regulatory regime that provides appropriate incentives to improve services, and is willing to discuss with the Regulator issues such as price versus service trade-offs." (p.12)*

Commission's final position

6.46 The Commission has not changed its analysis underlying draft recommendations (21) and (22).

6.47 However, in view of the scope which would be provided by the Code review process at recommendation 5 to respond to future developments as they affected the network technical code or planning criteria, the Commission considers it appropriate to withdraw draft recommendation (23).

6.48 The Commission considers the issues raised in draft recommendation (24) deserve further consideration by the parties involved. It is therefore a matter that should be subject to the Code review process proposed in recommendation 5.

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. The Code review process at recommendation 5 should apply to any exercise of this power.

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 Withdrawn

Recommendation 24 Using the Code review process at recommendation 5, further consideration should be given to whether 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

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

6.50 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.

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

Code's timeframes

Views in submissions on the Issues Paper

6.52 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)*

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

Commission's draft analysis and conclusions

6.54 The Commission acknowledged that the timeframes currently set out in chapter 2 of the Code are broadly consistent with the timeframes adopted in other jurisdictions.

6.55 However, without a default use-of-system agreement in relation to retailers seeking access to network services, the Commission considered it unlikely that the timeframes set out in chapter 2 of the Code would be satisfied. The same comment applied 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.

6.56 While not raised in submissions, the Commission was 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. Rather, the Commission saw merit in a mechanism being put 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.

6.57 Accordingly, it was the Commission's draft recommendation that clause 11(2)(a) of the Code 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 (draft recommendation (25)).

Views in submissions on the Draft Report

6.58 NT Treasury agreed with draft recommendation (25), noting that:

> *"…[it] would provide the access seeker with some redress where it felt that the assessment of its application was being unnecessarily delayed." (p.3)*

6.59 Power and Water did not support this draft recommendation, arguing that:

> *"…access applicants have redress to the Regulator via clause 13 should they have concerns in relation to the access application, it would appear unnecessary to amend 11(2)(a)." (p.12)*

Commission's final position

6.60 Given the difference of view expressed in submissions, the Commission considers the issues raised in draft recommendation (25) deserve further consideration by the parties involved. It is therefore a matter that should be subject to the Code review process proposed in recommendation 5.

> ***Recommendation 25 Using the Code review process at recommendation 5, further consideration should be given to whether clause 11(2)(a) of the Code should be amended to allow an access seeker to request 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

Views in submissions on the Issues Paper

6.61 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)*

6.62 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.*
>
> *…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)*

6.63 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 draft analysis and conclusions

6.64 The Commission agreed that the Code's negotiation framework should anticipate future changes in the Territory's electricity supply industry. However, 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.

6.65 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.

6.66 The Commission did 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.

6.67 However, the Commission accepted that changes may be required to clause 18 of the Code and the load balancing arrangement were a significant new generator to emerge in the near future. However, such changes would be best addressed via the proposed Code change process as and when the need arises. Obviously the particular circumstances applying at that time would influence the form and arguments in support of any changes to the Code which have been developed to deal with the establishment of a significant new generator.

6.68 Accordingly, it was the Commission's draft recommendation that, if a significant new generator was to emerge in the near future, consideration be given to amending clause 18 of the Code and the load balancing arrangements (draft recommendation (26)).

6.69 No objections were raised to this recommendation in submissions in response to the Draft Report.

Commission's final position

6.70 Given the capacity provided by the Code review process in recommendation 5 to address issues as they arise, the Commission no longer

considers that a specific recommendation is required to cover the situation were a significant new generator to emerge. This issue could be dealt with as required by the recommended Code review process.

Recommendation 26 Withdrawn

Access terms

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

6.72 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.

Location of generation-related provisions

Views in submissions on the Issues Paper

6.73 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.

6.74 NT Treasury also saw no reason for change.

Commission's analysis and conclusions

6.75 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 grounds of:

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

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

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

6.78 Accordingly, it was the Commission's draft recommendation that the generation-related provisions of the Code be retained in their present location (draft recommendation (27)).

6.79 No objections were raised to this recommendation in submissions in response to the Draft Report.

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

Definition of network user

Views in submissions on the Issues Paper

6.80 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)

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

Commission's draft analysis and conclusions

6.82 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.

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

6.84 While the Commission was 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, it considered that such other categories of network users should be appropriately defined in clause 3 of the Code. In particular, the Commission noted that the term 'end-use customer' is used throughout the Code without any clear meaning.

6.85 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.

6.86 Accordingly, it was the Commission's draft recommendation that clause 3 of the Code 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 (draft recommendation (28)).

6.87 No objections were raised to this recommendation in submissions in response to the Draft Report.

Commission's final position

6.88 The Commission considers the issues raised in draft recommendation (28) deserve further consideration by the parties involved. It is therefore a matter that should be subject to the Code review process proposed in recommendation 5.

> ***Recommendation 28 Using the Code review process at recommendation 5, further consideration should be given to how clause 3 of the Code might most appropriately 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.***

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

Commission's draft analysis and conclusions

6.89 The Commission identified a more fundamental related issue relating to whether the Code should apply in the same manner to all network users. The

Commission was 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.

6.90 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.

6.91 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.

6.92 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).

6.93 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?).

6.94 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.

6.95 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.

6.96 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.

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

6.98 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.

6.99 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.

6.100 In general terms, under the straight line arrangement a deemed connection agreement 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.

6.101 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.

6.102 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.

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

6.104 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).

6.105 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.

6.106 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.

6.107 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.

6.108 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.

6.109 Accordingly, it was the Commission's draft recommendation that:

- further consideration 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 (draft recommendation (29)); and
- the Code be amended to remove references to the possibility that no generators may contract for the direct delivery of electricity to end-use customers (draft recommendation (30)).

