

---

# **REVIEW OF OPTIONS FOR THE DEVELOPMENT OF A RETAIL PRICE MONITORING REGIME FOR CONTESTABLE ELECTRICITY CUSTOMERS**

FEBRUARY 2010



Level 9, 38 Cavenagh Street DARWIN NT 0800  
Postal Address GPO Box 915 DARWIN NT 0801  
Email: [utilities.commission@nt.gov.au](mailto:utilities.commission@nt.gov.au)  
Website: [www.utilicom.nt.gov.au](http://www.utilicom.nt.gov.au)

---

## Table of Contents

<b>EXECUTIVE SUMMARY .....</b>	<b>1</b>
Introduction .....	1
Scope of the Inquiry .....	2
Focus of the Review .....	3
Objective of Retail Price Monitoring in the Territory .....	3
Options .....	4
<b>INTRODUCTION.....</b>	<b>6</b>
Background .....	6
Contestability in the Territory .....	6
Summary of Issues Raised by Contestable Customers.....	8
Customer Complaint Mechanism for Contestable Customers .....	9
Power and Water's Reporting Obligations .....	11
<b>PRICE MONITORING – OBJECTIVES AND PRINCIPLES.....</b>	<b>16</b>
Importance of Competition.....	16
Price Setting Regulation .....	17
Price Monitoring.....	19
<b>DEVELOPMENT OF CONTESTABILITY AND COMPETITION IN AUSTRALIA AND THE TERRITORY.....</b>	<b>26</b>
Electricity Industry Reforms in Australia .....	26
Electricity Reforms in the Territory.....	31
<b>PRICE MONITORING IN OTHER JURISDICTIONS AND IN THE TERRITORY.....</b>	<b>36</b>
Price Monitoring in Australian Jurisdictions .....	36
Western Australia .....	38
Price Monitoring and Information Disclosure Regime in New Zealand .....	42
Power Switch.....	44
United Kingdom Framework for the Gas and Electricity Industries.....	45
Experience of Price Monitoring in the Territory.....	47
<b>IMPLEMENTATION OPTIONS FOR THE NORTHERN TERRITORY .....</b>	<b>49</b>
Proposed Options.....	49
Implementation Issues.....	52
<b>Appendix 1 .....</b>	<b>59</b>
Index of Questions.....	59

## Confidentiality

In the interests of transparency and to promote informed discussion, the Commission intends to make submissions publicly available. However, if a person making a submission does not want their submission to be public, that person should claim confidentiality in respect of the document (or any part of the document). Claims for confidentiality should be clearly noted on the front page of the submission and the relevant sections of the submission should be marked as confidential, so that the remainder of the document can be made publicly available. In addition, a copy of the submission suitable for publication (i.e. with any confidential material removed) should also be provided.

## Public access to submissions

Subject to the above, submissions will be made available for public inspection at the office of the Commission and on its website ([www.utilicom.nt.gov.au](http://www.utilicom.nt.gov.au)).

To facilitate publication on the Commission's website, submissions should be made electronically by disk or email. However, if this is not possible, submissions can be made in writing.

## Inquiries

Any questions regarding this report should be directed in the first instance to the Executive Officer, Utilities Commission at any of the following:

Utilities Commission  
GPO Box 915  
DARWIN NT 0801

*Telephone:* 08 8999 5480

*Fax:* 08 8999 6262

*Email:* [utilities.commission@nt.gov.au](mailto:utilities.commission@nt.gov.au)

## Note

Unless otherwise explicitly noted, the discussion in this Issues paper relates only to electricity supply in the Darwin-Katherine, Alice Springs and Tennant Creek power systems.

---

# CHAPTER 1

## EXECUTIVE SUMMARY

### Introduction

- 1.1 Power and Water Corporation (PWC) is the dominant participant of the Territory's electricity supply industry. Aside from the four other firms licensed to operate power stations in the Darwin-Katherine or Alice Springs systems, PWC is the only industry participant.
- 1.2 PWC is a Territory Government owned, vertically integrated electricity supplier. Although part of the same firm, its generation, network and retail businesses operate as separate business units according to the requirements of the licences granted by the Commission.
- 1.3 The ability of electricity retailer to compete to supply customers was introduced in stages in the Territory from April 2000 with large to medium customers becoming contestable first. However, the incidence of competition in the Territory was limited to the period between 2000 and 2002 in the Darwin-Katherine system when NT Power Pty Ltd (NT Power) both generated and retailed electricity.
- 1.4 Following the exit of NT Power from the market in September 2002, PWC became the sole wholesale electricity supplier and retailer in the Territory. As a result, contestable customers<sup>1</sup> supplied by NT Power had to revert to PWC. Since then, a number of contestable customers have expressed concerns about their bargaining powers being undermined by PWC's market dominance and perceived lack of transparent information.
- 1.5 Existing Territory legislation requires the disclosure of a limited range of information on PWC's performance and regulatory accounts. Moreover, section 48 of the *Electricity Reform Act* provides the powers to the Utilities Commission (the Commission) to investigate complaints relating to PWC's conduct thought to be contrary to its licence conditions. A number of contestable customers have claimed that these protection mechanisms have proved to be insufficient in addressing their concerns.
- 1.6 As a result, in November 2009 and under section 31 of Part 7 of the *Utilities Commission Act*, the Treasurer approved the Terms of Reference (ToR) requiring the Commission to undertake a review of options for the development of a retail price monitoring regime for contestable customers. The purpose of the review is to consider a range of options for the implementation of a retail price oversight framework for contestable electricity customers in the Territory and assess the merits of each option.
- 1.7 The purpose of this issues paper is to commence initial consultation with key interested parties on the development of a retail price monitoring regime for contestable customers in the Territory. The Structure of the document is as follows:
  - Chapter 2 outlines the issues relating to the absence of competition in the Territory and the perception of PWC's market dominance. It also examines the complaint mechanism available to contestable customers under the current regulatory framework;

---

<sup>1</sup> As at the date of writing, contestable customers comprise those consuming more than 750MWh per annum.

- Chapter 3 explores the objectives and principles underpinning retail price monitoring within the context of a wider reform of oversight of PWC's performance;
- Chapter 4 reviews the issues of competition and contestability in the Territory and more widely in Australia;
- Chapter 5 reviews the different approaches to price monitoring implemented in other jurisdictions; and
- Chapter 6 considers a range of options and implementation issues for a price monitoring regime in the Territory.

## Scope of the Inquiry

- 1.8 The Treasurer has directed the Commission to undertake a review of:
- (a) an effective retail price oversight framework for contestable customers; and
  - (b) the associated reporting and disclosure arrangements.
- 1.9 The ToR endorsed by the Treasurer require the Commission:
- 1) to examine the options for a retail price monitoring regime for contestable customers, taking into account:
    - i. the objective of a retail price monitoring regime in the Territory context;
    - ii. the longevity of the regime and the market conditions that would warrant monitoring to cease, or monitoring arrangements to be revised;
    - iii. the practical implementation requirements of a retail price monitoring regime; responsibility for oversight of the regime; and arrangements for collecting and reporting data, with an emphasis on the treatment of commercially sensitive data; and
    - iv. interstate experience of price oversight in contestable markets.
  - 2) to propose the design options, reporting and disclosure arrangements for a retail price monitoring regime that complements the existing complaints mechanism available to contestable customers under the *Electricity Reform Act*.
- 1.10 The Commission is to take into account all relevant economic and policy developments, including current and forecast economic conditions, the proposed National Emissions Trading Scheme and the expanded renewable energy target.
- 1.11 The Commission is to recommend a course of action and provide detailed plans for the implementation of such recommendations.
- 1.12 The timetable guiding the Commission's consultation process and the final report to the Minister is tabled below:

Table 1: Review timeframe

Due date	Action
17 March 2010	Customer reference group consultation
2 April 2010	Submissions on Issues paper due
18 June 2010	Release of the Commission's Draft report
16 July 2010	Submissions on the Draft Report due
6 September 2010	Final report provided to the Treasurer

- 1.13 As part of the consultation process on the Issues Paper, the Commission proposes convening a customer reference group to facilitate consultation.

## Focus of the Review

- 1.14 The main focus of the retail price monitoring review is to examine the options for price oversight initially for those medium to large customers (tranches 1 to 4) which are currently contestable.
- 1.15 The Commission recognises that contestability may extend to all customers on 1 April 2010.<sup>2</sup> However, the Electricity Reform (Administration) Regulations establish a grace period of two years, so any newly contestable customers will continue to be protected by their current tariff arrangements.<sup>3</sup> On 1 April 2012, once the grace period expires, a price cap for the Standard Offer Contract might be implemented.
- 1.16 Given the small scale of the Territory market and the small likelihood of substantial retail competition at the end of the grace period, the Commission contends that retail price oversight should be flexible and extend to cover all classes of customers.

## Objective of Retail Price Monitoring in the Territory

- 1.17 In considering the various options for a retail price monitoring regime, the Commission needs to have regard to the objective of a price surveillance framework in the Territory context.
- 1.18 The objective of a price monitoring regime is to enable scrutiny and monitoring of prices, costs and performance of firms or markets where effective market competition is not fully developed and market power may be exercised. Applied to the Territory context, price monitoring would provide contestable customers with a level of protection against potential misuse of market power exercised by PWC through:
- disclosure of information which is not otherwise readily available; and
  - surveillance of prices, costs and performance.
- 1.19 Information transparency would facilitate commercial negotiations between existing contestable customers (presently those using more than 750MWh per annum) and PWC. Price surveillance could enable monitoring of PWC's revenues, prices, costs and performance using benchmarks or efficiency targets. This will be particularly relevant when all customers become contestable on 1 April 2010 and full retail contestability (FRC) is implemented.
- 1.20 The Commission is also of the view that a retail price monitoring regime would provide additional benefits through facilitation of competition in the electricity market by informing potential new market participants considering entry in the electricity market. Furthermore, the Commission considers that retail price monitoring and information disclosure would benefit PWC as it would provide the firm with a better understanding on how its costs and prices compare against industry wide benchmarks and key performance indicators.
- 1.21 The Commission views the introduction of retail price monitoring in the Territory as being complementary to the existing customer complaint mechanism. It will address the concerns of contestable customers about PWC's conduct without them having to resort to a formal investigation. The contestable customer complaint mechanism is intended to be used as a last resort. Instead, price oversight will provide increased transparency in retail electricity pricing without interfering with the negotiation process between contestable customers and PWC.

---

<sup>2</sup> Electricity Reform (Administration) Regulations, regulation 6(4).

<sup>3</sup> Ibid, regulation 5.

- 1.22 Based on the comprehensive work in price surveillance by the Productivity Commission and other, the Commission considers there are seven implementation principles which should guide the development of the regime. These principles are:
- consistency;
  - transparency;
  - flexibility;
  - relevance;
  - timeliness;
  - non-intrusive; and
  - minimal compliance cost.

## Options

- 1.23 Having considered the ToR, the objectives of retail price monitoring in the Territory, and the implementation principles, the Commission has identified the following options:

### *Option A – Disclosure of Profitability of PWC Business Activities*

- 1.24 Under this option, the Commission would increase transparency of relevant information that is not readily available. It would make available information on revenue, costs and profits for each of PWC's electricity business activities - generation, network, system control and retail. The financial reports would give an indication of whether PWC prices were giving rise to monopoly profits. In addition, publication of the PWC pricing methodology would assist individual customers understand the principles of price offers.
- 1.25 Under this option, the Commission would leave it to the market to assess the reasonableness of PWC retail prices.

### *Option B – Reporting of the Estimated Benchmark Costs and Prices of an Efficient Service Provider*

- 1.26 Under this option, the Commission would develop an average 'efficient' price for each customer group which would allow comparisons with PWC prices. These prices would be based on the Commission's assessment of revenues required by an efficient generator and retailer, and would take into account network and other non-discretionary costs. This option would provide more information about efficient costs, in addition to providing more detailed information about appropriate levels of price for particular customer groups. Publication of efficient costs of generation may be hindered by confidentiality restrictions. The methodology for allocation of costs between customer groups should also be published to address concerns about cross-subsidies between customer groups. The Commission is of the view that retail price monitoring under this option could also assist in responding to customer complaints. The benchmark prices would be used to assess PWC's compliance with the conditions of its licence and the object of the *Utilities Commission Act*.

### *Option C – Reporting of Price Indices and Benchmarks of Costs with other Jurisdictions*

- 1.28 This option proposes to use price indices based on a Weighted Tariff Basket approach and/or Revenue Yield approach. Under this option, the Commission would construct indices for three types of customer – residential, small to medium businesses and large businesses. This option would allow comparison of prices between customer groups, and would allow monitoring of price movements on a consistent basis over time, but would not inform customers as to whether prices are reasonable.
- 1.29 The Commission could also report the actual or notional prices of each of the components of retail price - wholesale energy, network charges and retail margins. Prices of these components would be reported for typical customers in each

customer group over time. Reporting could be extended to include comparison with comparable charges in other jurisdictions, where such information is available. Further analysis would be required to ascertain the reasons for difference between prices for various customer groups and between jurisdictions.

*Option D - Status Quo*

- 1.30 The existing mechanisms providing protection to contestable customers are considered to be adequate. No price monitoring would be carried. The existing complaint mechanism would continue to provide protection to contestable customers.



---

## CHAPTER 2

### INTRODUCTION

#### Background

- 2.1 The roll out of retail contestability in electricity supply in the Territory commenced in April 2000.
- 2.2 Between April 2000 and September 2002, contestable customers in the Territory could choose between two electricity retailers – PWC and NT Power. The exit of NT Power from the market in September 2002 left PWC as the only generator and electricity retailer supplying customers in the Territory's regulated electricity systems. As a result, contestable customers supplied by NT Power had to revert to PWC.
- 2.3 In 2004, the Commission received an application from a firm seeking an electricity retailer's licence. Owing to the applicant's failure to provide assurances regarding its financial capacity the licence was not granted. There have been no further applications.
- 2.4 In context of the lack of competition in the electricity sector in the Territory, a number of contestable customers have expressed the view that they have limited options in their negotiation with PWC. They report that the only alternative to PWC's terms is to bypass the supply system by self-generation. They have also indicated that they are unsure that the terms and conditions negotiated with PWC are reasonable. As a result they have expressed the view that, in order to redress these issues, they needed more transparency on how PWC derive its retail prices.

#### Contestability in the Territory

- 2.5 Part 3 of the Electricity Reform (Administration) Regulations sets out how a customer is classified as 'contestable'. Customers are classified as contestable solely on the basis of their electricity consumption. There is no distinction made between customers located on the regulated Darwin-Katherine, Alice Springs and Tenant Creek networks and customers on the non-regulated regional and remote networks. In theory, any customer anywhere in the Territory could be contestable if they satisfy the electricity usage benchmark, including customers in indigenous communities.
- 2.6 Contestability has been introduced in stages, firstly to the biggest customers, as it was assumed that they would have sufficient market power to negotiate favorable terms with retailers. It was considered that a staged approach would provide sufficient time for retail competition to develop without negatively affecting smaller, and potentially more vulnerable, customers. This is similar to the approach implemented in other Australian jurisdictions.
- 2.7 Table 2 below shows the Territory electricity customer tranches by date of introduction of contestability and minimum annual consumption.

