

Utilities Commission of the Northern Territory

CONTESTABLE PRICING GUIDELINES

September 2001

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Background

1. The purpose of these Guidelines is to set out the Commission's interpretation of:

- clause 4(e) of the Ring-Fencing Code regarding discriminatory conduct; and
- section 48(1)(b) of the *Electricity Reform Act 2000* ("the complaints provisions") regarding conduct that is contrary to the pro-competition and efficiency objects of that Act or the *Utilities Commission Act 2000*,

in relation to pricing to contestable customers and third-party retailers.

2. In particular, these Guidelines present the Commission's views on the types of pricing conduct that could give rise to a finding of 'anti-competitive' and/or 'discriminatory' conduct by the Commission under either the Ring-Fencing Code or the complaints provisions of the *Electricity Reform Act 2000*.

3. These Guidelines apply irrespective of the private versus public sector ownership of the contestable customers involved.

Authority for guidelines

4. These Guidelines are issued pursuant to Section 7 of the *Utilities Commission Act 2000*, which authorises the Commission to issue guidelines relating to the performance of its functions.

5. Among the functions of the Commission (at section 6(1) of the *Utilities Commission Act 2000*) is performance of the licensing function and investigating and helping resolve complaints relating to the conduct or operations of licensed entities.

6. Monitoring compliance with the Ring-Fencing Code is an aspect of the Commission's licensing functions. Clause 4(e) of the Code states that an electricity entity that carries on a 'prescribed business' (e.g. PAWA Generation) must:

"...ensure that goods or services provided to a Related Business by a Prescribed Business are provided on a non-discriminatory arm's length commercial basis to other Customers who wish to obtain the same type of goods or services from the Prescribed Business (including competitors of that Related Business)."

7. The Commission also has an obligation under section 48 of the *Electricity Reform Act 2000* to investigate complaints against any electricity entity made on the grounds that the entity is engaging in conduct that is contrary to the objects of that Act or the *Utilities Commission Act 2000*. Such objects include promoting efficiency and competition in the electricity supply industry.

8. In the Commission's view, the Guidelines are necessary given the considerable divergence of views apparent – among the parties and between the parties and the Commission – as to the regulatory and competitive implications of the Power and Water Authority's incumbency and vertically integrated operations, and the pricing conduct in such circumstances that would be consistent with the objects of the *Electricity Reform Act 2000*, the *Utilities Commission Act 2000* and the Ring-Fencing Code.

9. These Guidelines are intended to inform electricity entities and contestable customers of the Commission's position on certain matters that might be subject to enforcement¹ or investigation² by the Commission. While these Guidelines do not have the same force in law as a determination made by the Commission under section 20 of the *Utilities Commission Act 2000* or any codes or rules made under section 24 of that Act, any breach of these Guidelines will be pursued through all avenues available to the Commission.

Circumstances warranting a finding of 'anti-competitive pricing'

10. To avoid a finding by the Commission that PAWA Retail has engaged in **anti-competitive pricing** conduct when setting the (bundled) retail price it is charging, or intended to charge, an individual contestable customer, PAWA Retail must be able to demonstrate to the Commission's satisfaction that the price at least recovers the *incremental* costs PAWA Retail incurs in supplying that customer (i.e. the resources used exclusively by the customer and the additional cost that the contestable retail segment of PAWA Retail incurs to provide resources to that customer). These incremental costs must be based on:

- (a) the direct cost to the contestable retail segment of PAWA Retail on account of servicing that customer;
- (b) the fully distributed cost to the contestable retail segment of PAWA Retail of providing any non-standard services and/or value-added services to that customer;
- (c) the fully distributed cost to the contestable retail segment of PAWA Retail of the network access charge incurred on account of that customer (as per the approved tariff schedule) and any other network-related charges; and
- (d) the marginal price paid by the contestable retail segment of PAWA Retail to PAWA Generation for the purchase of the energy to be on-sold to that customer (with such purchases being priced entirely separately from the bulk purchases made by the franchise retail segment of PAWA Retail on account of the supply of electricity to non-contestable customers and grace-period customers or the bulk purchases made by the contestable retail segment of PAWA Retail on account of the supply of electricity to 'contestable' customers under contracts entered into prior to the opening of the Territory's electricity market to competition).