Views in submissions on the Draft Report

6.110 NT Treasury agreed with the draft recommendations (29) and (30), arguing that:

> *"Generators should be allowed to contract directly with end-use customers providing existing licensing conditions are satisfied." (p.4)*

6.111 Power and Water also supported further consideration being given to the issues raised by draft recommendation (29), arguing that:

> *"This recommendation raises a number of fundamental issues about the regulatory structure in place in the Northern Territory electricity market.*
>
> *The issues surrounding the adoption of a triangular or linear model are complex and cannot be adequately dealt with in the timeframes allowed in this review. Power and Water understand that these issues have been subject to detailed consideration in a number of other jurisdictions.*
>
> *The decision on which option is best for the Northern Territory will require consideration and consultation in relation to the unique features of the Northern Territory electricity industry." (pp.12-13)*

Commission's final position

6.112 The Commission considers the issues raised in draft recommendation (29) are complex and far reaching and therefore deserve further consideration by the parties involved. It is therefore a matter that should be subject to the Code review process proposed in recommendation 5.

6.113 While the Commission has not changed its position on draft recommendation (30), it recognises that it raises drafting issues that deserve further consideration by the parties involved. It is therefore a matter that should be subject to the Code review process proposed in recommendation 5.

Recommendation 29 Using the Code review process at recommendation 5, 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 Using the Code review process at recommendation 5, further consideration should be given to how Part 2 of the Code might most appropriately be amended to remove references to the possibility that no generators may contract for the direct delivery of electricity to end-use customers.

Definitional issues

Commission's draft analysis and conclusions

6.114 The Commission's legal advisers noted that a number of technical amendments were required to the definitions as they related to chapter 3 of the Code. 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 definition of 'network system assets' should specifically exclude connection assets to ensure that there is no overlap. 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.

6.115 Accordingly, it was the Commission's draft recommendation that clause 3 of the Code be amended to ensure appropriate definitions are included for 'connection services', 'electricity network' and a 'consumer of electricity' (draft recommendation (31)).

Views in submissions on the Draft Report

6.116 NT Treasury agreed with the draft recommendation.

6.117 Power and Water submitted that:

> *"…[they did] not oppose modifying definitions where necessary to clarify the regime, however Power and Water would expect to receive an opportunity to comment on detailed proposed amendments to the Code before changes are implemented." (p.13)*

Commission's final position

6.118 The Commission considers the drafting issues raised in draft recommendation (31) are of the type that deserve further consideration by the parties involved. It is therefore a matter that should be subject to the Code review process proposed in recommendation 5.

> ***Recommendation 31 Using the Code review process at recommendation 5, further consideration should be given to how clause 3 of the Code might most appropriately be amended to ensure appropriate definitions clarify the contractual arrangements that are to apply with respect to the provision of connection and network services to various categories of network users.***

Access disputes

6.119 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 regulator refer the dispute to arbitration.

6.120 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.

6.121 On receiving the request, under clause 38 of the Code the regulator 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 regulator fails to settle the dispute by conciliation after having made reasonable attempts to do so, appoint an arbitrator and refer the dispute to them.

6.122 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 on the Issues Paper

6.123 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.

6.124 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)*

6.125 On the matter as to whether the regulator 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.

6.126 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)*

6.127 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.

6.128 NT Treasury did not support a more explicit role for the regulator 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 draft analysis and conclusions

6.129 The Commission considered that the provisions of clauses 35 and 36 of the Code seemed sufficiently certain as to the conditions to be met before an access seeker or a network user can request the regulator to refer an access dispute to arbitration.

6.130 However, the Commission noted that these clauses 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 regulator. The provisions of clause 38(2) could then be used by the regulator to delay the commencement of conciliation or referral to arbitration if the regulator 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.

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

6.132 The Commission also noted that 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 regulator 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.

6.133 Finally, the Commission observed that 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.

6.134 Accordingly, it was the Commission's draft recommendation 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 NEC) (draft recommendation (32));
- clause 38(2) of the Code be amended to refer not only to the applicant, but also respondents (draft recommendation (33));
- clause 42(2) of the Code be amended to remove reference to expansions of the electricity network in the definition of 'extension of an electricity network' (draft recommendation (34));

- clause 42(2) of the Code 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 (draft recommendation (35)); and
- clauses 52(1) and 52(6) of the Code 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 (draft recommendation (36)).

Views in submissions on the Draft Report

6.135 NT Treasury expressed the view that draft recommendation (32) did not appear necessary, arguing that:

> *"While frivolous disputes may still be restricted under clause 38(2)(c), the recommended amendment would increase the ability for participants to prematurely declare disputes. If more flexibility in declaring such disputes is necessary, additional criteria could be added to clause 35." (p.4)*

6.136 Power and Water did not oppose draft recommendation (32).

6.137 On draft recommendations (33) through to (36), NT Treasury supported the recommendations, noting in relation to draft recommendation (35) that:

> *"The amendment would ensure that awarded capital contributions are consistent with those that are regulated more generally." (p.5)*

6.138 Power and Water supported draft recommendation (33).

6.139 Power and Water expressed qualified support for draft recommendation (34), stating that:

> *"Power and Water assumes recommendation (34) refers to clause 42(1), as clause 42(2) does not refer to expansion. Power and Water agrees that clause 42(1) should only refer to 'extension', a term defined in clause 3 of the Code." (p.13)*

6.140 Power and Water supported draft recommendation (35), on the basis that would add:

> *"…both clarity and consistency to the assessment of network extensions under the Code." (p.13)*

6.141 Indeed, Power and Water proposed that the recommended amendment should go further and specifically bind an arbitrator to the Chapter 8 principles.