Table 2: Introduction Dates for Contestability in the Northern Territory

Customer tranche	Date	Minimum annual usage (MWh)
1	1 April 2000	4000
2	1 October 2000	3000
3	1 April 2001	2000
4	1 April 2002	750
5	1 April 2010	160
6	1 April 2010	0

- 2.8 Since April 2000, tranche 1 to 3 customers (large to medium businesses, Defence and Territory Government customers) have progressively become contestable in the Territory and now pay tariffs determined by commercial negotiation.
- 2.9 Tranche 4 customers (medium size business) have been contestable since 1 April 2002. Although able to negotiate their own terms and conditions, these customers have access to tariffs specified in a pricing order set by the Territory Government at a level that is progressively moving to cost-reflective prices.
- 2.10 Tranches 5 and 6 (typically small businesses and households) are currently non-contestable but scheduled to become contestable on 1 April 2010. Currently, these customers can only be supplied by PWC and pay subsidised retail electricity tariffs that are uniform regardless of location and cost of supply.
- 2.11 Tranche 5 and 6 customers were originally to become contestable in 2003 and 2005 respectively. However in February 2003 the Territory Government postponed contestability for these customer tranches for 5 years, due to the lack of competition. In October 2007, the Territory Government further deferred contestability for tranche 5 customers to 1 April 2010 and approved the introduction of standard supply contracts for tranche 4, 5 and 6 customers from 1 April 2010. The Electricity Reform (Administration) Regulations give newly contestable customers a two year grace period during which they will continue to be protected by their current tariff arrangements until 1 April 2012.
- 2.12 The larger customers have been contestable for a number of years, yet PWC remains the sole retailer to the Territory customers and the sole wholesale supplier to the market systems.
- 2.13 Contestable customers must negotiate with a licensed retailer (currently only PWC) for supply of electricity. Terms and conditions of supply, including price, are a matter for commercial negotiation between the customer and the retailer. Section 21 of the PWC Retail Licence stipulates that if a customer has no negotiated contestable supply arrangements by the end of their two year grace period, PWC will continue to supply them as a 'default customer' but generally at a higher tariff than the gazetted tariffs. Default terms and conditions governing the sale of electricity to out-of-contract contestable customers are required to be 'fair and reasonable in the circumstances' and are published on PWC's website.

- 2.14 The same licence provisions cover customers whose existing contract with PWC has expired. In such cases, the default tariff may differ from the prices negotiated in the contract.
- 2.15 The default tariff for out of contract contestable customers is a bundled rate covering the cost of generation, network, system control and retail margin. The PWC principles underpinning the default tariff are as follows:
- the economic incentive to contract;
  - financial risk factors such as creditworthiness of the out of contract customers;
  - risk associated with the uncertainty of temporary electricity supply arrangements;
  - other factors such as geographic, power and loss factors and opportunity cost for PWC retail.<sup>4</sup>
- 2.16 The Commission does not have specific oversight of default tariffs for out of contract contestable customers.

## Summary of Issues Raised by Contestable Customers

- 2.17 The Commission has identified a number of issues raised by contestable customers in relation to PWC's market dominance. An overview of these issues is provided below:
- pricing based on historical rather than forward-looking costs, with no apparent attempt to take into account likely or foreseeable events;
  - a bundling, rather than a pass-through, of component network, generation and system control costs which, in effect, override the escalation arrangements and price signals intended by the respective component price levels and structures;
  - delayed responses from PWC to pricing queries, leaving little time to the counter parties to negotiate; and
  - the terms and conditions being one-sided.
- 2.18 More specifically to the terms and conditions negotiated between contestable customers and PWC, a number of issues have been communicated to the Commission over time. These issues are:
- a particularly onerous confidentiality clause, preventing customers from talking to other contestable customers or industry groups so that they could compare experiences;
  - a minimum consumption requirement, set at around 80 per cent of previous year's consumption, with customer required to pay for that amount of consumption whether it was used or not ('take or pay');
  - customers unable to terminate contract for any reason;
  - no obligation on PWC with respect to quality or reliability of supply, and PWC not liable to compensate customer for any losses or damage;
  - no notice required for PWC to disconnect customers; and

---

<sup>4</sup> Sourced from Power and Water Corporation website, [www.powerwater.com.au](http://www.powerwater.com.au).

- contract price to be adjusted quarterly in line with quarterly movements in the consumer price index (CPI).
- 2.19 Finally, subsequent to the consultations on Issues Paper and Draft Report for the Review of FRC for Northern Territory Electricity Customers, a number of issues were raised by submitters.<sup>5</sup> One submitter perceived that PWC's current structure allows it to cross-subsidise and provide electricity at below cost.<sup>6</sup> The Northern Territory Major Energy Users (NTMEU) submitted that, currently, there is no transparency in the activities between PWC Retail and Generation.<sup>7</sup> The NTMEU added that some large users considered that there was a need to gain access to such information in order to assess the reasonableness of PWC offers. Furthermore, NTMEU supported greater transparency through a dispute resolution mechanism via the Commission.

## Customer Complaint Mechanism for Contestable Customers

- 2.20 Section 48 of the *Electricity Reform Act* allows the Commission to investigate a complaint against an electricity entity if it is thought to be engaging in a conduct that is contrary to:
- its licence conditions; or
  - the objects of the *Electricity Reform Act*.
- 2.21 Section 9.1(b) of the PWC Retail Licence requires PWC to comply with all applicable provisions of the Northern Territory Electricity Ring-Fencing Code (the Ring-Fencing Code).<sup>8</sup> Monitoring compliance with the Ring-Fencing Code is an aspect of the Commission's licensing conditions. The primary objective of the Ring-Fencing Code is to promote competitive market conduct by requiring electricity entities to implement measures which:<sup>9</sup>
- prevent the misuse of monopoly power;
  - simulate behavior and outcomes likely to exist in a competitive market; and
  - ensure that its different related business units operate at an arm's length and that they do not engage in advantageous discriminatory pricing conducts.
- 2.22 The object of the *Electricity Reform Act* is to create an economic regulatory framework for regulated industries that promotes and safeguards competition and fair and efficient market conduct or, in the absence of a competitive market, that promotes the simulation of competitive market conduct and the prevention of the misuse of monopoly power. More specifically, the *Electricity Reform Act* is set out to:
- (a) promote efficiency and competition in the electricity supply industry;

---

<sup>5</sup> Sourced from the Utilities Commission website, [www.utilicom.nt.gov.au](http://www.utilicom.nt.gov.au).

<sup>6</sup> Aquaculture Licensee Committee, November 2009, Submission on the Utilities Commission Review of Full Retail Contestability for Northern Territory Electricity Customers Draft Report.

<sup>7</sup> Northern Territory Major Energy Users, September 2009, Submission on the Utilities Commission Review of Full Retail Contestability for Northern Territory Electricity Customers Issues Paper.

<sup>8</sup> Power and Water Corporation Retail Licence (Contestable Customers and Non-Contestable Customers), 2005.

<sup>9</sup> Northern Territory Electricity Ring-Fencing Code, clause 2.1.

- (b) promote the safe and efficient generation, transmission, distribution and selling of electricity;
- (c) establish and enforce proper standards of safety, reliability and quality in the electricity supply industry;
- (d) establish and enforce proper safety and technical standards for electrical installations;
- (e) facilitate the maintenance of a financially viable electricity supply industry; and
- (f) protect the interests of consumers of electricity.

2.23 The *Electricity Reform Act* stipulates that a complaint may only be made by a contestable customer (or an electricity entity) if it is adversely affected by the alleged conduct or non-compliance of the entity. Section 50 specifies that the Commission may only investigate a complaint if:

- the customer can demonstrate that they are, or may be, adversely affected by the alleged conduct;
- the customer can demonstrate that they have made a genuine, but unsuccessful attempt to resolve the matter with the electricity entity; or
- the Commission does not consider the complaint frivolous or vexatious.

2.24 Section 50 does not, however, give the Commission powers to investigate general customer concerns about a supplier's conduct, unless a formal complaint is lodged with the Commission.

2.25 Section 51 defines the procedures to be followed by the Commission when running an investigation resulting from a complaint. Once the investigation is completed, the Commission must report the results of the investigation to the Minister stating:

- whether the complaint has been substantiated; and
- the reasons for the decision.

#### *Experience to date with the Customer Complaint Mechanism*

2.26 The Commission has only received one formal complaint, from Northern Cement Limited, about PWC's conduct during contract negotiations. The Commission found that PWC did not engage in contrary market conduct as defined in legislation. However, this finding is probably not evidence of ongoing exemplary conduct by PWC, with contestable customers known to have expressed dissatisfaction with PWC's to the Commission (e.g. through the NTMEU) and to the Territory Government about perceived misuse of market power by PWC.

2.27 The potential reasons why contestable customers might not use the complaints mechanism could include:

- a lack of certainty about what constitutes contrary conduct;
- the relatively stringent criteria that must be met before the Commission can become involved in a complaint;
- the formality of the investigation process the Commission must follow (e.g. a less formal process could involve the Commission acting as an arbitrator or mediator).

- 2.28 When the Territory's regulatory framework was established, it was predicated on the basis that contestable customers would have a choice of multiple retailers and some actual bargaining power, equivalent to the experience of the national electricity market. This meant that the complaint mechanism was intended as a last resort, and is not designed to address general customer concerns in relation to suspected market misconduct by PWC.

#### *Contestable pricing guidelines*

- 2.29 In September 2001, the Commission published Contestable Pricing Guidelines to provide guidance to PWC about the types of pricing conduct that could give rise to a finding of anti-competitive and discriminatory conduct following a complaint being lodged against it.
- 2.30 To avoid a finding of anti-competitive pricing, the Commission set out that:
- as far as its Retail business unit was concerned, PWC had to be able to demonstrate that the bundled retail price quoted to a contestable customer was to be reflective of the incremental costs incurred in supplying the services to that customer (including retail, network and wholesale energy costs); and
  - as far as its Generation unit was concerned, it had to demonstrate that its wholesale energy price was based on the long-run incremental costs of generating for that retailer.
- 2.31 To avoid a finding of discriminatory pricing, PWC Generation had to demonstrate to the Commission that gas cost advantages and recovery of non-gas costs did not favor PWC's retail segment.
- 2.32 In April 2007, recognizing that the guidelines needed updating following significant changes in the Territory electricity market, the Commission decided to withdraw them.<sup>10</sup>

## **Power and Water's Reporting Obligations**

- 2.33 Current regulations and licence conditions require that certain information, analysis and reporting on PWC be disclosed. The purpose of this section is to review the information currently disclosed in order to determine whether further information is warranted.

## **Retail Licence Conditions - Unbundling of Retail Charges for Customers**

- 2.34 Clause 22 of PWC's Retail Licence requires that, at the request of a customer, retail charges be unbundled at the time the contract is entered into:

*A statement of charges to customers must, if requested by a customer, at the time the contract is entered into, separate items for :*

*(a) the amounts charged for the electricity sold; and*

*(b) the total amounts charged by an electricity entity which is authorized to operate an electricity network in respect of that customer.<sup>11</sup>*

<sup>10</sup> See Commission's website, [www.utilicom.nt.gov.au](http://www.utilicom.nt.gov.au), Reports and Publications, September 2001, Contestable Pricing Guidelines.

<sup>11</sup> Power and Water Corporation Retail Licence (Contestable Customers and Non-Contestable Customers), 2005.

- 2.35 PWC's interpretation of the licence requirements is that the unbundling of a customer's retail price is limited to the customer's bill. It does not extend to the initial pricing stage when a customer negotiates terms and conditions with PWC.
- 2.36 The retail price charged to an individual contestable customer needs to include a pass-through of the network access charge incurred by the retailer on account of the customer (as per the approved tariff schedule).
- 2.37 PWC must also be able to demonstrate that the price charged at least recovers the incremental costs PWC Retail incurs in supplying that customer. These incremental costs should include the fully distributed cost to the contestable retail segment of Retail of the network access charge incurred on account of that customer.
- 2.38 The final (bundled) price that PWC Retail charges to contestable customers includes a:
- peak and off-peak energy rate (cents/kilowatt hour – c/kWh);
  - peak and off-peak demand rate (dollars/kilovolt ampere - \$/kVA); and
  - system availability rate (dollars/day - \$/day).
- 2.39 This bundled price is made up of the following charges:
- generation charges – peak and off-peak energy charges (c/kWh) received as quotes for individual customers from PWC Generation (with the demand (kVA) cost component implicit in the energy charges);
  - network access charges – peak and off-peak energy charges (c/kWh), peak and off-peak demand charges (\$/kVA) and a fixed system availability charge (\$/month), as per the network access tariff schedule approved by the Commission;
  - system control charge (c/kWh), as per the system control tariff approved by the Commission; and
  - retail costs (c/kWh) based on budgeted expenses, and a risk/profit margin.

### **Regulatory Pricing of Network and Control Services**

- 2.40 Under clause 78(3) of the Electricity Networks (Third Party Access) Code<sup>12</sup>, the Commission is required to approve each year PWC's annual maximum networks tariffs and charges relating to the use of its electricity networks.
- 2.41 The price schedules for the regulated networks derived by PWC are based on the weighted average tariff basket determined by the Commission as part of the Network Reset Determination.<sup>13</sup>
- 2.42 The breakdown of network charges for customers with a consumption over 750MWh is as follows:
- the maximum system availability charge (flat charge);
  - peak and off peak charges (\$/kVA) related to monthly demand;

<sup>12</sup> The Electricity Networks (Third Party Access) Code is a schedule to the *Electricity Networks (Third Party Access) Act*.

<sup>13</sup> The most recent determination was published in March 2009 for the period 2009-10 to 2013-14.



- peak and off peak charges (c/kWh) related to energy metered.
- 2.43 The breakdown of network charges for customers with a consumption below 750MWh is as follows:
- system availability charges (cents/day) for commercial and domestic customers;
  - charges (c/kWh) related to energy metered.
- 2.44 The Network Reset Determination and PWC's yearly price schedules are published on the Commission's website.

### Financial Accounts

- 2.45 Section 19(2) of the *Electricity Reform Act* requires that:
- The holder of a licence granted for 2 years or more must –*
- (a) in each year lodge with the Utilities Commission before the date prescribed for that purpose an annual return containing the information required by the Utilities Commission by condition of the licence or by written notice.*
- 2.46 The Regulatory Accounts are submitted as part of Part 2 of PWC's Annual Licence Return, due on 1 December each year.
- 2.47 Clause 9.1(b) of PWC's licences provides that the licensee must comply with all applicable provisions of the Ring-Fencing Code made by the Commission.
- 2.48 The Ring-fencing Code provides, under clause 3.1, the minimum requirements for financial accounts. An electricity entity carrying on a prescribed business must establish and maintain a separate set of financial accounts and reports for each prescribed business, and its electricity business as a whole.
- 2.49 The Ring-Fencing Code defines a Prescribed Business as:
- a) a business carrying out the operation of an electricity network;
  - b) a business carrying out the sale of electricity to non-contestable customers;
  - c) a business carried on by PWC of generating of electricity for sale to third parties or notionally to another business division of PWC while PWC Generation has a substantial degree of market power; and
  - d) the provision of power system control and dispatch services.<sup>14</sup>
- 2.50 Clause 4 requires that an electricity entity carrying on a prescribed business in the Territory must submit to the Commission for approval its final draft accounting procedures, cost allocation procedures and information procedures.
- 2.51 Financial accounts must be prepared in accordance with the accounting procedures applying to it under clause 4. The financial account must allocate costs shared between a prescribed business and a related contestable business in a manner which is consistent with the cost allocation procedures applying to the electricity under clause 4.
- 2.52 The Commission notes that, with all customers becoming contestable from 1 April 2010, the requirement on PWC to produce annual regulatory

---

<sup>14</sup> Northern Territory Electricity Ring-fencing Code, clause 13.2, Defined Terms.



accounts for its retail business unit will fall away if there is no change to the Regulations.

- 2.53 Furthermore, the Commission considers that there would be benefits in requesting PWC to produce regulatory accounts for its generation business unit in compliance with its licence conditions and the requirements of the Ring-Fencing Code.
- 2.54 Also, the Commission recognises that a number of issues would need to be addressed. These are:
- review of PWC's accounting and cost allocation procedures - after approval from the Commission in 2001, these procedures were due to be reviewed in 2004. However, the review was postponed indefinitely pending the review of the Ring-fencing Code;
  - accounting and cost allocation methodologies should be publicly disclosed;
  - the reporting templates would need to be reviewed; and
  - regulatory guidelines would need to be developed.

