TERRITORY GENERATION

TGen reference: TGD2024/43632

Utilities Commission of the NT
Level 3 NT House
22 Mitchell Street
Darwin NT 0800.

By Email: Utilities.Commission@nt.gov.au

Attention: Kimberlee McKay, Director, Utilities Commission

Dear Kimberlee

Review of NTESMO 2024-27 System Control and Market Operator Charges Regulatory Proposal Consultation – Submissions

I refer to the Utilities Commission's (Commission) communication dated 7 June 2024 under the caption "Review of NTESMO 2024-27 System Control and Market Operator Charges Regulatory Proposal Consultation" and the related Consultation Paper prepared by the Commission.

Territory Generation (TGen) thanks the Commission for the preparation of the Consultation Paper and the opportunity to provide feedback on the proposal made by the Northern Territory Electricity System and Market Operator (NTESMO). TGen notes that NTESMO engaged directly with stakeholders including TGen nearly one year ago. Although the Commission would no doubt be aware of the feedback from stakeholders, several of TGen's prior submissions remain pertinent to the proposal currently before the Commission and are accordingly also attached to the present correspondence for ease of reference (Attachment 1).

TGen provides the feedback set out in Attachment 2 in response to each of the questions posed by the Commission in the Consultation Paper.

If you have any queries in relation to any of TGen's submissions, please contact me by email hieu.nguyen@territorygeneration.com.au or by phone on (08)7979 2509.

Yours sincerely

Hieu Nguyen
General Manager People & Governance

16 July 2024

Attachment 1 - Submissions by TGen submitted to NTESMO dated 29 September 2023
Attachment 2 – Submissions by TGen – response to questions – Consultation paper

TGen reference: TGD2023/70936

Anna McGill
Manager Regulation & Policy
Power and Water Corporation
Email: Anna.mcgill@powerwater.com.au

Dear Ms McGill

NTESMO Revenue Proposal Consultation – Submissions - Territory Generation (TGen)

I refer to your email dated 29 August 2023 in regard to the above matter.

Please find below TGen's submissions.

1. Re-coup of old costs retrospectively

1.1 Under the caption "Steep increase in regulated charges in next regulatory period" at page 4, the Northern Territory Electricity System and Market Operator (NTESMO) proposes to increase the regulated charges by System Control and the Market Operator. The proposal is to increase from the FY25 charges to FY26 for System Control from 0.0056 cents/kWh to 0.0207 and for Market Operator from 0.00060 kWh to 0.00411 kWh. It is stated that there is a shortfall between FY20 and FY25 of approximately $37 million and that NTESMO's proposal is to recover that shortfall in the remaining two year period of FY2027 and FY2028.

1.2 The regulated charges to the NTESMO for the relevant period are paid by system participants and customers. Accordingly, the charges for the period FY2020 to FY2025 will be paid by the system participants and customers who are system participants and customers in the years FY2020 to FY2025.

1.3 The NTESMO proposes to recover the shortfall during that period from system participants and customers retrospectively in FY2027 and FY2028 from customers and system participants in those years who are not necessarily the same customers and system participants from the years FY2020 to FY2025.

1.4 The NTESMO has not set out the legal basis for such a course of action.

2. Steep increase in proposed charges

2.1 The NTESMO proposal is to increase from the FY25 charges to FY26 for System Control from 0.0056 cents/kWh to 0.0207 and for Market Operator from 0.00060 kWh to 0.00411 kWh.

2.2 The System Control charges increase by 269% in one year whereas the market Operator charges increase by 585% in one year. The reason attributed by NTESMO is that they failed to anticipate the increase in costs relating to increase in solar penetration and incident response costs. It is not clear why the increase in solar penetration was not anticipated given the NT Government's policy target of 50% renewables by 2030 is well known. There is no comparable information relating to incident responses.

2.3 It is TGen's submission that such a steep increase of 269% and 585% respectively cannot be justified by regulatory means, especially considering the basis for such a move and imposes an unfair burden on current market participants.

3. Ancillary Services – reimbursements parallelly

3.1 TGen provides ancillary services to Power and Water Corporation (PWC) and has no means of independently adequately charging for such services. This anomaly will only be rectified when the Australian Electrical Rules (AER) are adopted by the Territory fully.

3.2 The rate of $5.40 that TGen is being paid presently, which has not been adjusted to reflect the increase in service level or inflation since 2014, has failed to maintain parity with the cost of service provision.

3.3 In the absence of the System Controller amending the current rate, TGen will have to wait for the adaptation of AER provisions fully (if it happens) to receive adequate reimbursement for these services. NTESMO has access to readily available mechanisms to increase its charges.