6.142 Power and Water did not support draft recommendation (36), arguing that:

> *"On preliminary review, it appears that clauses 52(1) and 52(6) are consistent. Clause 52(1) refers to an award on access made to the access applicant. Presumably the dispute could only arise between an applicant and the network provider. Clause 52(6) notes that the award takes effect as a contract between the access applicant (now called the network user) and the network provider.*
>
> *Clause 52(3)(e) does not alter this position. There is no need to assume, as the Draft Report does, that the earlier award or access contract would be with another network user. If necessary, clause 40 would allow another network user to be a party to the arbitration, which would mean that clause 56(1) would be effective." (p.14)*

Commission's final position

6.143 The Commission recognises that draft recommendation (34) dealt with matters already raised under recommendation 31. Accordingly, it has been withdrawn.

6.144 The Commission considers the drafting issues raised in draft recommendations (32) through (36) are of the type that deserve further consideration by the parties involved. They are therefore matters that should be subject to the Code review process proposed in recommendation 5.

Recommendation 32 ***Using the Code review process at recommendation 5, further consideration should be given to whether clause 35 of the Code should be amended to allow any party to an access application to declare that a dispute exists by notifying the regulator.***

Recommendation 33 ***Using the Code review process at recommendation 5, further consideration should be given to how clause 38(2) of the Code might most appropriately be amended to refer not only to the applicant, but also respondents.***

Recommendation 34 ***Withdrawn***

Recommendation 35 ***Using the Code review process at recommendation 5, further consideration should be given to how clause 42(2) of the Code might most appropriately be amended to ensure that an arbitrator would 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 ***Using the Code review process at recommendation 5, further consideration should be given to how clauses 52(1) and 52(6) of the Code might most appropriately 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

6.145 The Code establishes certain rights and responsibilities for network providers, access seekers and network users. To ensure that these rights are upheld and responsibilities are adhered to, the Act contains provisions for legal enforcement of the Code.

6.146 In particular:

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

Enforcement provisions

Views in submissions on the Issues Paper

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

6.148 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

6.149 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.

6.150 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.

6.151 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.

6.152 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.

6.153 Accordingly, it was the Commission's draft recommendation that the enforcement provisions in section 19 of the Act be retained in their present form (draft recommendation (37)).

6.154 No objections were raised to this recommendation in submissions in response to the Draft Report.

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?

Commission's draft analysis and conclusions

6.155 Section 36 of the Gas Access Act provides that 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 Gas Access Act that prohibits a person from engaging in conduct for the purpose of preventing or hindering access to a relevant service.

6.156 The wording of section 36 of the Gas Access Act is set out below for ease of reference:

"36(1) A person who suffers loss or damage by conduct of another that was done in contravention of a conduct provision may recover the amount of the loss or damage by action against that other person or against any person involved in the contravention.

(2) An action under subsection (1) may be commenced at any time within 3 years after the date on which the cause of action accrued and may not be commenced after that period.

(3) A reference in subsection (1) to a person involved in a contravention of a conduct provision is a reference to a person who –

(a) has aided, abetted, counselled or procured the contravention; or

(b) has induced, whether by threats or promises or otherwise, the contravention; or

(c) has been in any way, directly or indirectly, knowingly concerned in, or party to, the contravention; or

(d) has conspired with others to effect the contravention."

6.157 An example of a 'conduct provision' is section 13(1) of the Gas Access Act which states:

"A service provider or a person who is a party to an agreement with a service provider relating to a service provided by means of a Code pipeline or, as the result of an

arbitration, is entitled to such a service or an associate of a service provider or such a person must not engage in conduct for the purpose of preventing or hindering the access of another person to a service provided by means of the Code pipeline."

6.158 This can be contrasted to section 44ZZJ of the TPA which requires the ACCC to apply for an order directing a provider of an access undertaking to compensate any person who has suffered loss or damage as a result of a breach of that access undertaking.

6.159 The Commission considered that it would be it appropriate for further consideration to be given to the incorporation of a direct right to claim compensation for a contravention of the Code in certain circumstances into the Act.

6.160 Accordingly, it was the Commission's draft recommendation 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 (draft recommendation (38)).

Views in submissions on the Draft Report

6.161 NT Treasury agreed with the draft recommendation, adding that:

"Direct rights to compensation should be transferred from the regulator to participants where breach of the Code also involves an obligation between the participants." (p.5)

6.162 Power and Water neither supported nor opposed this draft recommendation, expressing the view that there had been insufficient opportunity to come to a considered conclusion, and suggesting that this draft recommendation be the subject of further consideration and consultation. Power and Water stated that:

"In order to come to a considered conclusion, and to make considered submissions in relation to it, Power and Water needs to:

- *research the background to section 36 of the Gas Pipelines Access Law;*
- *research the position in respect of electricity in other jurisdictions, and come to an understanding of why that position was adopted; and*
- *consider whether there are any other factors which would justify a different position in respect of the Territory electricity network to that existing under the Gas Pipeline Access Law.*

It is also difficult to provide any meaningful submission without knowing the circumstances in which the Commission considers the right to compensation should apply." (pp.14-15)

Commission's final position

6.163 The Commission acknowledges that draft recommendation (38)) deals with policy issues which require further consideration by the Minister. The Commission has modified its recommendation accordingly.

Recommendation 38 The Minister should give consideration to whether an amendment to the Act be sought aimed at including a direct right to claim compensation for a contravention of the Code.

Other issues

Flexibility to develop ring-fencing obligations outside of the Code

Commission's draft analysis and conclusions

6.164 In relation to clause 7A of the Code, the Commission's legal advisers noted 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.

6.165 Accordingly, it was the Commission's draft recommendation that 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 (draft recommendation (39)).

Views in submissions on the Draft Report

6.166 Both NT Treasury and Power and Water supported this draft recommendation, with Power and Water adding that it would rectify an ambiguity in the Code.