### **Power System Review**

- 2.55 Under section 45 of the *Electricity Reform Act*, the Commission is required to prepare and publish an annual review of the prospective trends in the capacity and reliability of the Territory's power system relative to projected load growth. The Commission currently only reports on the Darwin-Katherine, Alice Springs and Tennant Creek systems.<sup>15</sup> For the 2008-09 review, the Commission decided to expand the scope of the review to provide all power system performance data in a single document.
- 2.56 The Commission is of the view the revised Power System Review will enable interested parties to assess whether PWC's performance and planning are at a level that reflects consumer demand and expectations.
- 2.57 For the previous Reviews the Commission separately collected and reported information relevant to monitoring and advising on system capacity and performance in the:
- Northern Territory Electricity Market Information statement, an annual report on electricity usage, generation capacity and network length. This information is provided as part of annual licence returns by licensed participants of the electricity supply industry, and is published by the Commission to provide key statistics for the electricity supply industry; and
  - Standards of Service Performance report, an annual report on the standard of electricity generation, network and retail service performance. The Electricity Standards of Service Code requires the PWC to report annual performance against minimum standards.
- 2.58 The Commission considers that collating and analysing all data relevant to power system capacity and performance in a single document will assist

---

<sup>15</sup> The Territory's electricity market is defined as those electricity systems where the activities of electricity industry participants and customers are regulated by the Electricity Reform Act, Electricity Networks (Third Party Access) Act and associated legislation. At present, only the Darwin-Katherine, Alice Springs and Tennant Creek systems meet these criteria.

participants in the electricity supply industry and the community in making an informed view about the performance and prospective trends for the Territory's power systems.

- 2.59 Additionally, the expanded scope of the Review should make power system reporting in the Territory more consistent with practices elsewhere in Australia.

<b>Question 1:</b>
Under the current regulations, do you consider that there is sufficient information publicly disclosed? If not, which other information would need to be published and why?

## CHAPTER 3

### PRICE MONITORING – OBJECTIVES AND PRINCIPLES

- 3.1 This chapter reviews the issues relating to price regulation and price monitoring as mechanisms to protect customers in markets where there is little or no competition.

#### Importance of Competition

- 3.2 The Commission considers competition as being the most effective mechanism in delivering efficient outcomes. The reason for this is well stated by the Australian Energy Market Commission (AEMC) in a 2008 report on the effectiveness of competition in electricity and gas retail markets in South Australia:

*Markets are better able to process complex and rapidly changing information, particularly in relation to changes in costs, in a timely manner and coordinate the actions of market participants. When competition is effective, markets maintain prices in line with real costs of supply as they adjust to changing conditions.<sup>16</sup>*

- 3.3 Competitive markets are considered to be quick in processing complex information, responsive and flexible to underlying supply and demand conditions, and proactive. Regulatory intervention is therefore second-best as it is less effective in achieving efficient price outcomes.
- 3.4 Despite the evident constraints of the local electricity market conditions, the Commission considers that facilitating an environment conducive to competition in the Territory is still a worthwhile objective. It is therefore desirable to pursue the development of further market and regulatory reforms in the Territory to foster and strengthen the long-term prospects of competition.
- 3.5 A working paper by Northern Territory Treasury (Treasury) on the options for reform of the existing legislative framework noted that, to provide the best possible options for market entry, a number of market and regulatory prerequisites need to be in place. The strategic priorities identified by Treasury are:

---

<sup>16</sup> Australian Energy Market Commission, December 2008, Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in South Australia, Second Final Report, page 25.

- **To strengthen the long term prospects of competition** by making the market and regulatory environment attractive to new suppliers through improved disclosure of vital system and market information, a more effective wholesale trading mechanism, and more transparent system planning processes:
  - **To encourage the entry of new retailers in the short term** by putting in place trading arrangements that minimise entry costs and risks, in particular by ensuring transparent and commercially oriented market conduct; and
  - **To create an effective consumer protection regime** that gives consumers confidence that suppliers are not able to take advantage of a lack of vigorous competition to charge excessive prices or offer poor service (or otherwise act inefficiently).<sup>17</sup>
- 3.6 As competition is yet to be fully effective in the Territory, there is a strong case for developing a customer protection regime to give confidence to customers that PWC, as the monopoly supplier, does not misuse its market power. The following section will examine the merits and drawbacks of price setting regulation, and will then review price monitoring as an alternative light-handed form of regulation.

## Price Setting Regulation

### Rationale for price regulation

- 3.7 Prior to market reforms in the early 1990s, Australian governments played a key role in electricity supply, including setting prices. As electricity prices were not automatically related to actual costs, electricity authorities had few incentives to pursue least cost objectives.
- 3.8 When retail contestability (further discussed in Chapter 4) was initially introduced in a number of jurisdictions in Australia, retail price control was used by governments and regulators as a transitional measure to protect customers unable to participate in the competitive market. The intention was to prevent the abuse of monopolistic power exercised by gas and electricity suppliers. At the Council of Australian Governments (COAG) meeting on 10 February 2006, Australian governments supported the principle of phasing out energy price regulation where effective competition could be demonstrated. This agreement was premised on the fact that price regulation hinders the development of a competitive market, and that competition only produces efficient outcomes.
- 3.9 As a result, regulators in jurisdictions such as New South Wales and Western Australia, set retail electricity and gas prices to a more cost reflective levels to attract greater competition in the electricity industry, while maintaining customer protection. For example, the Independent Pricing and Regulatory Tribunal for New South Wales (IPART) noted in 2007 that prices need to be sufficient to ensure that:
- efficient and economic investment in electricity generation can occur;
  - they cover the costs of selling electricity in a competitive market, and compensate for the risks that they face;

---

<sup>17</sup> Northern Territory Treasury, December 2008, A New Legislative Framework for the Northern Territory Electricity Industry – Draft Final Policy Paper.

- they allow recovery of investments in the distribution network associated with increased reliability standards and higher peak demand; and
- retailers are able to meet their obligations regarding greenhouse gas emissions and purchases of renewable energy.<sup>18</sup>

### **Objections to price setting regulation:**

- 3.10 In recent times, the price setting model of regulation has attracted some criticism, in particular:
- the lack of clear objectives, or existence of conflicting objectives, provided to the price setting body;
  - non-cost reflective prices distort the signal to consumers to manage their demand and prevent new entrants from entering the market;
  - difficulties in determining an appropriate efficient regulated price (considering uncertainties associated with knowledge and information gaps between the regulator and market participants) while, at the same time, providing enough headroom to attract competition;
  - regulated default prices are used as a safety net for customers choosing not to participate in the competitive market; and
  - regulated prices can be used as a mechanism for maintaining price parity between customers in urban and regional areas despite differing cost structures.<sup>19</sup>
- 3.11 Further, when applied to electricity retailers, price regulation is considered to be inflexible and inadequate in forecasting wholesale energy prices. The AEMC is of the view that there is an intrinsic misalignment between making price determinations for a future multiple year period, and the changing dynamics of the energy sector. The mismatch between forecast and actual costs generates distortions in market signals, supply responses and the development of competition.<sup>20</sup>
- 3.12 As a result, there is increasing concern that price regulation is stifling competition, particularly where prices are set below full cost reflective levels.
- 3.13 The Energy Retailers Association of Australia (EERA) is of the view that customer protection is better provided by existing general consumer laws such as State fair trading legislation, the Commonwealth *Trade Practices Act 1974* (TPA) and common law. It also contends that, rather than using regulated prices, transparent and well targeted policies funded by government would better assist vulnerable customers.<sup>21</sup> This view appears

---

<sup>18</sup> Independent Pricing and Regulatory Tribunal, June 2007, Promoting retail competition and investment in the NSW electricity industry – Regulated electricity retail tariffs and charges for small customers 2007 to 2010.

<sup>19</sup> NERA Economic Consulting, December 2007, Assessment of Price Monitoring in Australia; Productivity Commission, August 2001, Review of the Prices Surveillance Act 1983; Energy Retailers Association, June 2005, Retail Price Regulation, Policy Position Paper.

<sup>20</sup> Australian Energy Market Commission, December 2008, Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in South Australia, Second Final Report, page 27.

<sup>21</sup> Energy Retailers Association of Australia, June 2005, Retail Price Regulation, Policy Position Paper, page 5.

also to be shared by the Energy Supply Association of Australia (ESAA) in its submission to the Commission's issues paper on FRC.<sup>22</sup>

- 3.14 In contrast, price monitoring is considered to be less intrusive than price regulation, while providing a degree of customer protection and supporting competition. The following section examines the overall purpose, objectives and implementation principles underpinning price monitoring.

## Price Monitoring

### Objectives of Price Monitoring:

- 3.15 The Productivity Commission (PC), referring to price monitoring, states that:
- In imperfectly or potentially competitive markets, scrutiny of prices and market performance can be achieved through the publication of key information. This enables customers, the community, policy makers and regulators to monitor market outcomes and gain a better understanding of the workings of the market. Thus monitoring can enhance market transparency and assist the competitive process. This role for monitoring is not intended as a way to effectively regulate prices.*<sup>23</sup>
- 3.16 Price monitoring in Australia is carried out by the Australian Competition and Consumer Commission (ACCC) under the TPA. Section 95 of Part VIIA of the TPA sets out that 'the object of this Part is to have prices surveillance applied only in those markets where in the view of the Minister, competitive pressures are not sufficient to achieve efficient prices and protect consumers'.<sup>24</sup> The TPA specifies the functions of the Commission with regards to price inquiries, price notifications, and price monitoring. With regards to the latter function, the TPA stipulates that the 'Commission is to monitor prices, costs and profits in any industry or business that the Minister directs it to monitor and is to give the Minister a report on the results of such monitoring'.<sup>25</sup> These functions were originally provided by the *Prices Surveillance Act 1983*, which is now repealed.
- 3.17 In 2001, the PC undertook the review of the *Prices Surveillance Act*, which was intended to slow the rate of inflation in the economy but was gradually used as a regulatory instrument for Government monopolies or for newly privatised Government infrastructure. In its review paper, the PC justifies monitoring as a mechanism enabling scrutiny of prices and market performance through the publication and availability of key information in imperfectly or potentially competitive markets. This enables customers, the community, policy makers and regulators to monitor market outcomes and gain a better understanding of the workings of the market.<sup>26</sup>
- 3.18 Two main forms of price monitoring are identified in the PC's review: the first one as an instrument of regulation and compliance by a regulator, the other as a means of observing and understanding the performance of a firm,

---

<sup>22</sup> Energy Supply Association of Australia, September 2009, Utilities Commission Review of Full Retail Contestability for Northern Territory Electricity Customers: Issues Paper.

<sup>23</sup> Productivity Commission, August 2001, Review of the Prices Surveillance Act 1983: Inquiry Report, Report No 14, page 47.

<sup>24</sup> *Trade Practices Act 1974*, Part VIIA, section 95, Division 1 – Preliminary.

<sup>25</sup> *Ibid*, Division 2 – Commission's Functions under this part.

<sup>26</sup> Productivity Commission, August 2001, Review of the Prices Surveillance Act 1983: Inquiry Report, Report No 14, page 48.

industry or market. The distinction made by the PC between these two forms of monitoring is outlined below:

***As an instrument of regulation and compliance by a regulator:***

*The intent in this context is to put pressure on firms to achieve acceptable outcomes in terms of key factors, such as prices, profits and quality. The reporting process is used by the regulator to state publicly whether they are satisfied with the outcomes and whether further action, such as price control, is warranted. The regulator can use the threat of more intrusive forms of regulation (which may be strengthened by public and government support generated by the regulator's report) to persuade the firm to comply with the regulator's formal or informal targets. In this context, monitoring is used as a form of incentive regulation. A variation on this is where monitoring is used to assess compliance of a firm or industry with an agreement it may have with the Government regarding the implementation of a policy.*

***As a means of observing and understanding the performance of a firm, industry or market***

*In some situations there may be suspicion about market power. This can arise because of price volatility, a significant increase in price, or deregulation of the industry. Monitoring provides a means of observing and understanding the performance of the firms and the industry. It facilitates the systematic disclosure of information not readily available from other sources, such as reports produced by firms. For example, it may collect, publish and report on segregated company results and key indicators of performance such as prices for certain classes of customers or users, profitability and quality. The monitoring report provides information to the public and policy makers. However, it is not intended to be used to regulate behaviour. Notwithstanding this intent, it is likely to have some effect on the behaviour of firms being monitored. The intent of this type of monitoring is to provide an alternative in circumstances where price control is likely to be inferior to the operation of the market, even though there is some degree of market power that might be exercised.<sup>27</sup>*

- 3.19 As it carries a threat of further action, the first form of price monitoring is relevant to industries where firms have monopoly characteristics. The second form of pricing monitoring appears to be more appropriate in those industries where major changes have occurred, such as deregulation and privatisation, and where there may be some concerns about market power. In such cases, price monitoring may provide a response to public concerns. In its submission to the PC review, the ACCC stated:

*from time to time there are likely to be areas of the economy where there is considerable public concern about particular pricing outcomes. Government is likely to want to respond to these community concerns. In this situation a price oversight power is required that allows Government to respond. Price monitoring which requires the firm to provide specific cost, profit and price data at regular intervals can be used in the first instance or a public inquiry may be considered to be necessary.<sup>28</sup>*

- 3.20 The ACCC adds that disclosure of certain data to the public places a firm or industry's pricing decisions under public scrutiny.

*Objectives of a Retail Price Monitoring Regime in the Territory*

- 3.21 The Commission considers that, in response to the Treasurer's request for a review of options for a retail price monitoring regime in the Territory, the proposed options identified by the Commission must have regard to the

<sup>27</sup> Ibid.

<sup>28</sup> Australian Competition & Consumer Commission, June 2000, Submission to the Productivity Commission Review of the Prices Surveillance Act 1983, page 38.



objective of a retail price monitoring regime in the Territory context. In turn, in defining the objective of a retail price monitoring regime need consider the object of the *Utilities Commission Act*.

- 3.22 The object of the *Utilities Commission Act* is to:
- create an economic regulatory framework for regulated industries that promotes and safeguards competition and fair and efficient market conduct or, in the absence of a competitive market, that promotes the simulation of competitive market conduct and the prevention of the misuse of monopoly power.*
- 3.23 The Commission's functions and powers are defined in section 6 of the *Utilities Commission Act*. In performing its functions, the Commission must have regard to the need:
- a) to promote competitive and fair market conduct;
  - b) to prevent misuse of monopoly or market power;
  - c) to facilitate entry into relevant markets;
  - d) to promote economic efficiency;
  - e) to ensure consumer benefit from competition and efficiency; and
  - f) to protect the interest of consumers with respect to reliability quality of services and supply in regulated industries.
- 3.24 The central purpose of the *Utilities Commission Act* is to promote the long-term benefit of consumers in the electricity market. The Commission considers that this can be best achieved by promoting outcomes which are consistent with those in competitive markets. The Commission's review of the options for a retail price monitoring regime in the Territory is part of the reform program requested by the Territory Government.
- 3.25 In this context, the Commission considers that the objective of a price monitoring regime in the Territory is to provide a level of protection to contestable customers through scrutiny and monitoring of prices, costs and performance of firms or markets where effective market competition is not fully developed and market power is suspected to arise. Price monitoring should:
- provide contestable customers with a level of protection against potential or perceived market power exercised by PWC; and
  - facilitate competition.
- 3.26 The Commission believes that greater information transparency would respond to the concerns raised by current contestable customers (using more than 750MWh per annum). This approach would facilitate commercial negotiations with PWC when negotiating their contract's terms and conditions.
- 3.27 Surveillance of PWC's costs, prices and performance using would, in conjunction with an analysis of efficient costs, enable monitoring of PWC's performance against benchmarks or efficiency targets. This objective will be particularly relevant when full FRC is implemented and small customers become contestable. The Commission considers that monitoring of prices, costs and quality performance against efficiency indicators would provide additional protection to customers.
- 3.28 In addition to the above objectives, the Commission is of the view that, in assessing the options for a retail price monitoring regime in the Territory, it



needs to consider the wider context of facilitating the introduction of competition in the Territory. Given PWC's current market dominance as the sole wholesale energy generator and electricity retailer, greater disclosure of PWC's prices and underlying costs is an important step in the development of competition in the Territory. Availability of such information will assist potential market new entrants in their decision to enter the market.