4. Various arms of PWC seeking revisions in charges independently of each other

4.1 In addition to NTESMO seeking revision of its charges, it is known that Network Services are also currently seeking revisions in their charges.

4.2 The NTESMO has stated that parts of corporate costs are included in its proposal to increase its charges.

4.3 Various arms of PWC are independently seeking revisions of their charges. The Utilities Commission will benefit by having a full picture, if all these independent revisions are presented as a combined amount with breakdowns, to determine whether corporate and administrative costs are properly distributed among various business units and that there is not in fact “double dipping” for the same costs. This is important because PWC is in a unique position of having semi-regulatory arms such as System Controller, Network Operator and Market Operator who have the means of obtaining regulatory charges unlike other government departments and corporations.

5. Increase in costs is universal taken together with restricted budget and recruitment freeze in the NT

5.1 It is not in dispute that operation costs have increased, including for NTESMO, and the budget situation in the Territory is tight.

5.2 Government bodies are required to tighten their spending whilst on restricted budgets. While all other government bodies are operating in such circumstances, it would be an anomaly for PWC to circumvent such restrictions through regulatory means and increase their charges by 269% for System Control and 595% for the Market Operator.

If you have any queries, please do not hesitate to contact me by email eddie.mallan@territorygeneration.com.au or by phone on 0490 021 529.

Yours sincerely

Eddie Mallan
General Manager, Commercial

29 September 2023

ATTACHMENT 2

Territory Generation (TGen)'s feedback in response to questions posed by the Utilities Commission in the Consultation Paper - Review of NTESMO 2024-27 System Control and Market Operator Charges Regulatory Proposal

Q1 Do stakeholders agree the building block model is an appropriate method to calculate NTESMO's allowed revenues for the upcoming and future regulatory periods? Why or why not?

A: TGen is of the view that whilst the building block model is an appropriate approach to calculate NTESMO's allowed revenues, it is important to establish clarity on what constitutes each building block suggested.

Q2 Do stakeholders agree NTESMO's proposed 3-year regulatory period (for the upcoming period only) is reasonable? Why or why not?

A: TGen views the proposed 3-year period as appropriate to respond to current uncertainties, however, notes that it is equally important to balance short-term responsiveness with long-term planning and investment incentives. A clear transition plan and rationale for returning to a 5-year period would help mitigate uncertainty and align stakeholders' expectations.

Q3 Do stakeholders agree NTESMO's proposed approach to corporate overheads reasonable? Why or why not?

A: NTESMO's proposed approach to corporate overheads appears reasonable, however due to NTESMO being a business unit within PWC the corporate overheads allocation should be regularly reviewed and audited by an appropriate independent external party.

Q4 Do stakeholders consider NTESMO's proposed base-step-trend approach to forecasting operating expenditure, with the base year to be set as the most recent year of audited actual operating expenditure is reasonable? Why or why not?

A: TGen suggests referring to NT Government guidelines that are aligned with best practice. NTESMO's proposal appears reasonable in light of the information available.

Q5 Do stakeholders agree NTESMO's application of CPI to escalate professional fees, residual costs, and graduate and undergraduate contracts over the upcoming regulatory period is not appropriate? Why or why not?

A: NTESMO's use of a weighted average of three escalation rates for personnel costs is complex and deviates from simpler industry practices. Streamlining the escalation methodology to align with industry benchmarks, such as using a labour cost growth rate based on independent forecasts, would enhance transparency and comparability.

Q6 Do stakeholders support inclusion of a productivity factor within the regulatory framework, to be applied in future regulatory periods? Why or why not?

A: TGen supports the inclusion of a productivity factor within the regulatory network, provided that details on the calculation of the productivity factor is provided to stakeholders to understand the impact on existing cost structures and regulatory tariff estimates.

Q7 Do stakeholders support NTESMO's proposed approach to capitalisation? Why or why not?

A: TGen agrees with the Commission that the proposed approach to capitalisation would require further explanation from NTESMO.

NTESMO has not set out the accounting basis for the departure from the accounting standards. The capitalisation of expenditure and forecast capital expenditure should **not** vary from accounting standards. TGen has concerns over this proposed approach and the accountability of NTESMO, as they propose to report and forecast outside of accounting standards.

Q8 Do stakeholders agree that the third capital expenditure assessment approach is the best option given the electricity market reform uncertainties as they relate to NTESMO? Why or why not?

A: In light of ongoing market reform and related uncertainties, NTESMO's approach to the third capital expenditure assessment is appropriate if aligned well with best practices adopted by regulators of similar size and governance functions.