6.167 While NT Treasury acknowledged that there may be problems in the application of clause 7A of the Code, it noted that:

> *"…it is not clear that any anomalies exist between this clause and the Utilities Commission Act." (p.5)*

Commission's final position

6.168 The Commission considers the drafting issues raised in draft recommendation (39) are of the type that deserve further consideration by the parties involved. They are therefore matters that should be subject to the Code review process proposed in recommendation 5.

> ***Recommendation 39 Using the Code review process at recommendation 5, further consideration should be given to how clause 7A of the Code might most appropriately be amended to remove any anomalies with Regulation 2 under the Utilities Commission Act which authorises the Electricity Ring-fencing Code.***

Network capacity limits

Commission's draft analysis and conclusions

6.169 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.

6.170 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.

6.171 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.

6.172 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.

6.173 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.

6.174 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.

6.175 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.

6.176 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.

6.177 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).

6.178 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 forecast 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).

6.179 The Commission acknowledged that this 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).

6.180 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.

6.181 Accordingly, it was the Commission's draft recommendation that further consideration be given to the arrangement applying in clause 18 of the Code for assigning available network capacity between competing access applications (draft recommendation (40)).

Views in submissions on the Draft Report

6.182 NT Treasury agreed that the current wording of clause 18 of the Code does not ensure appropriate allocation of spare capacity, and suggested that this may be related to the problems addressed in draft recommendation (26).

6.183 Power and Water did not support the draft recommendation, arguing that:

> *"…the existing clause 18 provides a sound and practical approach to allocating capacity for the following reasons:*
>
> - *Available capacity (whether relating to Generator access or access to network capacity) should be provided to the applicant who has applied first. …there is precedent for this treatment elsewhere in Australia.*
> - *It seems unlikely that more than one application will be made for spare capacity at a particular point in time in the Territory market.*
>
> *…This issue is a complex issue which gives rise to a number of steps required to address it. Power and Water note also that it is presently rooted in theory rather than practice in the Northern Territory. To this end, Power and Water encourages the Regulator to focus more on the flexibility provided by the existing system, rather than the medium term need for a new provision to replace it.*
>
> *It is noted, however, that Power and Water's rights are impacted by the proposed amendment. To this end, Power and Water request close involvement in any subsequent process to ensure that it is workable." (pp.15,17)*

Commission's final position

6.184 The Commission considers the issues raised in draft recommendation (40) are complex and so deserve further consideration by the parties involved. They are therefore matters that should be subject to the Code review process proposed in recommendation 5.

> ***Recommendation 40 Using the Code review process at recommendation 5, further consideration should be given to whether amendments are required to the arrangements applying in clause 18 of the Code for assigning available network capacity between competing access applications.***

Existing contractual entitlements

Commission's draft analysis and conclusions

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

6.186 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).

6.187 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).

6.188 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.

6.189 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).

6.190 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.

6.191 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.

6.192 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'.

6.193 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.

6.194 The Commission noted 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.

6.195 Accordingly, it was the Commission's draft recommendation that further consideration be given to clarifying the rights of network users under existing access agreements as currently defined in chapter 2 of the Code (draft recommendation (41)).

Views in submissions on the Draft Report

6.196 Both NT Treasury and Power and Water supported the draft recommendation for further consideration of this issue, with NT Treasury noting that there is some ambiguity regarding existing access rights.

6.197 Power and Water also noted that:

> *"This recommendation foreshadows a review of the Code to provide unspecified changes. Power and Water await this review process with interest, and look forward to contributing to the final form and intent of any Code changes." (p.17)*

Commission's final position

6.198 The Commission considers the issues raised in draft recommendation (41) are complex and so deserve further consideration by the parties involved. They are therefore matters that should be subject to the Code review process proposed in recommendation 5.

> ***Recommendation 41 Using the Code review process at recommendation 5, further consideration should be given to whether amendments are required to clarify the rights of network users under existing access agreements as currently defined in chapter 2 of the Code.***

Financial guarantees

Commission's draft analysis and conclusions

6.199 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.

6.200 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.

6.201 However, the Commission considers it appropriate that the regulator 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.

6.202 Accordingly, it was the Commission's draft recommendation 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) (draft recommendation (42)).

Views in submissions on the Draft Report

6.203 Neither NT Treasury nor Power and Water supported the draft recommendation.

6.204 NT Treasury argued that:

> *"The decision to require the payment of a financial guarantee should be left to the network provider. While this discretion could potentially provide a basis for competitive neutrality complaints, Treasury is of the view that a complaint on these grounds could not be sustained." (p.5)*

6.205 Power and Water argued that:

> *"•* *Financial guarantees exist to protect the network provider from actions taken by connecting parties including refusal to pay for damage to equipment which are in contravention of either use-of-system or connection agreements. It is a matter of logic that one part of Power and Water should not need to offer securities to another part of Power and Water to protect against such events. Payment disputes generally only occur between companies, not within them;*
>
> - *Competitive neutrality refers to the removal of any advantage held by a Government owned entity that arises from its Government ownership. If Power and Water does not require financial guarantees from its related parts, it is because they form part of*

the same entity and are therefore considered to be at lower risk of default. This would occur in the case of private ownership.

…In any event, competitive neutrality has already been addressed through the legislative review program. Power and Water welcomes a third party review of the Code against competitive neutrality provisions." (p.18)

Commission's final position

6.206 The Commission's view remains that the nature and magnitude of a financial guarantee required of a network user by the network provider could reflect the monopoly power advantage of the network provider.

6.207 Nevertheless, the Commission acknowledges that the issues raised in draft recommendation (42) are complex and so deserve further consideration by the parties involved. They are therefore matters that should be subject to the Code review process proposed in recommendation 5.

Recommendation 42 Using the Code review process at recommendation 5, further consideration should be given to whether 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).

Definitional issues

Commission's draft analysis and conclusions

6.208 The Commission's legal advisers 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.

6.209 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.