- 3.29 The Territory Government, as owner of the PWC, would benefit from a price monitoring regime, as it would provide some assurance that the company is performing efficiently and the level of community service obligation funding to meet social welfare objectives is minimised.

<b>Question 2:</b>
--------------------

Do you agree with the objectives defined by the Commission and why?
---

### Economic Principles

- 3.30 Price surveillance is an instrument that can be used to promote allocative efficiency.
- 3.31 Allocative efficiency is more dependent on individual price levels and structure than on the overall revenue of the firm. Consumers respond to the prices they face. As a result, interested parties need to be able to assess whether a supplier is setting efficient prices for different consumer groups, individual services or price components, and reflect the quality that is demanded.
- 3.32 In non-competitive markets, information on prices and costs may not be readily available. The Commission considers that, to promote allocative efficiency, a price monitoring regime should ensure disclosure of prices as well as pricing methodologies, price terms and conditions, and contracts.
- 3.33 Furthermore, information on service quality is associated with price levels. The Commission is therefore of the view that disclosure of performance and service quality provides important information to consumers and interested parties. As part of the work program requested by the Treasurer, the Commission is to review electricity standards of service. An Issues Paper will be released to start this review in March 2010.

### Implementation Principles of Price Monitoring

- 3.34 In 2007, the AEMC undertook a review of competition in electricity and gas retailing. The AEMC's finding was that retail competition was effective. In this context it considered the option of phasing out price regulation arrangements and adopting a light-handed retail price regulation framework.<sup>29</sup> NERA was asked to prepare a briefing note advising the AEMC as to how a light-handed price monitoring regime for energy retail in Victoria should be structured.<sup>30</sup>

---

<sup>29</sup> Australian Energy Market Commission, 19 December 2007, Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria, First Final Report.

<sup>30</sup> NERA Economic Consulting, 14 December 2007, Assessment of Price Monitoring in Australia, A Briefing Note to the AEMC.

- 3.35 In its paper, NERA identifies five basic principles which should underpin price monitoring regimes. They include:<sup>31</sup>
- Transparency – the method for monitoring prices should be known, conclusions (where made) or further action should be based on observations and results of monitoring activities (where not confidential) should be published;
  - Flexibility – the regime should be sufficiently flexible to allow the monitoring body to report on areas of concern (e.g., barriers to entry may not be considered to be substantial at the beginning of a monitoring regime and therefore not reported but this may change over time);
  - Timeliness – Price monitoring should not be indefinite. NERA refers to the PC's recommendation that price monitoring should, preferably, be for a three year period or less, five years in exceptional cases. The PC supports the implementation of price monitoring for a limited period of time until it can be demonstrated that no unforeseen issues have been identified and oversight is no longer warranted. The PC considers that:
 

*Monitoring for a limited period of time, if implemented effectively, may help measure progress against the expected outcomes of reform without unduly interfering in the market. It is the threat of price control with other legislative instruments, such as the national access regime and industry-specific legislation, that acts as an incentive for firms not to abuse market power, rather than monitoring itself.*<sup>32</sup>
  - Non-intrusive – Price monitoring should not be intended as a form of price control or to entail unwarranted intrusion into the operation of businesses; and
  - Compliance Costs – reporting requirements should not overly onerous on the business being monitored.

*Implementation of a Retail Price Monitoring Regime in the Territory*

- 3.36 The Commission shares the views of NERA and the PC, in that the above underpinning principles are relevant to the development of a 'best practice' retail price monitoring regime in the Territory context. To these principles, the Commission has identified another two:
- consistency – information will be of most use to interested parties if it allows comparisons over time and against benchmarks, requiring information to be disclosed on a consistent basis. The Commission considers that comparability may be achieved by prescribing the type of information and methodologies used to derive the information;
  - relevance – the required information published needs to be relevant to interested parties by meeting their needs. The Commission is of the view that it needs to carefully consider the nature and purpose the information to be disclosed.
- 3.37 The Commission acknowledges that the extent to which some implementation principles are given effect, may be constrained by other implementation principles. For example consistency, transparency and relevance of information have to be balanced against flexibility, cost

<sup>31</sup> Ibid, page 9.

<sup>32</sup> Productivity Commission, August 2001, Review of the Prices Surveillance Act 1983: Inquiry Report, Report No 14, page 49.

---

effectiveness, and intrusiveness. Flexible price monitoring regimes have been found, in some instances, to be unclear and thus result in increased uncertainty. Flexibility as an implementation principle would need to be considered in conjunction with consistency.

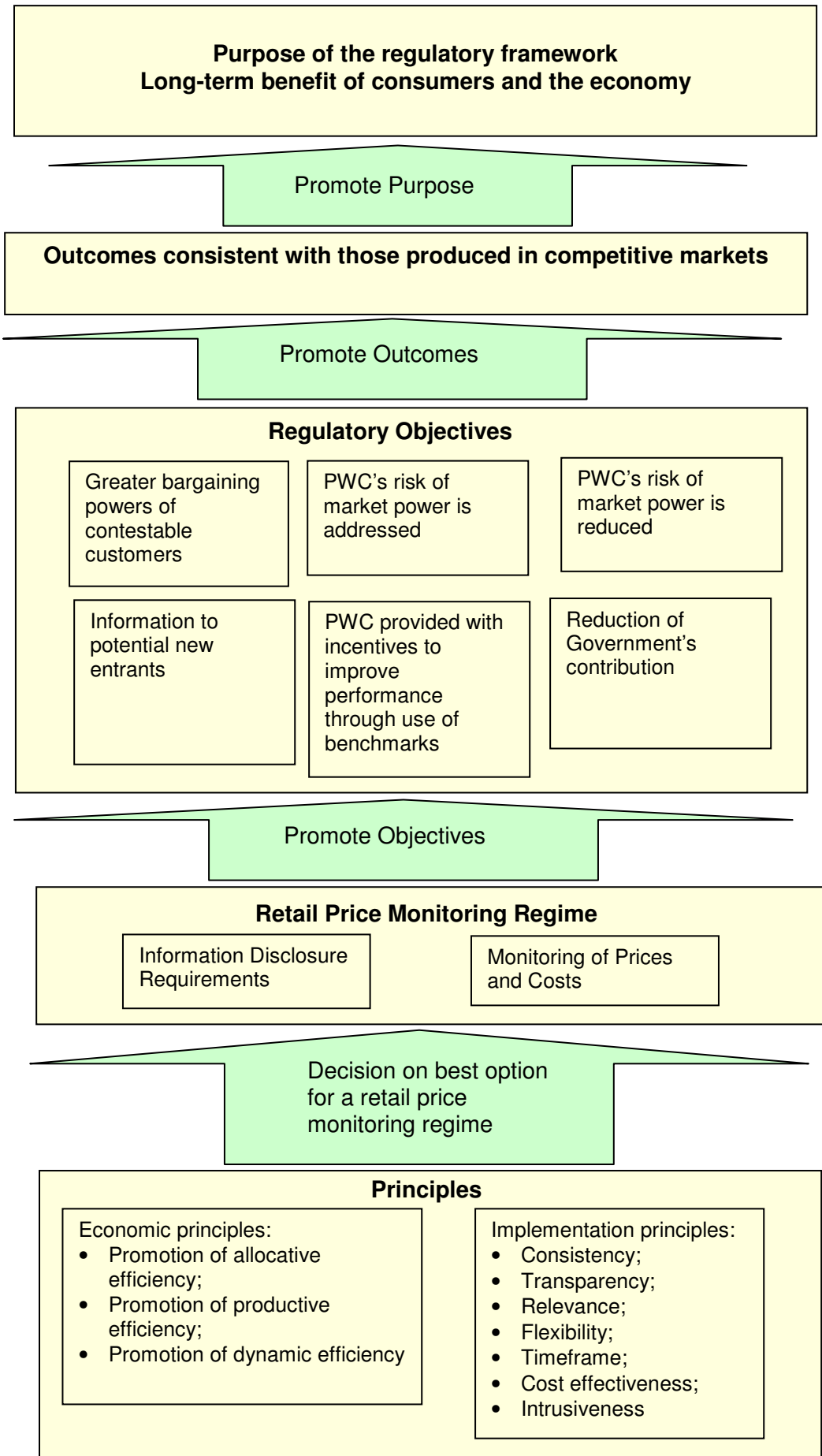
- 3.38 The Commission is of the view that conflicting implementation principles provide the grounds for pragmatic outcomes. The Commission is also of the view that some principles will, at certain points in time and depending on the circumstances, have more weight than others.

<b>Question 3:</b>
--------------------

Do you consider the above principles relevant for the assessment of options for the development of a price monitoring regime in the Territory and why? Do you agree with these principles? Does the Commission need to consider any other principles?
---

- 3.39 Figure 1, below, illustrates how the retail price monitoring regime would fit within the overall regulatory framework.

Figure 1: Regulatory Framework:



## CHAPTER 4

### DEVELOPMENT OF CONTESTABILITY AND COMPETITION IN AUSTRALIA AND THE TERRITORY

- 4.1 The purpose of this chapter is to provide a context to retail price monitoring in the Territory by reviewing the electricity industry reforms in Australia and the Territory.

#### Electricity Industry Reforms in Australia

- 4.2 During the early 1990s, the Commonwealth, state and territory governments recognised there were significant economic benefits available from restructuring and reforming electricity markets. There have since been a number of intergovernmental agreements related to the development and implementation of industry and market reforms.

#### Market Reforms

##### *National Competition Policy*

- 4.3 In 1994, COAG agreed to objectives and principles that provided the basis for the gradual implementation of consistent governance, institutional and structural reforms to the electricity markets in Queensland, New South Wales and the Australian Capital Territory, Victoria, South Australia and Tasmania. The Territory and Western Australia were not party to this agreement primarily on the basis that they were not connected to the national electricity grid. However, this intergovernmental agreement is the basis for all subsequent energy market reforms, including those undertaken in the Territory and Western Australia. The main objectives of the agreement were:
- the ability for customers to choose which supplier they will deal with;
  - non discriminatory access to interconnected transmission and distribution networks;
  - no regulatory barriers to entry to new participants in competitive wholesale (generation) or retail supply markets; and
  - no discriminatory legislative or regulatory barriers to interstate and/or intrastate trade.
- 4.4 The principles underlying these objectives are based on the premise that nationally integrated, competitive energy markets were an important means of ensuring the efficient provision of services, the responsible development of resources and the alleviation of environmental concerns. The expected outcome is increased economic growth and improved customer welfare.

- 4.5 The 1995 commitment by all Australian governments to the National Competition Policy (NCP) required a number of reforms intended to support higher economic growth on a sustainable basis.<sup>33</sup> In part, NCP requires:
- price oversight and competitive neutrality to ensure that publicly owned businesses do not enjoy any net competitive advantage arising from their public ownership [as specified in clause 2 and 3 of the Competition Principles Agreement 1995 signed by all Australian states and territories];
  - structural reform of public monopolies by adopting a corporatisation model with the imposition on the business of full taxes and the application of business regulations normally applying to private sector businesses; the removal of legislative provisions that restrict competition; and
  - the establishment of third party access regimes for infrastructure with natural monopoly (subject to a public benefits test) recognising that third parties have legal rights for access to energy infrastructure services on reasonable terms and conditions.
- 4.6 The key principles of NCP are consistent with the reforms of the electricity industry resulting from the 1994 COAG agreements, but there is no requirement for electricity industry specific reforms to be introduced.<sup>34</sup>

#### *Ministerial Council on Energy*

- 4.7 In June 2001, COAG established a national energy policy body, determined a set of core national energy policy objectives and principles, and agreed to an independent review of energy market directions and options for future development.<sup>35</sup>
- 4.8 The Ministerial Council on Energy (MCE) was given the responsibility of providing oversight and coordination of energy policy development and leadership so that broader convergence issues and environmental impacts are effectively integrated into energy sector decision making.<sup>36</sup>

#### *Parer Report and Australian Energy Market Agreement*

- 4.9 The independent review of the energy market (known as the Parer Report) was published in December 2002. The MCE considered the findings and recommendations of the Parer Report and other policy development work and reported with recommendations to COAG in December 2003. The MCE recommendations were considered a substantial response to the Parer Report and provided the basis for development of a truly national and efficient energy market.<sup>37</sup>
- 4.10 Subsequently, all Australian governments entered into the Australian Energy Market Agreement (AEMA) in June 2004 to give effect to the MCE

---

<sup>33</sup> The intergovernmental agreements that underpin the National Competition Policy are the Competition Principles Agreement, the Conduct Code Agreement and the Agreements to implement the National Competition Policy and Related Reforms (Implementation Agreement) dated April 1995.

<sup>34</sup> National Competition Council, April 2002, Submission of the National Competition Council to the COAG Energy Market Review, page 22, and sourced from [www.ncc.gov.au](http://www.ncc.gov.au), on 23 September 2005.

<sup>35</sup> Ministerial Council on Energy, December 2003, Report to COAG on Reform of Energy Markets, page 3.

<sup>36</sup> Sourced from [www.mce.gov.au](http://www.mce.gov.au), on 10 October 2005.

<sup>37</sup> Ministerial Council on Energy, December 2003, Ministerial Council on Energy Report to COAG on Reform of Energy Markets, page 3 and Ministerial Council on Energy Communiqué, 11 December 2003.

recommendations to COAG. The AEMA makes explicit the principles and objectives of the energy market reform program. These include promoting the long term interests of customers with regard to the price, quality and reliability of electricity and gas services and establishing a framework that will result in timely and appropriate investment.<sup>38</sup>

- 4.11 The AEMA also details the institutional arrangements of the national electricity market, including:
- the legislative framework that establishes the functions and powers of regulatory bodies and arrangements for market operation;
  - the functions and roles of the MCE, the ACCC, the AEMC and Australian Energy Regulator (AER) and the Australian Energy Market Operator (AEMO); and
  - the timeframe for individual jurisdictions to transfer functions and powers related to electricity transmission, distribution and retail (excluding retail pricing) to the AEMC and AER.
- 4.12 The Territory and Western Australia are exempted from introducing most obligations imposed by the AEMA for electricity, but retain the option to fully adopt the arrangements at their discretion. Specifically, the Territory and Western Australia are both exempted from the obligations imposed by the AEMA for electricity, while Western Australia is partly exempted from the obligations imposed for gas.<sup>39</sup>
- 4.13 On 16 June 2005, the Commonwealth wrote to the states and territories proposing to renegotiate the AEMA to expedite and expand the reform program. The proposal was in response to potential delays in the implementation of the reforms agreed in the AEMA in June 2004. The changes to the AEMA involved:
- agreement that the Australian government will fund the AER while the states and territories will fund the AEMC;
  - developing a nationally consistent approach to third party access arrangements, including exemptions from obligations;
  - establishing a timeframe for the transfer of certain distribution and retail regulatory functions currently undertaken by jurisdictional regulators to the AER and the AEMC; and
  - establishing a timeframe for the phase out of retail price controls, subject to effective competition.
- 4.14 The Territory and Western Australia retain their exemptions from the current and proposed obligations imposed by the AEMA, with the exception of the requirement to phase out retail price controls. The requirement to phase out retail price controls means that jurisdictions will only be able to apply retail price controls (i.e. regulate retail electricity tariffs) where it is in the public interest and it has been established by an independent authority according to explicit criteria that competition does not exist.<sup>40</sup>

---

<sup>38</sup> Australian Energy Market Agreement, amended July 2009, section 2.1.

<sup>39</sup> Council of Australian Governments, 30 June 2004, Australian Energy Market Agreement.

<sup>40</sup> The independent authority will be the AEMC in all jurisdictions except Western Australia, which will use its Economic Regulatory Authority (ERA).

