2014 Networks Price Determination

Revised Regulatory Proposal Overview

1 July 2014 to 30 June 2019

January 2014

1 Introduction

In the lead-up to the commencement of the fourth regulatory control period (the five year period commencing 1 July 2014), the Utilities Commission (the Commission) is required as regulator - in consultation with interested parties - to review the networks price regulation methodology. The Commission refers to this review and consideration of the price regulation methodology to apply from 1 July 2014 as the '2014 Networks Price Determination'.

The Commission regulates network charges in the Northern Territory and the purpose of Power Networks' Revised Regulatory Proposal (RRP) is to set out the funding that Power Networks believes is necessary to enable it to continue to provide a safe, secure and reliable supply of electricity throughout the Northern Territory.

This document is intended to provide an overview of Power Networks' RRP submitted to the Commission as part of the 2014 Networks Price Determination process.

Retail electricity prices currently paid by consumers comprise a number of cost components:

- electricity generation costs;
- network (transmission and distribution) costs;
- system operation and control costs; and
- customer retail services.

The RRP concerns only the network component of electricity charges.

Small to medium sized customers are not currently impacted by Network Tariff pricing decisions, as they are subject to an Electricity Pricing Order issued by the NT Government.

The Commission will make its final determination on the network charges to apply for the 2014-15 to 2018-19 period in April 2014.

2 Power Networks' Revised Regulatory Proposal

The Commission has decided, where practicable, to adopt the regulatory framework that has been established in the National Electricity Market (NEM). The NEM covers Queensland, New South Wales, the Australian Capital Territory, Victoria, Tasmania and South Australia. This regulatory framework is set out in the National Electricity Rules (the Rules) and Guidelines issued by the Australian Energy Market Commission (AEMC), and regulated by the Australian Energy Regulator (AER).

The NEM regulatory framework uses a cost build-up method to determine efficient network charges. This is known as a "building block" approach, with the following building block elements:

- return on assets;
- depreciation of assets; and
- operating and maintenance expenditures.

The network charges from the building block process are intended to provide sufficient revenue for the network business to operate on a commercial and sustainable footing.

2.1 Major elements of the Revised Regulatory Proposal

The RRP updates the documents and associated information that were submitted to the Commission in September 2013 in Power and Water's Initial Regulatory Proposal. The RRP does not restate elements of the Initial Regulatory Proposal that remain unchanged; rather, it is limited to the coverage of those matters that have changed. The chapters of the RRP are set out in the following Table.

Chapter	Summary of content
1. Introduction	Regulatory background, key assumptions and variations to information provided in the Initial Regulatory Proposal.
2. Business overview and context	Description of Power Networks' business and the circumstances in which it operates.
3. Transitional issues	Issues associated with moving to the NEM regulatory framework.
4. Classification of services	Division of Power Networks' services into those that are covered by the RRP and those that are not covered by the RRP.
5. Control mechanism for standard control services	Describes how Power Networks' tariffs will be set each year, following the 2014 Networks Price Determination.
6. Demand forecasts	Forecasts of the electrical demand, number of new customers and energy delivered by the network.
7. Real cost escalation and CPI	Economic parameters that influence future costs.
8. Forecast capital expenditure	Forecasts of the capital expenditure required to provide a secure and reliable supply.
9. Capital contributions	Describes how proposed charges for new customers will ensure they do not increase costs for existing customers.
10. Forecast operating and maintenance expenditure	Forecasts of the operating and maintenance expenditure required to provide a secure and reliable electricity supply.
11. Service standards framework	Current and forecast reliability for 2014-19.
12. Regulatory asset base	The value of Power Networks' assets.
13. Weighted average cost of capital	The rate of return required on the asset base.
14. Depreciation	Funding the depreciation of Power Networks' assets over their useful lives.

Chapter	Summary of content
15. Indicative revenue and pricing for standard control services	The revenue required to allow Power Networks to continue to provide secure and reliable electricity supply and the price impacts on customers.
16. Pass through arrangements	The circumstances in which for some major events beyond Power Networks' control (eg. major cyclone damage, regulatory framework changes etc.) the Commission may permit additional costs to be recovered through tariffs.