6.210 While the Territory's access regime cannot and should not directly mirror the NEC, the Commission acknowledged 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.

6.211 The Commission's legal advisers identified a number of definitional issues relating generally to Part 2 of the Code:

- No definition section in the Act: 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: 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: 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. 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.

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

6.212 Accordingly, it was the Commission's draft recommendation that clause 3 (and associated clauses) of the Code be amended to address the definitional anomalies identified by the Commission's legal advisers (draft recommendation (43)).

Views in submissions on the Draft Report

6.213 NT Treasury agreed with the Commission that some definitional problems currently existed within the Code.

6.214 Power and Water neither supported nor opposed this draft recommendation on the basis that insufficient information was provided in order to form a view. However, Power and Water noted that:

> *"The Regulator has not proposed a specific recommendation for changes to the Code in recommendation 43, rather contributors are asked to comment on a general intention without seeing the final form of proposed amendments. Power and Water submits that these changes, as with others discussed in this submission, should be the subject of more specific consultation." (p.18)*

6.215 Power and Water provided the following general comment on the matters raised by the Commission:

" • *Definitions section in the Act – Power and Water has no objections to the drafting of a definitions section, however note that wide consultation on the workability and impact of new or amended definitions will be required;*

- *All definitions should appear in the same place – Power and Water has no objection;*
- *Access to services, not networks – Power and Water supports this amendment, subject to consultation on the final form of the changes;*
- *Definitions should be consistently applied - Power and Water supports this amendment, subject to consultation on the final form of the changes;*
- *Incorrect definitions used in clause 10(3) - Power and Water supports this amendment, subject to consultation on the final form of the changes;*
- *Schedule 2 issues – Power and Water has no objection to this amendment." (pp.18-19)*

Commission's final position

6.216 The definitional problems identified by the Commission are simply examples of some of the definitional anomalies and uncertainties which currently exist in the Act and the Code.

6.217 The Commission acknowledges that the drafting issues raised in draft recommendation (43) are of the type that deserve further consideration by the parties involved. They are therefore matters that should be subject to the Code review process proposed in recommendation 5.

Recommendation 43 Using the Code review process at recommendation 5, further consideration should be given to how clause 3 of the Code might most appropriately be amended to address the definitional problems identified by the Commission.

Drafting anomalies in chapter 2 of the Code

Commission's draft analysis and conclusions

6.218 The Commission's legal advisers identified a number of deficiencies in relation to the drafting of chapter 2 of the Code. For example:

- clause 11(1) 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;
- clause 12(2) 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);
- clause 14 of the Code should apply in a reciprocal manner to the network provider and any respondent;
- clause 16(1) of the Code does not identify a date from which the 30 day period will commence to run;
- 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;
- 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;

- 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;
- the conditions precedent set out in clause 19(3) of the Code should form part of any access offer or access agreement;
- clause 20 of the Code should also apply to access seekers. The test set out in clause 21(3) is fairly imprecise; and
- 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.

6.219 Accordingly, it was the Commission's draft recommendation that Part 2 of the Code be amended to address the drafting anomalies identified by the Commission's legal advisers (draft recommendation (44)).

Views in submissions on the Draft Report

6.220 NT Treasury agreed with the draft recommendation, noting that some of the clauses identified could be more specific and consistent.

6.221 Power and Water provided detailed comment on each of the examples provided by the Commission, supporting amendment of some but not all of the identified clauses.

Commission's final position

6.222 The drafting problems identified by the Commission are simply examples of some of the anomalies and uncertainties which currently exist in the Code.

6.223 The Commission acknowledges that the drafting issues raised in draft recommendation (44) are of the type that deserve further consideration by the parties involved. They are therefore matters that should be subject to the Code review process proposed in recommendation 5.

Recommendation 44 Using the Code review process at recommendation 5, further consideration should be given to how Part 2 of the Code might most appropriately be amended to address the drafting anomalies identified by the Commission.

CHAPTER

7

PART 3: ACCESS PRICE REGULATION

Introduction

7.1 Part 3 of the Code specifies the price control framework to be observed by the regulator 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 In its submission responding to the Issues Paper, 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 At the same time, 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 agreed 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.

7.10 Accordingly, it was the draft recommendation that the network price control framework provided for in Part 3 of the Code – involving an independent regulator – be retained (draft recommendation (45)).

7.11 No objections were raised to this recommendation in submissions in response to the Draft Report.

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

Pricing principles

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

7.13 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.

Clause 63 pricing principles

7.14 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."

7.15 These criteria involve a balancing of interests.

7.16 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]

7.17 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]

7.18 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]

7.19 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]

7.20 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.

7.21 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

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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.

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.

Views in submissions on the Issues Paper

7.22 On the matter as to whether the objectives of price regulation set out in the Code are appropriate, Power and Water argued that the clause 63 objectives were broadly appropriate.

7.23 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)*

7.24 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]

7.25 In its submission responding to the Issues Paper, 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)*

7.26 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.

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

7.28 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:

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

> *"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.*
>
> *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

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

7.30 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, namely that:

> *"…regulated access prices should 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."*

7.31 Accordingly, it was the Commission's draft recommendation that:

- clause 63 of the Code 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 (draft recommendation (46)); and
- 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 (draft recommendation (47)).

7.32 No objections were raised to these recommendations in submissions in response to the Draft Report.

> ***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 objects of the Code.***
>
> ***Recommendation 47 Clause 63 of the Code should be amended to explicitly include in the pricing principles that regulated access prices are to 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 that regulated service or services, and includes a return on investment commensurate with the regulatory and commercial risks involved.***

Definitional issues

Commission's analysis and conclusions

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

7.34 For example, 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).

7.35 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.

7.36 Accordingly, it was the Commission's draft recommendation that chapter 5 of the Code be amended to address the definitional anomalies identified by the Commission's legal advisers (draft recommendation (48)).