- 4.15 At this time, retail price controls in the Territory only apply to customers with an annual consumption under 750 MWh (tranches 4, 5 and 6).
- 4.16 Under the AEMA, the AEMC is responsible for assessing the effectiveness of competition, in accordance with criteria contained in Schedule Three to the amended AEMA. To date the AEMC has concluded reviews of South Australia and Victoria, determining competition to be effective in both jurisdictions. At its meeting in Darwin in July 2009, the MCE directed the AEMC to review the effectiveness of retail competition in the Australian Capital Territory in 2010, New South Wales in 2011, Queensland in 2012 and Tasmania in 2013.<sup>41</sup>

#### *National Energy Customer Framework (NECF)*

- 4.17 The MCE Retail Policy Working Group has been tasked to implement reform under clause 14 of the AEMA in relation to the non-economic regulation of energy distributors and for regulation (excluding price regulation) of energy retailers. This reform encompasses the transfer of current state and territory responsibilities to the National Electricity Law, National Gas Law and other regulatory arrangements.
- 4.18 The main objectives for the creation of the NECF are to:
- streamline the regulation of energy distribution and retail regulation functions in a national framework; and
  - develop an efficient national retail energy market including appropriate consumer protection.
- 4.19 The NECF will cover a range of subject matters, including:
- the governance model, including a contractual model that forms the basis of the framework;
  - supply of energy to retail customers including a regulatory obligation to offer supply to small customers;
  - provision of customer distribution services to customers;
  - arrangements between distributors and retailers in provision of energy services to customers;
  - authorisations; and
  - enhancements to the enforcement and compliance regime.
- 4.20 In July 2009, the MCE agreed to a revised timing for the NECF with introduction of legislation to the South Australian Parliament in the 2010 Spring Session.<sup>42</sup>

### **Wholesale Arrangements - National Electricity Market (NEM)**

- 4.21 The centre piece of the national electricity market (NEM) design is a mandatory gross power pool. With minor exceptions, generators are required to submit offers to the market operator AEMO to dispatch their energy into the pool. On the basis of dispatch offers, AEMO determines a regional reference price (spot price) for each of the NEM regions. For each half-hourly market trading interval, generators receive from the market

<sup>41</sup> Ministerial Council on Energy Communiqué, Darwin, 10 July 2009.

<sup>42</sup> Ibid.



operator a payment equal to the product of their sent out energy and the regional reference price (adjusted by a site specific marginal loss factor). Similarly Market Customers (mainly retailers) are required to make a payment to the market operator equal to the product of the energy they supply to their customers from the pool and the regional reference price (adjusted by a site specific marginal loss factor). Generators and retailers typically hedge their exposure to the electricity spot price by entering into financial contracts for which they are natural counterparties.

## Development of Competition

- 4.22 In Australia and elsewhere, the introduction of competition in the electricity sector has been preceded generally with significant restructuring of the electricity supply industry and adoption of wholesale trading arrangements. In the case of the east Australian states, this has included the separation or unbundling of the principal activities of generation, transmission, distribution and retail and in most cases further disaggregation of generation and retail into a number of competing businesses (some of which were subsequently privatised); and adopting the Rules of the NEM by becoming member jurisdictions. These structural and market reforms ensured that a functioning, transparent and in some cases highly competitive wholesale electricity market has developed.
- 4.23 FRC commenced in New South Wales and Victoria in January 2002, in South Australia in January 2003, and in Queensland in July 2007. The introduction of FRC has resulted in high numbers of customers switching to a different retailer (known as “churn”) in Victoria and South Australia and moderate churn in New South Wales and Queensland. Churn levels in these jurisdictions can be related readily to the macro determinants of efficient wholesale market, prior structural reform, and adequate retail margins. In the cases of Victoria and South Australia, reviews of the effectiveness of retail competition have resulted in recommendations for the removal of retail price caps. However the AEMC has recommended that the obligation of retailers to offer to supply and sell energy to residential customers be maintained and that retailers subject to this obligation be required to determine and publish the prices at which they will offer to supply and sell energy.
- 4.24 In Tasmania, FRC had been scheduled for introduction in July 2010. However, the decision was subject to a public benefit assessment of specific conditions being in place by July 2010. These conditions were identified as:
- access to competitively priced wholesale energy;
  - a wholesale energy market being responsive to upstream competition;
  - cost of the system to support FRC not being overly onerous on electricity consumers.
- 4.25 In December 2009, the Tasmanian government stated it would not proceed with the full implementation of FRC but would extend retail competition to businesses with electricity consumption above 50MWh per annum.<sup>43</sup>

---

<sup>43</sup> Public announcement on the Office of the Tasmanian Economic Regulator’s website: [www.power.tas.gov.au](http://www.power.tas.gov.au).

## Electricity Reforms in the Territory

### Characteristics of the Electricity Market in the Territory

- 4.26 The regulated Territory electricity market currently consists of the Darwin-Katherine, Alice Springs and Tennant Creek systems. A 132 kV transmission line connects Darwin and Katherine. No other systems are interconnected.
- 4.27 Power in the market systems is mainly supplied using gas fuelled generators which are owned and operated by PWC or purchased by PWC from private operators under power purchase agreements.
- 4.28 In 2008-09, there were 82,889 customers in the market system with an annual electricity demand of nearly 1,900 gigawatt hours (GWh). This is a small market compared to other Australian jurisdictions. For example, Tasmania, the smallest jurisdiction in the NEM, has about 273,000 small businesses and domestic customers consuming 2,680 GWh per annum.<sup>44</sup>
- 4.29 From the viewpoint of introducing competition, a small market presents two major issues. The first is the smaller number of customers over which the fixed costs of supplying customers can be recovered resulting potentially in higher per customer costs. The second is the lower appeal of a small market to intending new entrant retailers as they too have the issue of recovering fixed costs of market entry over lower customer numbers and sales volume.

### Government commitments and history of reform in the Territory

- 4.30 In April 2000, the Territory Government introduced electricity market reforms as part of NCP commitments. The main reform initiatives included:
- abolition of the statutory monopoly over electricity supply held by the Territory Government owned Power and Water Authority;
  - implementation of a third party access regime for specified electricity networks, certified for the purposes of the TPA;
  - instigation of a timetable for phased introduction of FRC; and
  - establishment of an independent economic regulator, the Commission, to regulate monopoly electricity services, licence market participants and enforce regulatory standards for market conduct and service quality.
- 4.31 However, since that time no new market entry has occurred and the Territory electricity supply industry continues to operate under a monopoly market structure.
- 4.32 In 2006 and 2007, Treasury conducted a review of the electricity market regulatory framework to identify impediments to the associated policy objectives of efficient and reliable electricity supply.
- 4.33 The review concluded that the small and fragmented Territory market combined with deficiencies in market and regulatory arrangements pose a significant barrier to these policy objectives. The review also found that moving to the national regulatory regime for electricity could ameliorate the deficiencies identified in the Territory framework.

---

<sup>44</sup> Office of the Tasmanian Energy Regulator, May 2008, Public Benefit Assessment for Electricity Retail Competition in Tasmania.

- 4.34 On 13 April 2007, the COAG requested the Territory to consider the merit of adopting the institutional framework established through the Australian AEMA for the local electricity industry, with the timing at the Territory's discretion.
- 4.35 The Territory Government subsequently undertook a comprehensive analysis of the merits of, and options for, adopting the national electricity laws and rules, including transitional arrangements necessary to take into account local circumstances.
- 4.36 In May 2008, Treasury released a draft policy paper outlining the regulatory options to promote efficient and reliable electricity supply in the Territory. The overarching finding of the draft policy paper was that the national electricity framework would best achieve these objectives, with the following derogations:
- system and operating standards relevant to local market conditions;
  - retaining PWC as a vertically integrated electricity generation, networks and retail business; and
  - provision for the Territory Government to introduce market monitoring and conduct rules that would complement the national electricity framework.
- 4.37 Submissions made to the draft policy paper were generally supportive of the paper's findings. Treasury commenced preparation of a final policy paper for consideration by the Territory Government.
- 4.38 The preparation of the PWC's 2008-09 Statement of Corporate Intent (SCI) raised concerns with PWC's underlying financial viability. This issue, combined with the outcomes of the Davies enquiry into power outages that occurred in September and October 2008,<sup>45</sup> prompted the Territory Government to commission an independent review of the financial sustainability of PWC in February 2009.<sup>46</sup> The Territory Government announced a reform program to strengthen regulatory oversight of the Territory electricity market and improve system reliability and performance. The main elements of the reform program are as follows:
- expanding the Commission from one to three members, including a Commissioner and two Associate Commissioners;
  - a review of options for the implementation of full retail contestability in the Territory from 1 April 2010, including standard service contracts for small customers;
  - review of options for retail prices oversight;
  - review of the existing customer standards of service, including options for the introduction of a standards of service incentive scheme;
  - review of system planning, performance monitoring and market operation arrangements; and
  - review of the efficiency of the PWC's capital and maintenance program, including options for greater independent oversight of asset management and planning.

---

<sup>45</sup> Mervyn Davies, 4 February 2009, Independent Enquiry Into Casuarina Substation Events and Substation Maintenance across Darwin, Preliminary Report, 10 November 2008; Final Report.

<sup>46</sup> See Final Davies Report, April 2009 for further details.

- 4.39 The Commission has been commissioned to undertake the work program outlined above, and to recommend to Territory Government options for reform.

### **Wholesale Market Arrangements in the Territory**

- 4.40 The purpose of this section is to describe the current arrangements in the Territory for the trading of wholesale electricity and provision of retail contestability in the absence of NEM arrangements.

#### *Electricity Networks Third Party Access*

- 4.41 Third-party access to the services provided by prescribed electricity networks in the Territory is currently governed by the *Electricity Networks (Third Party Access) Act* and Code. The framework establishes the terms and conditions under which access to an electricity network is to be granted to third parties and the processes to be followed in negotiating and implementing access agreements and resolving access disputes.
- 4.42 In developing the current legislative framework, it was not considered feasible to establish a wholesale electricity pool.<sup>47</sup> In lieu of a wholesale electricity market, new-entrants were required to follow a “bilateral contracting model” by which they would arrange to supply directly contestable end-use customers and supply all the power needs of individual contracted customers (under normal circumstances). Consistent with this, the System Control Technical Code provides that a generator shall follow the load of its customers plus network losses plus transfer commitments to other generators, and specifies PWC Generation as the “last resort” source of provision of energy in the power system. It obliges the network user to ensure that its input to the power system is equal to the quantity of electrical energy used plus expected network losses between entry and exit points for each energy usage period. System Control is required to establish a methodology to determine “out of balance energy” for each energy usage period and undertake the settlement of resultant charges between generators. Out of balance energy prices are determined by System Control on the basis of generator buy and sell bids.
- 4.43 These arrangements primarily envisaged retail competition being enabled by competitive new-entrant generation i.e. being driven by access to a lower wholesale cost of electricity. The alternative would be for a new-entrant retailer to approach PWC Generation and obtain a wholesale contract on the same terms as PWC Retail.

### **Introduction of Retail Contestability:**

#### *Experience of Competition in the Northern Territory to Date*

- 4.44 Only one firm has entered the Territory electricity market to compete with PWC. NT Power entered the market after April 2000 to provide electricity generation and retail services to customers on a commercial basis. NT Power succeeded in contracting two large customers that represented approximately 8 per cent of total annual consumption (and 20 per cent of the contestable market). Citing difficulties in obtaining gas supplies NT Power ceased electricity generation on 1 August 2001 while continuing with its retail business until it also ceased operating at the end of August 2002. The

---

<sup>47</sup> Utilities Commission, January 2002, Implementing Economic Dispatch, Background Paper.

firm surrendered its generation and retail licences and totally withdrew from the market in November 2002.<sup>48</sup>

*Progressive Implementation of Retail Contestability in the Territory*

- 4.45 All Australian jurisdictions are committed to introducing competition in the electricity generation and retail market sectors. FRC has now been fully implemented in all jurisdictions apart from the Territory, Western Australia and Tasmania.
- 4.46 The introduction of FRC in stages was a requirement of the National Competition Council (NCC) for certification of the Territory's third party access regime under the TPA. Certification was considered desirable by the Territory Government because it establishes a legal avenue for third parties to access network infrastructure and avoids costly legal disputes.
- 4.47 Since April 2000, tranche 1 to 3 customers (large to medium business, Defence and Territory Government customers) have progressively become contestable in the Territory and pay tariffs determined by commercial negotiation.
- 4.48 Tranche 4 customers (who use between 750MWh and 2GWh of electricity per annum) are also contestable. Whilst being able to negotiate their own terms and conditions, these customers are subject to a pricing order set by the Territory Government at a level that is progressively moving to cost-reflective prices. The Territory Government recognised that this tranche of customers would experience a significant price shock as they moved from non-contestable tariff to a cost reflective contestable tariff. Currently, most tranche 4 customers exercise the option of taking supply under tariffs capped by the Territory Government.
- 4.49 Tranches 5 and 6 (typically small businesses and households) are currently non-contestable. Such customers can only be supplied by PWC and pay subsidised retail electricity tariffs that are uniform regardless of location and cost of supply.
- 4.50 Tranche 5 and 6 customers were originally to become contestable in 2003 and 2005 respectively. However in February 2003 the Territory Government postponed contestability for these customer tranches for 5 years, due to the lack of competition. In October 2007, the Territory Government further deferred contestability for tranche 5 customers to April 2010 and approved the introduction of standard supply contracts for tranche 4, 5 and 6 customers from April 2010.

*Objectives of FRC in the Northern Territory Context*

- 4.51 Elsewhere objectives of FRC have included ensuring that the benefits of competition in wholesale markets are transferred to customers, and that customers might receive the benefits of retail competition through improved customer service and the offer of cost-reflective services that better meet customer needs.
- 4.52 In the case of the Territory, there are a number of significant impediments to retail competition including lack of competition and transparency in the wholesale market, the absence of cost-reflective tariffs with adequate provision for a retail margin, lack of active market trading and settlement

---

<sup>48</sup> Utilities Commission, July 2003, An update on Energy Policy and Regulation in the Northern Territory, page 2, and Utilities Commission, December 2002, 2002 Annual Power System Review, page 8.

---

systems, and the vertically integrated structure of the Power and Water Corporation (PWC). While there is the potential to address these by means of reforms, the small size of the Territory market is likely to remain an issue for prospective new-entrants. It is therefore debatable whether the cost of undertaking extensive reforms would be justified.

- 4.53 Realistic short term objectives of FRC for the Territory include retention of certification of access arrangements and the removal of the legislative barrier to retail competition. The introduction of FRC would of itself constitute an important reform and provide the basis for subsequent reforms aimed at furthering the prospects for competition.

*Encouraging the Development of Competition*

- 4.54 Considering the necessary conditions for the development of competition, there are a number of actions that Territory Government might consider to encourage the development of competition. Broadly these are:
- while PWC remains the sole source of wholesale electricity supply, requiring its generation business to determine and publish ‘standing offer’ wholesale contract prices subject to Commission oversight;
  - retail tariff reform – approving a regulated retail price path that will result in tariffs that are reflective of wholesale electricity costs, network costs, Territory Government approved subsidies (irrespective of supplier) and commercial retail margin;
  - strengthening the ring-fencing of PWC’s component businesses; and
  - reform of wholesale market arrangements which may include, for example, adopting or reflecting the NEM wholesale market arrangements. This would also contribute to a common national approach to energy markets.
- 4.55 With respect to reform of industry structure it is noted that the retention of PWC as a vertically integrated entity has been justified previously based on arguments of economies of scale and scope.



