

2006-07 Network Tariff Schedules: Statement of Reasons

The Power and Water Corporation (Power and Water) is regulated under a Weighted Average Price Cap (WAPC). A key design element of a WAPC regime is that the tariffs can be re-balanced each year prior to new tariff schedules being published. Re-balancing primarily refers to changes to prices (for individual tariffs), to more closely reflect their cost of provision.

Power and Water has rebalanced the 2006-07 Network Access Tariffs. On average, the pricing constraints in 2006-07 allows for the weighted average price to increase by no more than 0.61536% ("CPI + Z - X" WAPC constraint) and for no individual tariff to increase by more than 12.9356% ("CPI+10%" side constraint) as instructed in the Utilities Commission's *Networks Pricing: 2004 Regulatory Reset Final Determination*. Power and Water has submitted detailed evidence to the Utilities Commission demonstrating compliance with each of these constraints.

The minor re-balancing adjustments that Power and Water has made result from amendments to the *Electricity Reform (Administration) Regulations* that allow for the reversal of contestability for those customers whose annual consumption has fallen (and is expected to remain) below 750 MWh. As a result, a number of contestable customers are expected to move to franchise tariffs. Power and Water has amended some components of its tariffs to reduce the costs allocated to the contestable tariff classes (where these customers have left) and to increase the costs allocated to the franchise tariff class (where these customers have gone to).

Specifically, the changes are:

- A reduction in the first three tariff steps of the Northern and the Alice Springs (>750MWh) tariff of 3%. Across the entire tariff, this corresponds to an average decrease of 1.6%. This reflects the expected movement of around twenty-five customers from this tariff class into smaller classes;
- A corresponding increase in Northern and Alice Springs Commercial (<750MWh) tariffs of 1.3%, and the Northern and Alice Springs Domestic (< 750MWh) tariff of 2%, respectively.

Power and Water considers that the 2006-07 Network Tariff Schedules (and therefore the proposed re-balancing) complies with the approved 2006 Network Pricing Principles Statement. A qualitative explanation follows.

NETWORK TARIFF OBJECTIVES (Network Pricing Principles 2.1)

Power and Water is guided by the network pricing objectives laid down in clause 74 of the *Electricity Networks (Third Party Access) Code* (the Code). As noted in section 2.1 of the Network Pricing Principles Statement, Power and Water's interpretation of the Code's pricing objectives is as follows:

- Cost reflective signals - there should be appropriate signalling to network users of their impact on existing and future network capacity and costs. Prices should reflect underlying cost drivers and provide appropriate signals for load management;
- Revenue recovery - network prices need to provide a commercially sustainable regulated revenue stream to ensure business viability by recovering efficient operating costs and providing an adequate rate of return to encourage ongoing efficient investment in network infrastructure;
- Simplicity - prices should be straightforward in application and readily understood by network users;
- Stability - prices should remain stable over time to permit network users to make informed investment decisions. Network users should not be subject to price shocks that distort consumption of network access services;
- Equity - prices should be equitable for network users. Generally, this means that prices reflect the user's utilisation of the existing network; and
- Subsidy free - prices should be subsidy free.

The 2006-07 Tariff Schedules conform to the above Price Objectives because:

- The prices remain cost reflective. There has been a negligible change to the Network Access Tariffs when compared to increasing all components of all tariffs by the constraint, and the changes proposed have been designed to reflect movements in underlying costs between tariff categories. Power and Water considers that the relationship between prices and costs have been kept constant as a consequence of this re-balancing exercise;
- The prices provide for adequate revenue recovery. Power and Water has re-balanced its tariffs to better reflect its assessment of forecast revenues from all tariffs and its underlying costs of service provision. The 2006-07 Network Access Tariffs allow for adequate revenue recovery to ensure ongoing investment in network infrastructure;
- The prices remain simple for customers to understand. Power and Water has retained its current number and structure of tariffs, as it believes that customers do not demand either an alternative structure nor alternative tariffs at this time;
- The prices are stable. As there has been minimal change to tariff components and no change to tariff structures, this objective remains satisfied; and
- The prices reflect an equitable allocation of costs which are reflective of user's network utilisation.

COST ALLOCATION PRINCIPLES (Network Pricing Principles 2.3)

At the commencement of the second (current) regulatory control period, Power and Water Networks allocated its costs among network users using the Fully Distributed Cost (FDC) Model, as outlined in the 2006 Network Pricing Principles. The FDC Model allocates costs for different customer classes according to their level of connection in the system. At the commencement of the period, both Power and Water Networks and the Utilities Commission were satisfied that tariffs were reflective of costs.

Power and Water is conscious that costs that are allocated at the start of a regulatory period can theoretically 'drift' away from efficient levels within a regulatory period. However, Power and Water do not believe that this has occurred in any substantial way as demand has broadly followed Power and Water's expectations since the commencement of the period, there have been few major large customers entering and leaving the network, and Power and Water Network's underlying costs have not materially changed. As noted previously however, a number of customers are expected to shift from contestable customer tariffs to franchise tariffs, following amendments to the *Electricity Reform (Administration) Regulations* allowing this to occur.

This movement by customers between tariff classes has meant that Power and Water Networks must adjust its allocation of underlying costs between tariff classes. The tool by which Power and Water can achieve this is the WAPC. Power and Water accordingly believes that the proposed 2006-07 tariffs are consistent with the cost allocation principles.

NETWORK TARIFF STRUCTURE (Network Pricing Principles 2.5)

There has been no change to the Network Tariff Structure described in the 2006 Network Pricing Principles since the commencement of the current regulatory period.