7.37 No objections were raised to these recommendations in submissions in response to the Draft Report.

> ***Recommendation 48 Using the Code review process at recommendation 5, further consideration should be given to how chapter 5 of the Code might most appropriately be amended to address definitional and drafting anomalies identified by the Commission.***

Network revenue caps

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

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

Scope of the revenue cap

7.40 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.

7.41 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."*

7.42 Hence, 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 on the Issues Paper

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

7.44 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 draft analysis and conclusions

7.45 The Commission acknowledged 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.

7.46 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 regulator pursuant to clause 72.

7.47 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.

7.48 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.

7.49 Accordingly, it was the Commission's draft recommendation 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 (draft recommendation (49)).

Views in submissions on the Draft Report

7.50 NT Treasury neither supported nor opposed the draft recommendation, stating that:

> *"It is not clear from the Commission's discussion what specific services would be classified among a "third class" of services, and why these could not be subject to price controls or excluded altogether. It is also not clear that providing the regulator with discretion in identifying and regulating these particular services would add certainty for market participants." (p.6)*

7.51 Power and Water did not offer any objections to this draft recommendation.

Commission's final position

7.52 After further consideration, the Commission has decided to modify draft recommendation (49) in order to retain the distinction between 'included' and 'excluded' services. Instead, the Commission prefers that the Code recognises that there may be two types of 'included' services: those that lend themselves to inclusion in any revenue cap or general price control, and those that do not.

Recommendation 49 Clause 72(2)(b) of the Code should be amended (a) to include within the class of 'included services' those services provided by the network provider which in the regulator's opinion do not lend themselves to being regulated via the general price control mechanisms set out in chapters 6 and 7 of the Code; and (b) to provide that (i) a network provider should be required to provide these types of 'included services' to network users on fair and reasonable terms and (ii) the regulator may determine the fair and reasonable terms which should apply to the provision of such an 'included service' if the network user and the network provider are unable to reach agreement.

Length of regulatory control periods

7.53 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.

7.54 As foreshadowed in the Issues Paper, the Commission sought Ministerial agreement to extend the first regulatory control period through to 30 June 2004, on the grounds that this would 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 control period. The way the Code stood at that time, there was a prospect that any changes to the Code as a result of the Ministerial review may either not have had effect until the third regulatory control period or may have resulted in the truncation of the second regulatory control period. A one year's delay in the second regulatory control period seemed more sensible all around.

7.55 The Minister agreed with the Commission's proposal and amendments to the Code extending the regulatory control period to 30 June 2004 were published in Gazette G12 on 26 March 2003.

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

Views in submissions on the Issues Paper

7.57 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.

7.58 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

7.59 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 determinations in other jurisdictions to date, the Commission agrees that this remains appropriate for the Territory access regime.

7.60 Accordingly, it was the Commission's draft recommendation that the definition of 'regulatory control period' in clause 3 of the Code be amended to remove any doubt that such periods in future are to be five years in length (draft recommendation (50)).

7.61 No objections were raised to this recommendation in submissions in response to the Draft Report.

> ***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 control period?

7.62 Essentially, clause 69 of the Code provides for the revenue cap in the first year of a regulatory control period to be set by the regulator 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 regulator, 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.

7.63 Clause 70 of the Code requires the regulator 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 control 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.

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

Building blocks approach

7.65 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.

7.66 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 regulator 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.

7.67 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.

7.68 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

7.69 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.

7.70 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.

7.71 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]

7.72 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 on the Issues Paper

7.73 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.*

[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).

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)

7.74 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.

7.75 At the same time, 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

7.76 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.

7.77 At the very least, the Commission considers that it would be prudent to amend schedule 10 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"

7.78 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.

7.79 Accordingly, it was the Commission's draft recommendation 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 control 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 (draft recommendation (51)); and
- consideration 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 control period (draft recommendation (52)).

7.80 No objections were raised to these recommendations in submissions in response to the Draft Report, with NT Treasury noting that:

"…there is some ambiguity in schedule 9 (especially clause 1A) regarding the development of the revenue cap methodology." (p.6)

Recommendation 51 Part 3 of the Code (and associated schedules) should be amended as soon as possible to remove any doubt that the price control methodology to be used in the second and subsequent regulatory control 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 that applied in the first regulatory control period.

Definitional issues

Commission's analysis and conclusions

7.81 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 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).

7.82 Accordingly, it was the Commission's draft recommendation that clause 67(2) of the Code be deleted to address the definitional anomalies identified by the Commission's legal advisers (draft recommendation (53)).

7.83 No objections were raised to this recommendation in submissions in response to the Draft Report.

Recommendation 53 Clause 67(2) of the Code should be deleted.

Network tariffs

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

7.85 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

7.86 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 on the Issues Paper

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

7.88 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

7.89 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.

7.90 This process is overseen by the regulator in the manner set out in clause 75(6) of the Code (i.e., the regulator 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 to those services if in the regulator's opinion that statement is consistent with the principles set out in clause 74).

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

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

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

7.94 Accordingly, it was the Commission's draft recommendation that:

- the objectives of network pricing stated in clause 74 of the Code be retained in their present form (draft recommendation (54)); and
- clause 74 of the Code be amended to provide that, in the event of any conflict with the clause 63 pricing principles, the clause 63 principles will prevail (draft recommendation (55)).

7.95 No objections were raised to this recommendation in submissions in response to the Draft Report. Power and Water commented that:

> *"Power and Water previously noted that a conflict should not occur between the principles set out in Chapter 5, which sets out the objectives for all of Part 3 and section 74 which sets out the objectives for Chapter 7, which is itself a component of Part 3.*
>
> *However, if a conflict did arise, complex interpretative work would be required to resolve which interpretation should be accepted. Given this, a simple change to clause 74 to establish a hierarchy appears pragmatic." (p.22)*

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

7.96 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."