## CHAPTER 5

### PRICE MONITORING IN OTHER JURISDICTIONS AND IN THE TERRITORY

- 5.1 Price monitoring and regulation of standing offer prices have been adopted in other jurisdictions for those classes of customers where there are concerns about the effectiveness of competition. The various price oversight regimes examined in this chapter apply primarily to small customers.
- 5.2 Victoria, New Zealand and the United Kingdom publish energy retail prices to allow comparisons between retailers. In addition, the Victorian regime publishes market activity figures, and the New Zealand information disclosure regime is considering disclosure of a wide range of information including valuation, cost allocation and pricing methodologies.
- 5.3 In other Australian jurisdictions, retailers are required to offer electricity to small customers at prices set by jurisdictional regulators.
- 5.4 The Territory's previous experience of price monitoring focused on the efficiency and reasonableness of wholesale generation prices to contestable customers. The information provided to the Commission for the review was not disclosed to the public.

#### Price Monitoring in Australian Jurisdictions

##### Price Monitoring of Energy Retail in Victoria

- 5.5 The Victoria Essential Services Commission (ESCV) monitors the performance of the fourteen energy retailers in the Victorian market: eight are licensed to sell gas to households, while all 14 are licensed to sell electricity. Until 2008, retailers in Victoria were obliged to offer energy to all residential and small businesses at the standing offer contract price approved by the Victorian Government. Market contracts, with generally lower rates, could be negotiated between the retailers and their customers. Subsequent to the review by the AEMC of the state of energy retail competition in Victoria<sup>49</sup>, the Victorian Government decided to remove its statutory reserve pricing requirements from 1 January 2009. Instead, retailers are obliged to determine their own standing energy prices without Victorian Government oversight. Retailers must publish standing offer and market offer prices on their website, which are also published on the ESCV's website.

---

<sup>49</sup> Australian Energy Market Commission, Review of Retail Contestability in the Victorian Energy Market – Retailer and Customer Research, conducted by Wallis Consulting Group, 2008.

- 5.6 The ESCV's annual Energy Retail Comparative Performance report provides information on:<sup>50</sup>
- standing offer (or default prices) and market offer prices:
    - the historical trends for a range of tariffs and their impact on customers' bills. The report explains the trend in average gas and electricity standing offer prices for two types of residential and small business customers over the past decade. For residential, the trend shows a customer on a two-rate tariff (including hot water) while, for business customers, a single rate tariff;
    - the list of all standing offer prices available to residential consumers offered by all gas and electricity retailers in each of the distribution zones. The report identifies the cheapest and most expensive offers;
    - disclosure of a range of discount market offers. These figures are published so that customers can see the range of offers in each distribution zone;
    - the ESCV discloses findings resulting from a survey showing differences between market offers published on the internet and prices quoted over the phone.<sup>51</sup>
  - market activity: this section of the report shows customer market share in the electricity and gas sectors and customer churn (perceived to be a good indicator of competitiveness in the energy market);
  - customer quality: quality of customer's service against performance indicators which are important to customers, such as providing financial assistance, programs to avoid disconnections, and response to customer complaints.

## **New South Wales**

- 5.7 As at 30 June 2009, there were 29 companies holding electricity retail supplier licences in New South Wales. Of these, 14 supplied electricity to small retail customers in 2008-09.

### *Price regulation*

- 5.8 IPART is responsible for setting the regulated retail electricity prices charged to small electricity customers<sup>52</sup> on standard form customer contracts. Following the introduction of retail competition in 2002, the NSW Government asked IPART to continue to determine regulated retail prices during the transition to a competitive market. After seven years of competition, the NSW Government has agreed to phase out retail electricity price regulation where effective competition can be demonstrated. In this context, the NSW Government has decided to retain regulated retail tariffs at least until 2013.

---

<sup>50</sup> The Victoria Essential Services Commission, December 2009, Energy Retailers Comparative Performance Report 2008-09, Summary of Findings, page 2.

<sup>51</sup> Refer to the report conducted by Wallis Consulting Group on behalf of the Essential Services Commission, October 2009, Energy Retail Market Price Monitoring.

<sup>52</sup> Small customers are those using less than 160MWh of electricity per annum, equivalent to an annual bill of around \$20,000.



- 5.9 The terms of reference for the review of regulated tariffs require that IPART:
- use an approach that results in prices that recover an efficient Standard Retailer's costs in meeting the forecast demand of the regulated customers it is obliged to serve, including energy purchase costs, retail operating costs and a retail margin; and
  - make decisions that are consistent with the Government's policy aim of reducing customers' reliance on regulated prices.<sup>53</sup>

#### *Monitoring*

- 5.10 The current regulatory regime requires all licensed electricity retailers to report on a number of customer service indicators. These performance indicators aim to provide information on the affordability and accessibility of electricity services as well as customers' satisfaction with service quality. The key performance indicators used in the report are:
- disconnections due to non-payment of bills;
  - reconnections in the same name;
  - use of alternative payment methods by customers having difficulty paying bills;
  - number of security deposits being held by retailers;
  - call centre responsiveness; and
  - number of customer complaints.

## **Western Australia**

- 5.11 The retail market in Western Australia has progressively been opening to competition. From 1 January 2005, all electricity customers consuming more than 50MWh per annum have been eligible to choose an electricity retailer. This created two classes of small use customer:
- contestable customers consuming 50-160MWh of electricity per annum;
  - non-contestable customers consuming less than 50MWh of electricity per annum.
- 5.12 As at 30 June 2008, there were five retailers supplying small use customers and 10 licensed retailers supplying medium to large use customers. Non-contestable small use customers within the South West interconnected system (SWIS) can only be supplied by Synergy and by Horizon Power in the rest of the State.

#### *The Office of Energy*

- 5.13 In 2009, the Office of Energy, under the requirements of section 55 of the *Electricity Corporations Act 2005*, undertook a review of the electricity market comprising:<sup>54</sup>
- a review of retail tariff arrangements;

---

<sup>53</sup> Independent Pricing and Regulatory Tribunal, July 2009, Review of regulated retail tariffs and charges for electricity 2010-2013, Issues Paper.

<sup>54</sup> Government of Western Australia, January 2009, Office of Energy, Electricity Retail Market Review, Final Recommendations Report, Review of Electricity Tariff Arrangements.

- a review of the introduction of full retail contestability in electricity; and
  - the roll out of smart meters.
- 5.14 The report noted that regulated retail tariffs in Western Australia had not been increased for a considerable time, since 1997-98 for residential tariffs (a 30 percent reduction in real term) and since 1991-92 for small businesses (38 per cent reduction in real term). The report concluded that current electricity tariffs were not cost reflective. As a result, to avoid severe price shocks, it recommended that the Western Australian Government select a glide path for the residential and small customer electricity tariffs to reach cost-reflective levels. It was considered that the tariffs for large business customers (i.e. using at least 50MWh of electricity per annum) should be moved directly to cost reflective levels in order to promote competition in this tranche. Moreover, large businesses were likely to negotiate a market contract at a lower price than the set tariffs.
- 5.15 A building block approach to forecast cost-reflective tariffs was based on the following costs:
- wholesale electricity costs for contestable consumers and non-contestable consumers;
  - the retail components (retail operating costs and retail profit margin);
  - the network charges (calculated by the Economic Regulation Authority (ERA));
  - the Tariff Equalisation Fund;<sup>55</sup>
  - Carbon Pollution Reduction Scheme; and
  - National Mandatory Renewable Energy Target costs.
- 5.16 The modelling behind each cost component was based on a range of assumptions. For example, the wholesale electricity costs for contestable and non-contestable consumers were calculated separately based on the long-run marginal cost of wholesale electricity. Fuel costs were estimated using coal and gas price assumptions based on publicly available information or from data requests.<sup>56</sup>

#### *The Economic Regulation Authority*

- 5.17 ERA, in conjunction with the Independent Market Operator (IMO), is responsible for performing the surveillance of the effectiveness of the Wholesale Electricity Market in meeting the Wholesale Market Objectives which are defined in the Wholesale Market Rules. These main objectives are to:
- promote the economically efficient, safe and reliable production and supply of electricity and electricity related services in the SWIS;
  - encourage competition among generators and retailers in the South West interconnected system, including by facilitating efficient entry of new competitors;

---

<sup>55</sup> The Government of Western Australia has a uniform tariff policy such that customers within and outside the South West interconnected system, face the same tariffs.

<sup>56</sup> Details on how the cost components were modelled can be found in the report prepared by Front Economics, January 2009, Electricity Retail Market Review – Electricity Tariffs, Final Recommendations Prepared for the Western Australian Office of Energy.

- minimise the long-term cost of electricity supplied to customers from the SWIS.
- 5.18 Among other things, ERA approves the Energy Price Limits proposed by IMO in its final report on the Review of Energy Price Limits for the Wholesale Electricity market in the SWIS. In making its decision, ERA must consider whether IMO, when calculating the revised values, applied the guiding principles set out in the Market Rules.
- 5.19 Furthermore, ERA produces an annual performance report on electricity retailers. The purpose of the report is “to bring transparency and accountability to the performance of electricity retail businesses who supply small use customers<sup>57</sup> and to benchmark, where possible, performance against similar businesses in other electricity markets”.<sup>58</sup> All electricity retail licences require that the licensees must provide to the Authority any information that the Authority requires to fulfil its functions under the *Electricity Industry Act 2004*.
- 5.20 The report examines the performance of electricity retailers supplying small use customers in the following areas:
- **Affordability:** this section of the report is concerned about retailers developing hardship policies to assist small use residential and non-residential customers in meeting their financial obligation and responsibilities. The report key performance indicators are the number of customers accessing special billing arrangements such as instalment plans<sup>59</sup>, shortened billing cycles<sup>60</sup>, providing customers with more time to pay their bill and the level of direct debit plan terminations;
  - **Access:** this section of the report provides information on the rates of disconnection and reconnection of customers for non-payment of bills, with particular attention to customers on instalment plans, receiving a government funded concession and those who have been previously disconnected within the past 24 months;
  - **Customer service:** this section of the report examines information about customer satisfaction with service provided by their retailer as measured by complaints and customer contact centre responsiveness;
  - **Compensation payments:** the information provided relates to the number of compensation payments made by retailers for failing the service standards prescribed in the *2008 Code of Conduct*.
- 5.21 Finally, the report keeps a record of the number of residential and non-residential (business) customers for each of the five electricity retailers.

---

<sup>57</sup> Small use customers consume less than 160MWh of electricity per annum.

<sup>58</sup> Economic Regulation Authority Western Australia, March 2009, 2007/08 Annual Performance Report -Electricity Retailers.

<sup>59</sup> An arrangement between the retailer and a customer to pay arrears and continued usage on their account according to an agreed payment schedule and capacity to pay.

<sup>60</sup> Shortened billing cycles occur where a customer receives bills at a frequency that is greater than the standard billing frequency for similar customers.

## Tasmania

- 5.22 In Tasmania, FRC had been scheduled for introduction in July 2010. However this was subject to the findings of a public benefit assessment.<sup>61</sup> In its Energy Policy Statement, December 2009, the Tasmanian Government stated it would not proceed to full retail competition at the present time but would continually monitor the costs and benefits of doing so. It did, however, decide to extend contestability to an additional 2,600 small businesses with annual electricity consumption in excess of 50MWh from January 2011.
- 5.23 Maximum prices of tariffs for franchise customers are regulated by the Office of the Tasmanian Economic Regulator (OTTER). In addition, OTTER monitors and reports on price for franchise customers on the Aurora Pay As You Go (APAYG) and publishes comparisons of prices in other jurisdictions for a range of tariff configurations.
- 5.24 APAYG is a prepayment option offered to residential customers as an alternative to electricity supply via the standard tariffs. APAYG is used by 20 percent of all residential customers in Tasmania.<sup>62</sup> APAYG prices are not regulated, on the basis that customers are able to choose between the regulated tariffs and APAYG. The objective of the annual price monitoring is to aid customers in making informed choice as to which service offers more value to them. Price monitoring of APAYG is based on a 'typical customer' methodology developed by OTTER.<sup>63</sup>
- 5.25 Furthermore, in conjunction with AER, OTTER monitors the wholesale electricity price in Tasmania as part of its obligation to promote competition in the electricity supply industry. It produces a market snapshot, and daily, weekly and long-term analysis. The AER also prepares reports when the spot price exceeds \$5000/MWh.

---

<sup>61</sup> Office of the Tasmanian Energy Regulator, May 2008, Public Benefit Assessment for Electricity Retail Competition in Tasmania, Draft Report.

<sup>62</sup> Office of the Tasmanian Economic Regulator, June 2009, 2009 Aurora Pay as You Go Price Comparison Report (rates from 8 July 2009), page 5.

<sup>63</sup> See Office of the Tasmanian Economic Regulator, March 2006, Information Paper: Typical Electricity Customers.

## Price Monitoring and Information Disclosure Regime in New Zealand

### Retail Price Monitoring

- 5.26 The Ministry of Economic Development (MED) undertakes a quarterly survey of residential retail prices (QSDEP). The figures collected through the QSDEP provide an indication of what residential customers are paying for their electricity in different regions. The QSDEP figures are based on a set of standard assumptions about usage (8,000kWh per annum) and metering arrangements. The survey shows retail prices, the lines component, and estimates of retail market share in each region. The results of the QSDEP are published on its website.
- 5.27 MED also undertakes an annual survey of domestic and commercial electricity prices which contains prices back to 1984. MED publishes an annual schedule which is updated each year in August.<sup>64</sup> The survey only collects information for incumbent retailers and lines companies. The figures represent the average retail charge paid by the consumer and the component of that charge which can be attributed to distribution and transmission network companies.

Table 3: Average retail and line charges are calculated using six model consumers

Consumer characteristics		KWh a month
Domestic	Small	500
	Medium	1000
	Large	1500
Commercial	Small	500
	Medium	1500
	Large	3500

- 5.28 The network charges are derived from information contained in the Electricity Information Disclosure Regulations (currently under review as shown in the following section) which is administered by the Commerce Commission.
- 5.29 The retail charge figures represent the average retail price in each lines company area. A number of assumptions were made when determining retail charges:<sup>65</sup>
- tariffs associated with the meter configuration that is most common in the network area have been used. Typically, tariffs associated with a dual meter configuration, with one uncontrolled and one controlled meter, have been used. In some cases 'all inclusive' tariffs associated with a single 'composite' (with controllable load) meter configuration have been used;

<sup>64</sup> See Ministry of Economic Development website for further details on the last updated schedule, [www.consumer.org.nz](http://www.consumer.org.nz).

<sup>65</sup> See Ministry of Economic Development website for further details, [www.consumer.org.nz](http://www.consumer.org.nz).

- where a dual meter configuration has been used each model customer is assumed to consume 60 per cent of their energy on uncontrolled appliances and 40 per cent on controlled appliances.
- where retailers offer more than one controlled rate, the rate closest to 20 hours guaranteed supply each day has generally been chosen.
- in the case of domestic tariffs the optimal tariff at a given level of consumption, when comparing low user fixed charge options to standard tariffs, has been used.
- where different rates apply to summer and winter loads, weighted averages have been used;
- prompt payment discounts and loyalty rebates have been taken into account where available, but discounts for paying by direct debit have not been allowed; and
- for the model domestic consumers, a 1 phase, 60 amp connection (kVA rating of approximately 15) has generally been priced. Occasionally a smaller connection has been used for the small domestic consumer. The connection capacities for the commercial consumers have been targeted historically at 10, 20 and 30 kVA respectively. Generally, a single phase supply for small commercial and a three phase supply for the large commercial customer have been used.

5.30 The last report was published in January 2004 in which MED examined:<sup>66</sup>

- the national average retail charge (real and nominal terms) from 1990 to 2003;
- national average line charge (real and nominal terms) from 1994 to 2003;
- movements in wholesale prices (nominal terms) from 1993 to 2004;
- future price drivers;
- movements in mean energy price, modelled wholesale price, mean spot price, combined cycle gas turbines and geothermal long run cost from 1993 to 2004;
- movements in estimated retail/wholesale margin (excluding meter charge) from 1994 to 2003;
- recent movement in domestic energy charge when compared to the NZTF Industrial Index; and
- development of retail competition between 1998 and 2004.