Q9 Are there any other approaches the Commission should consider in terms of assessing NTESMO's proposed capital expenditure?

A: The Commission should consider several alternative approaches when assessing NTESMO's proposed capital expenditure:

1. Benchmarking: Comparing NTESMO's proposed capital expenditure against industry peers or benchmarks could provide insights into the reasonableness and efficiency of the expenditures.
2. Scenario Analysis: Conducting scenario analyses to assess the impact of different market reform outcomes on NTESMO's capital expenditure plans can help in determining robustness and flexibility.
3. Risk-adjusted Discounted Cash Flow (DCF): Using a DCF model that incorporates risk adjustments for uncertainty in market reforms can provide a clearer picture of the value and viability of NTESMO's proposed investments.
4. Qualitative Assessment: Considering qualitative factors such as strategic alignment, technological advancements, and regulatory compliance alongside quantitative financial metrics can offer a more holistic evaluation.
5. Peer Review or Expert Panel: Engaging external experts or forming a peer review panel to evaluate NTESMO's capital expenditure proposals can provide independent validation and diverse perspectives.

Q10 Do stakeholders have any concerns regarding NTESMO's proposed capital (depreciation) approach? If so, what are the concerns?

A: The depreciation approach needs to align with the asset's useful lives, consumption, and in line with accounting standards.

Q11 Do stakeholders agree the WACC value calculated by the AER for PWC's regulated electricity networks should be used rather than that proposed by NTESMO? Why or why not?

A: In principle, the Weighted Average Cost of Capital (WACC) value calculated by the AER for PWC's regulated electricity networks is certainly a better method of calculation than NTESMO's proposal.

However, it should be noted that the period of calculation to apply should be from 25/26 rather than 24/25 (if intended). The period 24/25 is covered already by the interim arrangement approved by the Commission. Please also see TGen's response to Question 7.

It is suggested that NTESMO cite its source and provide additional information to the Commission on how the indicated WACC rate was determined for the benefit of stakeholders.

Q12 Do stakeholders have any concerns regarding NTESMO's proposal regarding the tax allowance?

A: NTESMO is a business unit within PWC and is not a separate tax entity. NTESMO has calculated a forecast value of zero corporate tax liability and it proposed there will be a negative tax building block.

Q13 What are stakeholder's views on the application of the list of information, requested under the NT NER, for the Commission to determine whether an uncertainty mechanism event has occurred? Is there anything additional that should be included?

A: TGen views the application of the information list under the NT NER for determining uncertainty mechanism events as appropriate at the current stage of consultation, noting the potential for change based on ongoing market reforms.

Consideration should be given to include definitive/indicative timelines between the identification/occurrence of the event and the financial impacts from the event. This will contribute to the framework that is in development which will be of benefit to all stakeholders involved in the electricity market.

Q14 What are stakeholder's views on the application of the list of events, used by the AER, to NTESMO? Are there any additional events that should be considered?

A: TGen is of the view that the need for alignment between the AER's list and NTESMO's operational context should be given sufficient consideration to ensure effectiveness in managing electricity supply and grid stability in the Northern Territory. Additional events that are specific to the NT's unique geographical and environmental conditions, such as extreme weather patterns (e.g. cyclones) or local infrastructure challenges (e.g. remote area supply disruptions) should also be given due consideration. These proposed additions aim to enhance the comprehensiveness of event classifications, ensuring that NTESMO can effectively monitor and respond to all significant factors impacting electricity generation and distribution in the region.

Q15 What are stakeholder's views on the application of a materiality threshold? If supported, what would a reasonable materiality threshold be given NTESMO is an 'asset light' entity?

A: TGen's view on the application of a materiality threshold for NTESMO should be cautiously considered to ensure it effectively captures significant operational events without imposing undue administrative work. A reasonable threshold would ideally reflect the unique operational dynamics and infrastructure constraints within the Northern Territory, enabling generators to focus resources on maintaining reliable electricity supply while complying with regulatory requirements. Clear guidelines and transparent criteria for determining material events would be crucial to ensure fairness and predictability in regulatory oversight, thereby fostering a stable and competitive electricity market environment.

Q16 Do stakeholders agree with the Commission views to not consider NTESMO performance incentives for the upcoming regulatory period? Why or why not?