7.97 However, in the network tariff schedules approved for use in the first regulatory control 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 based charge (which also has peak and off-peak rates), levied based on the requirements of the end-use customer.

7.98 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. To date there were no network reference tariffs applicable to generators submitted or approved.

Views in submissions on the Issues Paper

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

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

7.101 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 draft analysis and conclusions

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

7.103 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.

7.104 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.

7.105 Accordingly, it was the Commission's draft recommendation that:

- the network pricing structure provisions in clause 75 of the Code be retained in their present form (draft recommendation (56)); and

- 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 (draft recommendation (57)).

Views in submissions on the Draft Report

7.106 NT Treasury supported the draft recommendations.

7.107 While raising no objections to draft recommendation (57), Power and Water indicated that it could:

> *"…neither support nor oppose this recommendation, for two reasons:*
>
> - *the Regulator has not proposed a specific recommendation for changes to the Code, rather Power and Water are asked to comment without seeing the final form of proposed amendments;*
> - *Power and Water query whether the Code is the appropriate instrument to address the need for this amendment. The proposed amendment likely requires Power and Water Networks to become involved in commercial arrangements between retailers and customers which is not appropriate." (p.23)*

Commission's final position

7.108 The Commission acknowledges the point made by Power and Water that the most appropriate instrument for advising contestable customers of the network component of their electricity charges deserves further consideration. Accordingly, it has modified draft recommendation (57).

> ***Recommendation 56 The network pricing structure provisions in clause 75 of the Code should be retained in their present form.***
>
> ***Recommendation 57 Using the Code review process at recommendation 5, further consideration should be given to the most appropriate means by which individual contestable customers might be advised, as a matter of course, about the network component of their cost of electricity supply.***

Pricing principles statement

7.109 Clause 75(5) of the Code provides that, prior to the commencement of each regulatory control period, the network provider is to submit for the regulator'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.

7.110 The regulator 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 on the Issues Paper

7.111 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)*

7.112 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

7.113 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.

7.114 Accordingly, it was the Commission's draft recommendation that the pricing principles statement provision in clause 78(1) of the Code be retained in its present form (draft recommendation (58)).

7.115 No objections were raised to this recommendation in submissions in response to the Draft Report.

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

Capital contributions

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

7.117 '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.

Form of regulatory control

7.118 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 regulator's approval details of principles and methods for establishing capital contributions.

Views in submissions on the Issues Paper

7.119 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.

7.120 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

7.121 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 regulator 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.

7.122 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.

7.123 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.

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

7.125 Accordingly, it was the Commission's draft recommendation that the capital contributions provisions in chapter 8 of the Code be retained in their present general form (draft recommendation (59)).

7.126 No objections were raised to this recommendation in submissions in response to the Draft Report.

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

Role of the regulator

Commission's draft analysis and conclusions

7.127 While clause 81(1) of the Code states that the broad application of the capital contribution principles will be overseen by the regulator, the only power granted to the regulator 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 regulator should be expanded by:

- granting to the regulator a specific right to require amendments to the statement of principles and methods for establishing capital contribution from time to time; and
- allowing the regulator 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.

7.128 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.

7.129 However, in an oversight, the Commission did not propose any specific draft recommendations dealing with these matters.

Views in submissions on the Draft Report

7.130 NT Treasury submitted that:

> *"The Commission has not provided sufficient justification that the Code's effectiveness would be improved by providing the regulator with further discretion under clause 81. The regulator's current approval and application powers seem appropriate, and any advice provided by the regulator regarding capital contributions would seem to inappropriately advantage the access seeker.*
>
> *Also, aside from not making a specific recommendation, the Commission has not adequately explained how clause 79(5) would expose network users to potentially onerous requirements, particularly where the prudential requirements covered by this clause are subject to negotiation between market participants." (pp.7-8)*

7.131 Given the absence of specific draft recommendations, Power and Water provided no specific comments on these issues.

Commission's final position

7.132 Because no draft recommendation was proposed, and the issue is such that further consideration by the parties concerned is warranted, the Commission's has limited its recommendation to proposing that this matter be subject to further consideration.

> ***Recommendation 59A Using the Code review process at recommendation 5, further consideration should be given to the role that might be played by the regulator in chapter 8 in oversighting the setting of capital contributions (including prudential requirements).***

Definitional issues

Commission's draft analysis and conclusions

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

7.134 The definition of 'capital contribution' in clause 3 of the Code and the provisions of clause 31 and chapter 8 involve a degree 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.

7.135 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.

7.136 Clause 31(1) of the Code does not clearly state whether the granting of an access application necessitating the extension of connection equipment or network system assets is to be determined in accordance with the procedures set out in chapter 8 of the Code.

7.137 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.

7.138 Accordingly, it was the Commission's draft recommendation that chapter 8 of the Code be amended where applicable to address the definitional and drafting anomalies identified by the Commission's legal advisers (draft recommendation (60)).

Views in submissions on the Draft Report

7.139 Power and Water argued that:

> *"The Regulator has not proposed a specific recommendation for changes to the Code in recommendation 60, rather Power and Water are asked to comment without seeing the final form of proposed amendments. This is particularly important with this recommendation, as the specific parts of the recommendation are not suitable to be grouped." (p.23)*

7.140 Further, Power and Water requested that:

> *"…these individual issues be treated as separate recommendations to the Minister. Power and Water submits that its views on each should be recorded independently." (p.24)*

Commission's final position

7.141 As with other draft recommendations proposing amendments because of drafting anomalies, the Commission acknowledges that such drafting issues are best dealt with through the Code review process proposed in recommendation 5.

> ***Recommendation 60 Using the Code review process at recommendation 5, further consideration should be given to how chapter 8 of the Code might most appropriately be amended to address the definitional and drafting anomalies identified by the Commission.***

Charges for out-of-balance energy services

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

7.143 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.