5.31 In its conclusion, MED commented on the difficulty to draw conclusive view on retail and wholesale margins using only five years of data. It also noted that recent increases in retail price could be related to increased costs of new generation and a shift in generation type. The margin between mean retail prices and the costs of new generation appeared to have kept constant. It concluded that there was evidence of slowly growing competition amongst retailers accompanied by a slow migration of consumers moving away from incumbent retailers.

---

<sup>66</sup> See Ministry of Economic Development website: [www.consumer.org.nz](http://www.consumer.org.nz).

## Power Switch

- 5.32 Power Switch is a recent initiative provided by Consumer NZ with the support of the Ministry of Consumer Affairs.<sup>67</sup> Recent enhancements have been assisted by the Electricity Commission. The aim of this free web based service is to encourage residential customers to compare prices and find the best gas and electricity retailers for their needs by providing a whole suite of services. The site provides monthly price trends for the electricity retailers in each region using rolling three year prices for annual electricity usage based on a number of assumptions:
- prices based on the most common plan type in the area; and
  - household of 3-4 people with an average annual consumption of 8,492kWh.
- 5.33 The price trends show how aggressive electricity retailers have been with their pricing over time. Power Switch will soon introduce a similar service for gas prices enabling comparisons for those customers on dual fuel plans.
- 5.34 Another recent feature of the site is the introduction of a comparison of retailer service performance ratings using figures from the Consumer NZ annual member survey.
- 5.35 From the information supplied by the users on their specific needs and consumption patterns, as well as information from their current power bills if available, the service provides estimated amounts of power use in a year, and the electricity cost based on the cheapest and most suited power plan available.
- 5.36 Finally the site provides consumers with information on switching electricity providers, customer contracts, consumer rights (including rights of low-income and vulnerable consumers) and complaint mechanism.

## Information Disclosure Regime

- 5.37 The Commerce Commission is currently reviewing its Information Disclosure Regime following the changes introduced by under Part 4 of the *Commerce Amendment Act 2008*. The suppliers of the following services are subject to information disclosure regime:
- electricity lines services (transmission and distribution);
  - gas pipeline services (transmission and distribution); and
  - specified airport services.
- 5.38 In July 2009, the Commerce Commission published a discussion paper presenting its preliminary views on the information disclosure regime under the provisions introduced under the *Commerce Amendment Act 2008*.

---

<sup>67</sup> See Ministry of Economic Development website for further details, [www.consumer.org.nz](http://www.consumer.org.nz).



- 5.39 The purpose of information disclosure regulation is to ensure that sufficient information is readily available to interested persons in order to:
- to promote the long-term benefit of consumers in markets referred to in section 52 by promoting outcomes that are consistent with outcomes in competitive markets such that suppliers of regulated goods and services –*
- (a) have incentives to innovate and to invest, including in replacement, upgraded, and new assets; and*
- (b) have incentives to improve efficiency and provide services at a quality that reflect consumer demands; and*
- (c) share with consumers the benefits of efficiency gains in the supply of the regulated goods and services, including through lower prices; and*
- (d) are limited in their ability to extract excessive profits.<sup>68</sup>*
- 5.40 The Commerce Commission is of the view that placing information and analysis about the regulated suppliers in the public domain can provide some of the incentives found in competitive markets such as:
- better information to consumers and other interested parties so that consumers' countervailing market power is enhanced, thereby potentially limiting excessive profits and engaging consumers with their suppliers in determining the desired level of service quality;
  - better information to the owners of regulated suppliers by allowing comparisons with suppliers in other areas and helping in identifying opportunities;
  - potentially increased incentives for the management of regulated suppliers to improve relative and absolute performance;
  - consistent information to the regulator thereby assisting the Commerce Commission in making determinations in respect of the other regulatory instruments.<sup>69</sup>
- 5.41 Among other things, the Commerce Commission's recommends the following information to be disclosed by the regulated suppliers on an annual basis:
- information on valuation of the regulatory asset base such as valuation methodology, depreciation, methodology for allocation of shared costs;
  - information on quality;
  - pricing information such as pricing methodologies, prices disclosures, terms and conditions of prices and contract disclosures.

## United Kingdom Framework for the Gas and Electricity Industries

- 5.42 The Office of the Gas and Electricity Markets (Ofgem) is the regulator for the gas and electricity industries in the United Kingdom. During the 1980s and 1990s the electricity and gas industries underwent significant reforms by

<sup>68</sup> Commerce Amendment Act 2008, section 52A.

<sup>69</sup> Commerce Commission, July 2009, Information Disclosure – Discussion Paper, page 10.

transforming integrated statutory monopolies to industries characterised by a high level of vertical and horizontal separation. After a decade of development of competition, Ofgem decided to remove retail price controls for electricity and gas in 2002. This decision was based on Ofgem's greater reliance on competition and consumer law.<sup>70</sup> Ofgem, however, did not exclude the re-introduction of price control if needed.<sup>71</sup>

- 5.43 The *Competition Act 1998* came into force at the beginning of March 2001. It prohibits anti-competitive agreements and abuse of market power.
- 5.44 Ofgem has, jointly with the Office of Fair Trading, powers to implement the Act.
- 5.45 The powers exercised by Ofgem are summarised below:
- consideration of complaints about breach of the prohibitions;
  - imposition of fines up to 10 percent of company turnover for three years for breaching the two prohibitions of the Act;
  - carrying out investigations both on the regulator's own initiative and in response to complaints; and
  - requiring the production of documents and information and search premises. When investigating potential infringements and requesting information under the *Competition Act 1998*, Ofgem needs to specify the potential infringements it is investigating and the legal instrument under which the questions are posed.
- 5.46 Following its decision to remove price controls for domestic retail customers in 2002, Ofgem considers that its primary role is to monitor market developments to ensure that residential energy consumers are still protected by effective competition. In response to political and media concerns about the competitiveness amongst electricity and gas retailers, Ofgem publishes periodic analysis on the development of the market. The Domestic Retail Market Report provides information on:
- domestic retail market such as suppliers' market share, number of domestic electricity and gas customers, and types of supply contracts and payment methods;
  - relationship between wholesale and retail energy prices in response to concerns about the slow suppliers' responses to cuts in wholesale prices;
  - spread in prices between the most expensive and cheapest suppliers;
  - product innovations - information (best offer prices, trends in number of customers) on different products such as price guarantee tariffs, online tariffs, green tariffs;
  - customer service - information on total number of complaints for each supplier;
  - switching data, including monthly customer transfer figures in the gas and electricity retail markets, as well as rates of gains/losses for the incumbent and transfers between entrants;

---

<sup>70</sup> Office of the Gas and Electricity Markets, February 2002, Review of Domestic Gas and Electricity Competition and Supply Regulation – Conclusions and Final Proposals.

<sup>71</sup> *Ibid*, page 60.

- market shares of incumbents and entrants at a national and regional levels;
- payment methods - trends in prices for prepayment customers, price differences between payment methods, information on fuel poor and vulnerable customers.

5.47 The Ofgem report shows that effective competition is taking place at all segments of the market demonstrated through price competition amongst the big six players for all customers, innovative products being developed, improvement in customer service, and annual switching rates at their highest in four years.

## Experience of Price Monitoring in the Territory

5.48 Immediately after NT Power exited the market, the Commission wrote to all contestable customers to inform them that it intended to monitor the wholesale energy (generation) charges:

*The Commission will monitor the extent to which the wholesale prices being passed on to contestable customers, on average, are based on efficient forward-looking costs and are no more than would reasonably be expected under competitive conditions.<sup>72</sup>*

5.49 In September 2003, the Territory Government approved the introduction of prices oversight of PWC's electricity generation by the Commission. The Commission was required to monitor and report to the Minister, on an annual basis, on the efficiency and reasonableness of generation prices to contestable customers. In accordance with the objective of the monitoring regime endorsed by Cabinet, the Commission focused on:

- the average revenue per kWh recovered from contestable customers that is attributed to PWC Generation; and
- the relationship between the indicator of average price and estimates of the reasonable long-run cost of wholesale energy.

5.50 The Commission was not able to publicly release the report as the information was deemed confidential and commercially sensitive.

5.51 Considering that the review was based on the assessment of PWC's average generation costs, the Commission concluded, in its recommendations to the Treasurer, that PWC's energy costs for the 2002-03 and 2003-04 were not inconsistent with estimates of the reasonable costs of generation in those years. The updated assessment in June 2006 of the 2004-05 year found that the increases in PWC's average wholesale revenues brought them close to or slightly higher than the Commission's estimated of the reasonable costs of generation. The Commission's view was that these increases were mainly due to the cost of fuel and a shift in the asset valuation methodology used for pricing from book values to replacement values.

5.52 However, these conclusions were based on the grounds that generation costs were passed on to the PWC's retail unit through transfer pricing arrangement. In reality the final bundled price was overridden by Retail

---

<sup>72</sup> See letter from the Commission to all contestable customers on the Commission website: [www.utilicom.nt.gov.au](http://www.utilicom.nt.gov.au).

during the negotiation process. In its 2006-07 annual reports, the Commission noted that:

*In practice, pricing decisions by Power and Water's retail business have the effect of overriding any wholesale generation price that has been subject to price monitoring. In these circumstances, the Commission believes that limited insight is gained from monitoring an internal transfer price that only a loose relationship with the price paid by customers.*<sup>73</sup>

---

<sup>73</sup> Utilities Commission, Annual Report 2006-07, page 10.

## CHAPTER 6

### IMPLEMENTATION OPTIONS FOR THE NORTHERN TERRITORY

- 6.1 In preparing the different classes of options in this issues paper, the Commission has considered the following:
- the objectives of the regime in the Territory context;
  - the longevity of the regime;
  - practical implementation requirements;
  - overseas and interstate experience of prices oversight in contestable markets; and
  - all other relevant economic and policy developments.
- 6.2 Furthermore, the Commission considers that a retail price monitoring regime in the Northern Territory is an integral part of the wider set of reviews of PWC's activities requested by the Territory Government.
- 6.3 The Commission's preliminary view is that a retail price monitoring regime in the Territory should be implemented until effective competition in the electricity market can be demonstrated. This is in line with practices in other jurisdictions.
- 6.4 Given the small scale of the Territory market and the lack of alternative supply, it may be appropriate to extend price monitoring to cover all customers.

#### Proposed Options

##### Option A – Disclosure of Profitability of PWC Business Activities

- 6.5 Under this option, the Commission would make available information on revenue, costs and profits for each of the major PWC retail electricity business activities, i.e. retail supply to the currently contestable tranche 1 to tranche 4 customers. It would then broaden the regime to include tranche 5 and tranche 6 customers once their grace period expires in April 2012. Under this option, the Commission would leave it to the market to assess the reasonableness of PWC retail prices. It is not expected that the Commission would provide information or comment on efficient costs and fair prices.
- 6.6 The depth and range of information to be disclosed would depend on a number of considerations such as commercial sensitivity of information, availability of information, benefits and costs, and the needs and requirements of interested parties.

- 6.7 The Commission considers that monitoring of service quality is an essential part of the disclosure requirements as it reduces the incentives for the business to decrease costs at the expense of quality.
- 6.8 Furthermore, the Commission is of the view that methodologies for asset valuation and allocation of costs should be disclosed as it would assist interested parties in calculating the allocation of costs between business units, and the way that retail prices are derived.
- 6.9 In addition, publication of the PWC methodologies for pricing of wholesale energy and the methodology for determining offer prices for retail contracts should provide greater assurance of the reasonableness of price offers.
- 6.10 This option would provide some assurance that PWC is not exploiting its market power to earn monopoly rents from its electricity generation or retail business. The network business is already regulated. The information should provide some assurance about cross-subsidies between the major customer groups.
- 6.11 At a minimum, the major components of the cost of the retailing activity would be reported. These components are:
- generation;
  - network;
  - retail cost and margin; and
  - other costs, including Renewable Energy Certificates.
- 6.12 Assuming that PWC has already implemented cost allocations as per the requirements set out in the Ring-fencing Code, the Commission considers that this option should not be overly onerous and costly.

<b>Question 4:</b>
--------------------

The Commission seeks the views of interested parties as to which type of information PWC should disclose as part of Option A and why.
---

### **Option B – Reporting of the Estimated Benchmark Costs and Prices of an Efficient Service Provider**

- 6.13 This option is styled on the methodology adopted by regulators in other jurisdictions to determine prices for standing offers for small customers in those jurisdictions where price controls still exist (i.e. all jurisdictions other than Victoria). An average price may be developed for each customer group, sufficient to provide an efficient generator and efficient retailer with a commercial margin, taking account of network and other non-discretionary costs. Generation costs could be based on the existing PWC portfolio, operated efficiently, or on the efficient costs of a hypothetical new entrant.
- 6.14 This option could be implemented in conjunction with option A to provide an assurance that customers are contributing no more than the revenues required by an efficient operator to earn a commercial return, taking account of costs and any subsidies provided by the Territory Government.

### Option C – Reporting of Price Indices and Benchmarks of Costs with other Jurisdictions

- 6.15 Retail prices for electricity users vary depending on their consumption patterns, peak demand, load factors and percentage of consumption in peak/off-peak periods. It is necessary to aggregate these various aspects of prices to measure price changes.
- 6.16 This option uses price indices based on a weighted tariff basket approach. These tariff baskets are usually constructed for various user profiles to account for differences in demand patterns. Under this option, the Commission would construct indices for three types of customer – residential, small to medium businesses and large businesses.
- 6.17 Alternatively, the Commission notes that a Revenue Yield approach has been used in other jurisdictions.<sup>74</sup> Under this approach, the index is based on average prices calculated by dividing total revenue received from all customers by the total number of units sold. This option could also propose to compare:
- movements in cost and price levels using historic trends;
  - relative performance of companies within the electricity industry using benchmarking; and
  - companies' price and cost levels relative to general inflation or other indices.
- 6.18 The Commission's view is that comments on the information disclosed would be of a factual nature only. The intent of this option is to facilitate provision of information rather than implementing a form of price control. The Commission would not make any determinations on the appropriateness of costs and prices.

<b>Question 5:</b>
<p>The Commission seeks the views of interested parties as to the advantages and disadvantages associated with:</p> <ul style="list-style-type: none"> <li>• price indices;</li> <li>• benchmarking prices and costs with other jurisdictions.</li> </ul>

### Option D: Status Quo

- 6.19 This option proposes that a retail price monitoring regime in the Territory would not be warranted. The rationale for retaining the status quo would be that the existing information disclosure and customer protection mechanisms are sufficient for contestable customers to conduct reasonable and fair negotiations with PWC Retail. Moreover, existing general consumer laws (e.g., State fair-trading legislation, Commonwealth Trade Practices Act, and common law) may provide sufficient additional protection to customers.
- 6.20 Under this option, the Commission might consider updating the Contestable Pricing Guidelines. This would provide guidance to the suppliers of services as to the Commission's views on what it regards as conduct consistent with

---

<sup>74</sup> Australian Competition & Consumer Commission, Price Monitoring and Financial Reporting – Price-monitored Airports, 2003-04.



Licence conditions, Code requirements and the objectives of the *Utilities Commission Act*. Failure to behave in accordance to these guidelines could result in a customer lodging a complaint to the Commission, and the Commission finding PWC behaving in an anti-competitive or discriminatory manner.

**Question 6:**

The Commission seeks the views of interested parties about the adequacy of current arrangements to conduct reasonable and fair negotiations with PWC.

## Implementation Issues

### Target of a Price Monitoring Regime

6.21 Table 4 shows a breakdown of the electricity use and number of contestable and non-contestable customers for each of the three regulated networks – Darwin-Katherine, Alice Springs and Tennant Creek:

Table 4 – Electricity use and customer numbers on regulated networks 2008-09

System	Customers using >750MWh a year		Customers using <750MWh a year	
	sites	Usage (GWh)	sites	Usage (GWh)
Darwin-Katherine	146	455	58 173	886
Alice Springs	24	55	12085	161
Tennant Creek	4	4	1705	22

6.22 From 1 April 2010 all customers will become contestable but the newly contestable customers will be protected for a two year grace period.

