

ON NEGOTIATING POWER PRICES WITH A LARGE NEW LOAD

{The views set out in this note represent guidance provided to Power and Water (and other interested parties) as to the Utilities Commission's likely interpretation of certain regulatory instruments.}

Role of the Ring-fencing Code

1. The *NT Electricity Ring-fencing Code* (as amended April 2002) effectively establishes 'Chinese walls' around the monopoly parts of Power and Water's business (in the Code termed a "prescribed business"), by placing limits on the accounting, information sharing and pricing conduct of these monopoly businesses.
2. Quite clearly, the Code does not:
 - establish Chinese walls between Power and Water's different monopoly businesses; or
 - place any limits on the pricing or other conduct of any of Power and Water's contestable businesses (in the Code termed a "related business").
3. In a case involving Power and Water's pricing to a large new load:
 - the only relevant prescribed business is Power and Water's networks business; and
 - P&W Generation and P&W Retail are related businesses for the purposes of the Code.
4. Perhaps less obviously, there can be no breach of the Code in pricing situations where there is an absence of any competitor to one of Power and Water's related businesses. With regard to pricing, breaches of the Code can only arise in circumstances where:
 - a prescribed business is offering to provide goods or services to a competitor of one of its related businesses (under clause 4.1(e)); and
 - a prescribed business is tendering to procure goods or services from a competitor of one of its related businesses (under clause 4.1(f)).
5. In the situation where a competitor to one of Power and Water's related businesses might emerge at a later date, the test is whether Power and Water's prescribed business would be prepared to offer (or pay) such prices to that competitor upon its later entry to the market. Provided any discounted network access tariffs complied with the Commission's network tariff discounting framework (see below), such a discount would be expected to also meet this requirement of the Code.
6. In situations where one of Power and Water's contestable businesses is not in fact in competition with any third-party generator or retailer, any other limits placed on the pricing activity of Power and Water's businesses – whether contestable or monopoly – is an exercise of Power and Water's discretion (including in light of its broader legal obligations), and not an obligation under the Code.

Network discounting framework

7. Under clause 4(b) of the Commission's *Framework for Negotiation of Discounted Network Tariffs* (issued May 2002), network tariffs may be negotiated below the approved reference tariffs where there is a genuine threat of network "by-pass" by a particular end-use customer – either in whole or in part.

8. Bypass includes "economic" bypass, where a service, if priced at the nearest reference tariff, would not be used.

9. The principal requirements to be met by any discounts offered by P&W Networks under the Framework are that:

- the discount be no larger than that necessary to:
 - enable a user (or prospective user) to use a network service where the nature of the market in which the user operates is such that the service, if priced at the nearest reference tariff, would not be used; or
 - ensure any savings in network costs elsewhere in the system as a result of a user's demand or location or load or import characteristics are appropriately shared with that user; and
- other users be no worse off as a result of the discount compared to the situation where the discount was not offered.

10. The Framework effectively endorses negotiation of network tariffs for an eligible new user within the range of:

- at the lower bound, the *incremental* cost of service provision; and
- at the upper bound, the average (i.e., fully distributed) cost of service provision.

11. When it comes to assessing that part of total costs that would be avoided by the service provider during the specified period of time if it were not to provide a service to the user in question, such an assessment should not be limited to shallow connection assets but should consider all system assets.

12. Under the sanctioned long-run incremental cost approach, capital recovery is only envisaged if any new connection is likely to result in system augmentation within the forthcoming capital planning period.

Scope for generation (and retail) discounting

13. Lest there is any doubt, the Commission's *Contestable Pricing Guidelines* (issued September 2001) provide only limited guidance, being restricted to certain aspects of pricing in a specific set of circumstances.

14. In particular, the Guidelines indicate:

- the requirements that may be necessary if pricing is to avoid being found to be "anti-competitive" under the complaints provisions of the *Electricity Reform Act*, which by its nature applies in circumstances where a third-party retailer or generator is competing with P&W Generation or P&W Retail; and
- the requirements that may be necessary if pricing is to avoid being found to be "discriminatory" under the Ring-fencing Code, which by its nature applies in circumstances where a third-party retailer is competing with P&W Retail.

15. In these regards, the Guidelines:

- set out certain lower bounds (or a floor) to be observed for pricing;
 - provide guidance applicable where Power and Water is in competition with a third-party generator or retailer; and
 - provide guidance on discriminatory pricing offers made by P&W Generation to competing retailers.
16. The Guidelines do *not*:
- provide guidance on any upper bounds (or a ceiling) regarding prices;
 - necessarily apply to situations where pricing is made in the absence a third-party generator or retailer; or
 - provide guidance on the avoidance of a finding of discriminatory pricing by P&W Retail among different customers of the same type or class.
17. Also of note is that these are Guidelines only. An actual finding would also depend upon the circumstances of the particular case. The possibility of “economic bypass” of the power system by the end-use customer or load in question would be a relevant consideration in the Commission coming to an actual finding.
18. For all the above reasons, in situations where one of Power and Water’s contestable businesses is not in fact in competition with any third-party generator or retailer, any limits placed on the pricing activity of Power and Water’s contestable businesses is an exercise of Power and Water’s discretion (including in light of its broader legal obligations), and not a requirement under the Guidelines.
19. Moreover, nothing in the Guidelines precludes P&W Generation or P&W Retail from following discounting logic identical to that endorsed for use by P&W Networks in the networks discounting framework, in such a way that would avoid an adverse finding of unfair price discrimination among end-use customers.

Utilities Commission
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