7.144 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

7.145 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 regulator 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."*

7.146 Clause 85A of the Code provides that settlement of out-of-balance energy services is to involve 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.

7.147 Clause 87(3) of the Code provides, among other things, that the regulator 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 regulator must assess the extent to which the arrangements are meeting the requirements of clause 85.

Views in submissions to Issues Paper

7.148 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.

7.149 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)*

7.150 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

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

7.152 Accordingly, it was the Commission's draft recommendation that the out-of-balance energy charging provisions of chapter 9 of the Code be retained in their present form (draft recommendation (61)).

7.153 No objections were raised to this recommendation in submissions in response to the Draft Report.

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

7.154 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."

7.155 '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.

7.156 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 on the Issues Paper

7.157 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)*

7.158 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.

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

Commission's draft analysis and conclusions

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

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

7.162 Accordingly, it was the Commission's draft recommendation that the provision for the regulator's determination of the methodology for estimating network energy losses in clause 82(2A)(b) of the Code be retained in its present form (draft recommendation (62)).

Views in submissions on the Draft Report

7.163 NT Treasury agreed with the draft recommendation.

7.164 Power and Water expressed concern that the draft recommendation did not acknowledge Power and Water's previous submissions that changes to the Code were necessary in this area. Power and Water restated its position as follows:

"Clause 82(2A) states:

"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."

Firstly, Power and Water does not agree that the Regulator should require losses to be determined in any other manner than that laid down in Schedule 13. Provision of regulatory certainty is important to all market participants, and has in the past led to disagreement on which of the wide range of methods available for loss estimation should be used.

Secondly, Power and Water has advised the Regulator that the calculation of energy loss factors for each contestable customer, as required by Schedule 13, is impractical and in need of amendment. While the Regulator notes this issue in the Draft Report, the Regulator has not proposed consequential amendments. Power and Water again stresses the importance that this issue is taken into account, and for generic loss factors to be considered as a workable alternative.

Thirdly, Power and Water remains concerned that the loss factor calculation algorithm is in need of review.

Fourthly, Power and Water remains concerned about the use of the word 'measure' in relation to losses. Power and Water again stresses that the word 'measure' is not appropriate, as it is technically incorrect.

…It is important that the Code is technically valid and these changes are necessary to ensure this." (p.25)

Commission's final position

7.165 The Commission acknowledges that Power and Water has on previous occasions raised technical and practical concerns with the Commission about the application of schedule 13 to the Code. Equally unacknowledged by Power and Water is the Commission's current inquiries into Power and Water's compliance with schedule 13 to date.

7.166 The Commission does not agree with Power and Water's contention that the ability of the regulator (in clause 82(2A)(b)) to determine an alternative way of taking account of network energy losses is inappropriate. The Commission understands that this provision was included in the Code to reflect uncertainty about whether the methodology currently in schedule 13 is the most appropriate means of 'measuring' network energy losses, a position supported by Power and Water in its submission in response to the Draft Report.

7.167 The fact is that the Commission has not yet formally embarked on the process of developing and publishing an alternative to the schedule 13 methodology, despite Power and Water's request to the Commission that it does so. The Commission's position has been to defer this matter until Power and Water's compliance with the schedule 13 methodology during the April 2000 to July 2001 period has been settled.

7.168 However, for consistency, the Commission proposes that, provided a Code review process is adopted (recommendation 5), clause 82(2A)(b) be deleted. The Code review process will allow consideration of the changes required to schedule 13.

Recommendation 62 Provided a Code review process is adopted (recommendation 5), clause 82(2A)(b) should be deleted and, using that process, further consideration then given to whether changes are necessary to the methodology for estimating network energy losses contained in schedule 13.

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.

APPENDIX

C

DRAFT RECOMMENDATIONS

General conclusions

In general, the Commission 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 (draft 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 (draft 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 (draft 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 (draft recommendation (4)).

Areas where no changes are required

In several important respects, the Commission recommended no change to the Act or the Code.

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

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

With regard to Part 1 of the Code, the Commission recommended that the generation-related provisions be retained in their present location (draft recommendation (27)).

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

- the network price control framework, involving an independent regulator (draft recommendation (45));

- the objectives of network pricing stated in clause 74 of the Code (draft recommendation (54));
- the network pricing structure provisions in clause 75 of the Code (draft recommendation (56));
- the pricing principles statement provisions in clause 78(1) of the Code (draft recommendation (58));
- the capital contributions provisions in chapter 8 of the Code (draft recommendation (59));
- the out-of-balance energy charging provisions in chapter 9 of the Code (draft 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 (draft recommendation (62)).

Substantive recommendations for change

To improve the effectiveness of the Code, the Commission recommended a series of substantive changes to the Code (and supporting elements of the Act).

The Commission framed all of its draft 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*.

The Commission recommended the following substantive changes to the Code (and to the Act), aimed at directly benefiting 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 (draft 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* (draft 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 (draft 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 (draft 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 (draft 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 control 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 (draft recommendation (51)).

The following draft recommendations for substantive changes to the Code were 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 (draft 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 (draft recommendation (47)).

The Commission recommended 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 (draft 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 (draft 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 (draft 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) (draft 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 (draft 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) (draft 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 (draft recommendation (57)).

Minor/technical recommendations for change

The Commission also made a series of draft recommendations involving minor technical or drafting improvements to the Code.

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

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

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

Areas requiring further consideration

Finally, the Commission flagged 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 (draft 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 (draft 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 (draft recommendation (29));
- considering alternative arrangements to apply in clause 18 of the Code for assigning available network capacity between competing access applications (draft recommendation (40)); and
- clarifying the rights of network users under existing access agreements as currently defined in chapter 2 of the Code (draft recommendation (41)).