6.23 Once the grace period expires, the question arises as to whether the retail price monitoring regime should be extended to parts of or all contestable customers in the Territory. The Commission is of the view that a retail price monitoring regime in the Territory needs to be sufficiently flexible to accommodate the needs of a wide range of interested parties. The interested parties and potential benefits of a retail price monitoring regime are summarised below:

- tranche 1 to 4 customers who are currently contestable in all regional zones – to address concerns about market power and provide a more level playing field in the negotiation process with the electricity retailer;
- tranche 5 and 6 customers who will become contestable in April 2010, as part of the Territory Government's commitment to full implementation of FRC;
- the regulator - as a regulatory instrument to allow the monitoring of the retailer behaviour and performance;
- the Territory Government - as a way of monitoring the company's efficient operation, providing best value for money for the owner;
- PWC - as a useful device to measure their performance against benchmarks and monitor any potential deficiencies.

- 6.24 The Commission acknowledges that a one-fits-all regime for all customer segments will need to be flexible and therefore less prescriptive.

**Question 7:**

The Commission is considering the merits of setting out a flexible retail price monitoring capable of meeting the requirements of a range of interested groups. The Commission is seeking the views of interested parties on this issue.

**Treatment of confidential information:**

- 6.25 Currently, the *Utilities Commission Act* stipulates that information obtained by the Commission should not be disclosed if that disclosure could undermine the competitive position of the licensed entity or other person, or if it is commercially sensitive for some other reason.<sup>75</sup> Information can only be disclosed under the following set of conditions:<sup>76</sup>

- the disclosure is made to another person who is also performing a function under the *Utilities Commission Act* or a relevant industry regulation act;
- the disclosure is made with the consent of the person who gave the information or to whom the information relates;
- the disclosure is authorised or required under any act or law or by a court or tribunal;
- the disclosure is authorised by regulations.

**Question 8:**

Do you consider that PWC generation prices are commercially sensitive and do you consider their disclosure would unfairly undermine PWC's competitive position?

**Disclosure of Information**

- 6.26 The Commission recognises that some of the information it intends to publish may be considered confidential by PWC. Wholesale generation prices and underlying costs may be seen as commercially sensitive.
- 6.27 The information provided under the *Utilities Commission Act* is to be treated as confidential if it could affect the competitive position of the licensed entity or other parties, or if it is deemed to be commercially sensitive for some other reasons.<sup>77</sup>
- 6.28 The *Utilities Commission Act* defines the obligations of the Commission in dealing with information deemed to be confidential. Confidential information may be disclosed in the following instances:<sup>78</sup>
- (a) the disclosure is made to another person who is also performing a function under this Act or a relevant industry regulation Act;

<sup>75</sup> *Utilities Commission Act*, June 2001, section 26(1).

<sup>76</sup> *Ibid*, section 26(2).

<sup>77</sup> *Ibid*, section 26(1).

<sup>78</sup> *Ibid*, section 26(2).

- (b) the disclosure is made with the consent of the person who gave the information or to whom the information relates;
  - (c) the disclosure is authorised or required by a court or tribunal constituted by law; or
  - (d) the disclosure is authorised by regulations.
- 6.29 Confidentiality may be an impediment to disclosure of the components of efficient costs, in particular the cost of generation. The Commission notes there is no provision in the *Utilities Commission Act* for consideration of the public interest in deciding whether any particular material should be confidential. Such a decision, where the public interest might over-ride any private interest, would be made by the Minister in deciding whether to authorise disclosure by Regulation.

### Disclosure of Wholesale Generation Prices

- 6.30 The Commission considers that an effective retail price monitoring regime is based on the premise that wholesale generation prices and their underlying costs are disclosed to interest parties. Wholesale generation prices represent a significant proportion of the total retail price. Availability of this information would assist contestable customers in assessing the reasonableness of PWC's retail prices and potentially, would provide them with greater bargaining powers.
- 6.31 However, the Commission notes that, due to the unique characteristics of the energy market in the Territory, there might be a number of inherent issues with releasing wholesale generation prices and, in particular, the underlying gas costs.

#### *Approach adopted for Wholesale Energy Price Monitoring*

- 6.32 As already mentioned in Chapter 2, the Territory Government approved the introduction of prices oversight of the PWC's electricity generation business in 2003 after NT Power's decision to cease its operations in the Territory.
- 6.33 In line with the procedures set out in the endorsed monitoring regime, the Commission investigated the average revenue per kWh received by PWC Generation during each of the financial years 2002-03 and 2003-04 for:
- each of the contestable customer tranches 1, 2, 3, and 4 by region; and
  - each contracted contestable customer (on a blind basis).
- 6.34 Average revenue per kWh was calculated by dividing the total revenue from the customers(s) by the total number of units of electricity supplied to the customers.
- 6.35 Furthermore, in order to assess the reasonableness of PWC's wholesale generation, the Commission adopted the standard merit order generation cost modelling approach used by other regulators, incorporating the same plant type, order of operation and fuel source as PWC as well as an indicative wet/dry season system load profile for the Darwin-Katherine zone. The estimates, which are substantially reliant on gas costs, incorporated indicative upper and lower values to reflect the probable range of costs a comparable generator would face.

<b>Question 9:</b>
--------------------

Do you consider the approach used by the Commission for the Generation
--

Price Monitoring regime appropriate? What are the advantages and disadvantages of such an approach?

### Information on PWC Retail Prices

- 6.36 The Commission considers that pricing disclosure should include disclosure of unbundled prices, underlying costs and pricing methodologies. The Commission is of the view that providing transparent pricing information would assist contestable customers and interested parties in their assessment of whether prices are derived in a consistent and equitable manner amongst the different customer segments but also within each segment. The Commission is also of the view that disclosure of PWC's pricing methodology would also place some scrutiny on the mechanisms and principles underpinning its pricing methodologies.
- 6.37 The retail price paid by a customer for electricity supply is a "bundled price" comprising the cost of energy generated, network tariffs, costs associated with the system controller, and retail costs. Retail costs relate to the billing and account management costs, and a retail margin providing the retailer a commercial return. Retail prices are set to fully recover the cost of supplying electricity.
- 6.38 The Commission understands that the charges are allocated differently between contestable and non-contestable customer groups. Prices for contestable customers are based on the following principles:
- the customer's expected load profile;
  - cost recovery of all costs associated with that particular customer; and
  - recovery of current and projected costs such as fuel, operating costs, capital and fixed costs.

**Question 10:**

Do you consider the current reporting for PWC provides sufficient information for contestable customers in negotiating with PWC? If not, what additional information should be disclosed?

### Disclosure of gas prices

- 6.39 Power in the regulated systems is almost all provided by gas-fired generators which are owned and operated by PWC or purchased by PWC from private operators under power purchase agreements. Gas for power generation is purchased under bi-lateral contract between PWC and its gas suppliers. Until recently, PWC's gas needs were met by the Amadeus Basin fields in Central Australia. However, as the Amadeus Basin fields were beginning to decline, PWC contracted to buy its future gas needs from ENI's Blacktip gas field. PWC's contract, which came into full operation from January 2010, is expected to meet PWC's needs until 2034. The contract is understood to entitle PWC to buy all of the available gas from the Blacktip gas field.
- 6.40 Other jurisdictions publish national and international market gas price trends to assist interested parties in assessing the reasonableness of wholesale generation costs and prices. However, in other jurisdictions, there would generally be a more developed market, with multiple sellers and buyers of

gas. In contrast, PWC will be relying on a single primary source of gas from 2012.

**Question 11:**

With regards to disclosure of generation costs, the Commission seeks the views of interested parties on the advantages/disadvantages of providing estimates of :

- underlying gas costs similar to the approach used by the Commission's previous generation price monitoring approach
- the advantages/disadvantages of providing national/international benchmarks for the generation costs.

### **Data Quality Provided to the Commission**

- 6.41 In performing its regulatory functions, the Commission has noted significant variation in the data provided by PWC. The Commission is of the view that, for the retail price monitoring regime to be effective, the data provided by PWC should be consistent. Consistency allows comparisons of performance over time and, also, with other suppliers. The Commission is of the view that consistency and comparability will be assisted by ensuring that information disclosure requirements are sufficiently prescriptive. The Commission notes, however, that it has to weigh the benefits of prescriptive information against other principles such as flexibility and cost effectiveness. The Commission is also of the view that the information should be audited by an independent auditor prior to being provided to the Commission.

**Question 12:**

The Commission seeks your views on how prescriptive information disclosure should be and whether the information should be audited.

### **Longevity of the Regime**

- 6.42 The Commission is of the view that the retail price monitoring regime for contestable customers in the Territory will be necessary until competition has become effective.
- 6.43 A transitional period of price surveillance is a useful mechanism at a time when there is no or limited competition, and consumers require assurance that untoward behaviour in the industry will be quickly identified.
- 6.44 Once competition has emerged and the Commission is satisfied that there is no abuse of market power, price monitoring will no longer be warranted. The Commission recognises that there are costs associated with the regime which need to be minimised.

### **Responsibility for Price Oversight**

- 6.45 This section examines which agency should be best placed to carry out the oversight of retail price monitoring in the Territory.
- 6.46 The Competition Principles Agreement, signed by all Australian governments in 1995, set out the implementation of independent prices oversight arrangements for government businesses. It specified that the

price oversight advice should be, among other things, “independent from the government business enterprises whose prices are being assessed”.<sup>79</sup>

- 6.47 As previously discussed in para 3.15, ACCC carries out price monitoring under the TPA. Part VIIA enables the ACCC to examine the prices of selected goods and services in the Australian economy. The Minister determines which industries or businesses are monitored and how often the ACCC should report. The ACCC currently conducts price monitoring of airports, container stevedoring, medical indemnity insurance and petrol.
- 6.48 The AER regulates the wholesale electricity market and is responsible for the economic regulation of:
- the electricity transmission and distribution networks in the national electricity market (NEM);
  - gas transmission and distribution networks.
- 6.49 The AER has not been given the power to regulate the electricity market in the Territory.
- 6.50 The AER is expected to regulate retail markets (other retail pricing) in all states except Western Australia and the Territory.
- 6.51 The Commission is of the view that, as the independent electricity and water industry regulator in the Territory, it is best placed to carry out the retail price monitoring functions. Under section 6(1)(h) of the *Utilities Commissions Act*, the Commission can be instructed “to perform any function assigned by or under this or any other Act or conferred by the Minister”.

**Question 13:**

In your views, which agency would be best suited to carry out the implementation of a retail price monitoring regime in the Territory?

### Emission Trading Scheme

- 6.52 The Commission recognises the impact that the Carbon Pollution Reduction Scheme (CPRS) and the Renewable Energy Target (RET) will have in regards to pricing arrangements. The Australian Energy Market Agreement (AEMA) as amended on 2 July 2009 states:
- The parties agree that, where retail prices are regulated, energy cost increases associated with the Carbon Pollution Reduction Scheme and the Renewable Energy Target shall be passed through to end-consumers.*<sup>80</sup>
- 6.53 Due to the fact that the CPRS and the RET have not yet been finalised by the Commonwealth Government, the costs that will be passed through to the end-consumers cannot as of yet be determined.
- 6.54 The Commission has considered the disclosure requirements for PWC in regards to the amount of increase caused by the CPRS and the RET.
- 6.55 The Commission considers the increased costs in relation to the CPRS and the RET as charges to the retail customer. These will be required to be disclosed on a customer’s bill inline with the recommendation of the

<sup>79</sup> Competition Principles Agreement, 1995, clause 2(2)(a).

<sup>80</sup> Australian Energy Market Agreement, amended July 2009, clause 14.17.

Essential Services Commission of South Australia<sup>81</sup>, the Essential Services Commission in Victoria<sup>82</sup>, and the draft National Electricity Customer Framework.<sup>83</sup>

- 6.56 Moreover, the Commission considers that wholesale energy costs and retail prices used for benchmarking should be net of CPRS and RET as these costs do not reflect the cost of production and delivery of electricity. However, this may be difficult to report the components of costs in other jurisdictions as, over time, CPRS will become embedded in energy costs.

### Issues regarding Benchmarking in the Territory

- 6.57 Benchmarking is a tool that can be used in an environment without sufficient competition in order to compare efficient prices. The Commission has considered benchmarking the costs of generation and retail across jurisdictions in order to provide comparative prices to customers of PWC.
- 6.58 Benchmarking will be able to provide a number of benefits to the retail customers in the Territory that otherwise would not be available, such as:
- Information – Benchmarking costs from other jurisdiction will increase the amount of information available to retail customers in regards to available prices. This will hence increase their bargaining power with PWC.
  - Efficiency Gains – Benchmarking costs would allow for the determination of inefficient practices in the generation and retail process that can be modified.
  - Reviews – The creation of benchmarking allows the Commission a method to review the impact of competition on PWC.
  - Increased Marketing – Benchmarking will help PWC to identify strengths to market in increased competition.
- 6.59 The Territory has several unique challenges in regards to electricity generation in comparison to other Australian jurisdictions:
- Population – Being the smallest jurisdiction in Australia means that the Territory is unable to benefit from economies of scale in regards to power production;
  - Size – Due to the relative size of the Territory relative to its population, the cost of transmission is higher than other jurisdictions;
  - Fuel Make-Up – The Territory is almost entirely reliant on natural gas to power generators. This gives significantly different costs of generation for the Territory than in other jurisdictions;
  - Geographic Location – The Territory is located in a section of Australia that is not likely to facilitate connection to the NEM in the foreseeable future.
- 6.60 These benefits and issues need to be considered when implementing any form of benchmarking for the PWC.

---

<sup>81</sup> Essential Services Commission of South Australia, March 2004, Energy Retail Code, ERC/01, 6.3.4(e).

<sup>82</sup> Essential Services Commission, October 2009, Energy Retail Code, Version 6, 4.2(i).

<sup>83</sup> National Energy Retail Rules, 30 April 2009, First Exposure Draft., Part 2, Division 4, 214(f).



## APPENDIX 1

### Index of Questions

Q.1	Under the current regulations, do you consider that there is sufficient information publicly disclosed? If not, which other information would need to be published and why?
Q.2	Do you agree with the objectives defined by the Commission and why?
Q.3	Do you consider the above principles relevant for the assessment of options for the development of a price monitoring regime in the Territory and why? Do you agree with these principles? Does the Commission need to consider any other principles?
Q.4	The Commission seeks the views of interested parties as to which type of information PWC should disclose as part of Option A and why.
Q.5	The Commission seeks the views of interested parties as to the advantages and disadvantages associated with: <ul style="list-style-type: none"> <li>• price indices;</li> <li>• benchmarking prices and costs with other jurisdictions.</li> </ul>
Q.6	The Commission seeks the views of interested parties about the adequacy of current arrangements to conduct reasonable and fair negotiations with PWC.
Q.7	The Commission is considering the merits of setting out a flexible retail price monitoring capable of meeting the requirements of a range of interested groups. The Commission is seeking the views of interested parties on this issue.
Q.8	Do you consider that PWC generation prices to be commercially sensitive and do you consider that their disclosure would undermine PWC's competitive position?
Q.9	Do you consider the approach used by the Commission for the Generation Price Monitoring regime relevant? What are the advantages/disadvantages of such an approach?
Q.10	Do you consider the current reporting for PWC provides sufficient information for contestable customers in negotiating with PWC? If not, what additional information should be disclosed?
Q.11	With regards to disclosure of generation costs, the Commission seeks the views from interested parties on the advantages/disadvantages of providing estimates of : <ul style="list-style-type: none"> <li>• underlying gas costs similar to the approach used by the Commission's previous generation price monitoring approach;</li> <li>• the advantages/disadvantages of providing national/international benchmarks for the generation costs.</li> </ul>
Q.12	The Commission seeks your views on how prescriptive information disclosure should be and whether the information should be audited.?
Q.13	In your views, which agency would be best suited to carry out the implementation of a retail price monitoring regime in the Territory?