A: Respectfully no. Performance incentives will encourage operational efficiency and reliability improvements, which could benefit overall grid stability and consumer satisfaction. It may become a driver going forward to align NTESMO's objectives more closely with market needs and regulatory expectations. However, it is also important to take note that the practicality and fairness of introducing incentives may be questioned, particularly if NTESMO's current operational framework or infrastructure constraints limit its ability to meet performance targets effectively. Furthermore, the type of performance incentives for NTESMO will depend on the overall assessment of the entity's capabilities, the potential benefits versus risks of implementing incentives, and NTESMO's broader objectives for maintaining reliable electricity supply and grid management in the Northern Territory.

Further, performance incentives should be flagged or determined that they will be applicable from the next regulatory period (2025/2026 to 2026/2027) so that NTESMO could better prepare for that eventuality. This is standard practice across Government departments with KPIs etc.

Q17 Do stakeholders support the proposed cost incentive approach? Why or why not?

A: TGen is supportive of the proposed cost incentive approach if it can be established that it will foster efficient operations and cost management within NTESMO. Clear and fair performance metrics would be crucial to ensure transparency and accountability in how cost efficiencies are measured and rewarded. One key reservation would be that stringent cost targets should not lead to adverse outcomes which could hinder necessary investments in infrastructure maintenance and upgrades as required. In particular, support could be extended to incentives that encourage NTESMO to minimise operational expenses without compromising grid reliability or service quality.

Q18 Do stakeholders agree with NTESMO's proposed approach for calculating regulated charges? Why or why not?

A: TGen is supportive of a transparent methodology that accurately reflects the costs and operational realities of NTESMO's role in managing the electricity grid. TGen would seek assurances that the charges are reasonable and equitable, ensuring that cost recovery does not disproportionately burden electricity producers. TGen would value a methodology where details around the X-factor (page 19) are explained and how it may incentivise efficient operations and investments in grid infrastructure while maintaining grid reliability and stability.

Q19 Do stakeholders agree with the Commission's initial view not to accept NTESMO's proposal regarding its opening RAB value for the current 5-year regulatory period (2019-2024), and instead set the value as zero? Why or why not?

A: TGen agrees with the Commission. The Commission's reasons are sound and agreed to by TGen. In addition, the Commission's reasoning to set the RAB value at zero should be extended to the year 2024/2025 for the same reasons in addition to the fact that the interim arrangements are in place and approved by the Commission for 2024/2025. There was no proposal put forward by the NTESMO for that period. The new mechanism should commence from 2025/2026.

Q20 Do stakeholders agree with the Commission's initial view to apply the proposed cost incentive approach to NTESMO's full overspend, consistent with the proposed approach to future any future overspends? Why or why not?

A: Regulated Asset Base (RAB) represents the amount that future consumers must pay back to past investors – (page 20, para 5 in Chapter 4). Hence, it is vital to get it right the RAB figures and the commence period. TGen agrees with the Commission's initial view to apply the proposed cost incentive approach which is consistent with the proposed approach to future overspends with emphasis on 'future overspends'.

For this calculation on future overspend, the RAB figures and when they apply is vital. It appears that the Commission intends to apply the RAB figure from 2024/2025 rather than 2025/2026.

The NTESMO states “[t]he capital expenditure is retrospectively added to the RAB in the years incurred and recovered via depreciation across the ‘asset life’ along with a return on capital. The resulting opening RAB value in 2024/2025 would be $12 million” (page 21 under Option 2). The NTESMO has failed to provide details as to how this figure was arrived at, nor the legal basis to claim retrospectively. Retrospective enforcement of laws is exceedingly rare and generally only where the intention is made quite clear in the wording of the law.

The Commission states “NTESMO’s proposal regarding how much of the overspent expenditure is recovered appears somewhat arbitrary”- (page 21 under Option 2). The last paragraph on page 21 under Option 3 states “According to NTESMO’s revenue model, the total amount of capital expenditure overspend across the current 5 year period is $19.75 million.” It is surprising that the NTESMO relies on a model rather than provide the actual figures for the current period ending 30 June 2024. The actual figures should be provided to the Commission rather than rely on modelling for purposes of any calculation of the RAB.

Further, from the estimated modelling value of $19.75 million, the NTESMO arrived at the figure of $18 million as the RAB value as of 2024/2025. Firstly, NTESMO has not provided details as to how they arrived at that figure. Secondly, the relevant period of RAB should be 2025/2026 as the interim arrangement applies to the period commencing 1 July 2024 ending 30 June 2025.

Q21 Do stakeholders agree that the difference between actual revenues in 2024 25 and allowed revenues (as determined by the Commission) be added to NTESMO’s RAB and depreciated across a set ‘asset life’ or seven years? Why or why not?

A: TGen is of the view that revenue adjustments and depreciation methodologies be aligned to best practices as recommended by relevant NT government authorities.