¹ The Commission has the authority to initiate remedial action with regard to any finding of discriminatory pricing (by PAWA Generation), with such conduct being in contravention of the Ring-Fencing Code (and of a licence condition).

² With regard to any finding of anti-competitive pricing (by either PAWA Retail or PAWA Generation), the Commission's role is restricted to recommending remedial action for the Regulatory Minister's consideration.

10A. To avoid a finding by the Commission that PAWA Generation has engaged in **anti-competitive pricing** conduct when setting the wholesale price it is charging, or intended to charge, a licensed electricity retailer with respect to electricity supplied under a particular power purchase agreement, PAWA Generation must be able to demonstrate to the Commission's satisfaction that the price at least recovers the *long-run incremental* costs that PAWA Generation's contestable business segment would incur as a stand-alone business when generating the required additional amounts of electricity for that retailer in total under that power purchase agreement, where:

- 'incremental cost' means the costs that could be saved over the long term by not generating and selling the additional electricity involved;
- 'long-run' means at least the length of time in the planning horizon in PAWA Generation's capital budgeting cycle; and
- any costs shared between PAWA Generation's contestable and franchise business segments are allocated between those business segments on a causation basis.

Circumstances warranting a finding of 'discriminatory pricing'

11. To avoid a finding by the Commission that PAWA Generation has engaged in **discriminatory pricing** conduct when setting the energy price it is charging, or intended to charge, PAWA Retail, PAWA Generation must be able to demonstrate to the Commission's satisfaction that the basis of its pricing for PAWA Retail involves:

- (a) any delivered gas cost advantages accruing to PAWA Generation – on account of the gas contracts negotiated by the Territory Government prior to opening up of the Territory's electricity market to competition – being shared among retailers (including PAWA Retail) in a manner that does not favour PAWA Retail; and
- (b) recovery of non-gas costs – both capital costs and operating costs – in a manner that does not favour PAWA Retail.

12. The Commission recognises that non-discriminatory pricing does not necessarily involve offering or charging the identical (average) price per kWh for energy sold to a third-party retailer as for energy sold to PAWA Retail or to a third-party generator,³ with justified differentials arising on account of differences between purchasers with respect to, among other things:

- (a) the required duration of the power purchase agreement;
- (b) the required total (additional) quantum of energy to be purchased under that power purchase agreement, but not counting the quantum of energy purchased by the franchise retail segment or the quantum of energy

³ The Commission considers that PAWA Generation would be selling electricity produced to a *third-party retailer* where the purchasing entity holds a retail licence only or, in the case where the purchasing entity holds a retail and generation licence(s), where the new power purchase agreement (PPA) is for the purpose of supplying new customers or the increased load of existing customers beyond the load met by the entity's existing generation capacity or any existing PPAs.

On the other hand, PAWA Generation would be selling electricity to a *third-party generator* where the purchasing entity holds a generation licence only or, in the case where the purchasing entity holds a generation and retail licence(s), where the new PPA is for the purpose of substituting for load associated with end-use customers already contracted to the purchasing entity that, prior to the new PPA, had been supplied by the third-party generator's own generation capacity or by any existing PPA which the entity has with another generator.

purchased on account of supply to 'contestable' customers under contracts entered into prior to the customer becoming contestable;

- (c) the required daily, weekly and annual load profile of the (aggregate) energy being purchased under the power purchase agreement; and
- (d) the purchaser's relative credit rating.

Costs refer to future costs

13. All references to "cost" or "costs" in these Guidelines are to future costs as forecast by the price setter at the time the relevant price (or offer price) is settled, based upon current costs. Provided such forecasts are made on a 'reasonable endeavours' basis, any subsequent disparities that emerge between actual and forecast costs will not of themselves be taken as evidence of a breach of these Guidelines. Evidence of a breach of these Guidelines may arise if any forecasting errors reveal the deliberate or systematic mis-estimation of *forecast* costs.

Utilities Commission
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