The following are the key elements of the Power Networks' RRP, insofar as they have the most significant effect on the proposed network charges:

- ***Capital expenditure:*** A significant portion of Power Networks' capital expenditure is categorised as replacement capital expenditure. Replacement capital expenditure is required where network equipment has reached the end of its serviceable life and must be replaced to ensure a secure and reliable electricity supply. Capital expenditure is also required for other reasons, including: to connect new customers, to improve the reliability and quality of supply, to augment the capacity of the network, and to ensure that safety and compliance obligations can be met. The RRP contains forecast capital expenditure that Power Networks considers is both prudent and efficient.
- ***Operating and maintenance expenditure:*** Power Networks' operating and maintenance expenditure is required to: meet or manage the expected demand for network services over that period; comply with all applicable regulatory obligations or requirements associated with the provision of network services; and maintain the quality, reliability, safety and security of supply. Power Networks' forecasts of operating and maintenance expenditure provide the most prudent and efficient solutions to meet these objectives.
- ***Asset base:*** The regulatory asset base is based on an optimised network value. The depreciated value of this optimised asset base is used for calculation of the return on assets. The resulting Optimised Depreciated Replacement Cost (ODRC) of assets is the same process as for all the NEM networks and has a value of $930 million as at 1 July 2014.

2.2 Customer outcomes

Power Networks' RRP has been framed so as to deliver the following customer outcomes:

- meeting an annual growth in electrical demand of about 2.7% in the Darwin-Katherine system, significantly higher than the growth rates in other states;
- the connection of approximately 2,000 new customers per annum to the network; and
- providing for an improvement in the reliability performance of the network.

The proposed increase in Network Tariffs is passed on to retailers in the first instance. Retailers can pass on the increased Network Tariffs to contracted customers if they have a pass-through clause in their contracts. However, for customers on pricing orders, retailers cannot charge above the regulated retail tariff.

The table below outlines the impacts of the proposed 2014-15 Network Tariff increase for each customer type, based on a sample of customers.

Tranche	Customer Type	2014-15	
		Average Increase	Increase Range
1-4	Medium to Large Contracted Customers	11%	6-14%
5-6	Residential and Small Commercial Pricing Order Customers	No Impact	

Please note that these impacts are indicative only, as the final 2014-15 Networks Pricing Proposal will be subject to the Commission's Final Networks Price Determination. In addition, the impact on each contracted customer will depend on its individual consumption and demand profile.

Power Networks' will submit its final 2014-15 Networks Pricing Proposal following the Commission's Final Networks Price Determination in April 2014.

3 Customer engagement

Power Networks is well aware of customer concerns regarding both the cost of electricity supply and the reliability performance of the network. To this end, the RRP sets out what Power Networks believes to be the efficient cost of electricity delivery whilst making modest improvements in reliability.

The NEM processes that Power Networks is now following will provide greater opportunity for customers and interested parties to provide feedback on the network business activities, in areas such as:

- the RRP, which is published for comment;
- the draft Pricing Proposal, which sets out Power Networks' proposals to improve the equity and cost reflectivity of network charges; and
- the use of demand management and non-network solutions to meet the increasing demand on the network.

Through these consultation processes Power Networks will address any relevant customer concerns identified.

4 Risks and benefits of the Revised Regulatory Proposal

The RRP sets out the minimum charges necessary to maintain a secure and reliable supply to customers.

The main benefit of the RRP is that the proposed adjustment to network tariffs is based on a comprehensive, detailed and thorough assessment of prudent and efficient investment in both capital projects and programs; and in operating and maintenance expenditure requirements for the network. This has delivered a price path for network charges which allows the business to be operated on a sustainable commercial footing, enabling the recovery of efficient operating and maintenance costs, and, over time, of investment in infrastructure and the provision of a reasonable and necessary return on efficient capital.

Power Networks believes the main risk associated with the RRP is unexpected or unforseen macroeconomic changes in the NT economy resulting in significant shifts to the underlying assumptions that support the proposed capital, operating and maintenance expenditure.

A further risk is the possibility of the Commission not accepting the proposed network charges and setting a lower level of revenue. This will result in the Networks business continuing to rely on significant cross subsidisation and underwrite to recover efficient operating costs to ensure that service security and reliability are not compromised.