

23 September 2009

FROM THE OFFICE OF THE
CHIEF EXECUTIVE OFFICER

Mr Andrew Reeves
Utilities Commissioner for the Utilities Commission
38 Cavenagh Street
Darwin NT 0800

Level 12
15 William Street
Melbourne VIC 3000
Postal Address:
GPO Box 2008
Melbourne VIC 3001
T 03 9648 8777
F 03 9648 8778

Dear Mr Reeves,

**Re | REVIEW OF OPTIONS FOR FULL RETAIL CONTESTABILITY FOR NORTHERN TERRITORY
ELECTRICITY CUSTOMERS**

The Australian Energy Market Operator (AEMO) welcomes the opportunity to provide the Utilities Commission with feedback on the options for implementation of full retail contestability in the Northern Territory.

Attached for your review, marked as Appendix A, is AEMO's response to the Utilities Commission's Issues Paper seeking comment on the options for implementing FRC.

If you or your staff have any queries please don't hesitate to contact either myself or Terry Grimwade, Executive General Manager Market Development (terry.grimwade@aemo.com.au).

Yours sincerely



Matt Zema
Managing Director and Chief Executive Officer

Appendix A

(1) Is the current lack of wholesale price transparency an impediment to FRC, and if so, what should be done, if anything to provide greater wholesale price transparency in the Northern Territory prior to introducing FRC?

AEMO Response

A lack of wholesale price transparency is not an insurmountable barrier to Full Retail Competition (FRC). For example, FRC has been introduced and has been operating for a number of years in the retail gas markets of NSW, ACT, SA and Queensland. To date, these markets are characterised by bilateral contract trades, with no spot market or price transparency.

However, AEMO's experience in both gas and electricity market implementations throughout Australia has demonstrated that full price transparency provides significant benefits in facilitating competition and greater participation of FRC.

The concept of a "level playing field" is important in broad terms. However, there may well be structural imbalances that exist, particularly in the early life of any developing FRC market. While size and incumbency will naturally tilt the playing field, where there is price transparency at the wholesale level, 2nd tier entrants can build business models that can still provide value, particularly in the development of market niches for greater consumer benefit.

The chosen mechanism to establish a transparent wholesale price in the Northern Territory should be one that recognises the role of separate networks and the nature of the power generation and the unique role of each in the market.

AEMO is currently developing a Short Term Trading Market (STTM) for the gas markets in NSW and South Australia, and this has demonstrated that it is possible to develop a spot market with transparent pricing signals that accommodates pre-existing production and transportation contracts. AEMO would be willing to offer assistance to NT in considering options in this regard.

(2) Is the current structure of Power and Water an impediment to FRC and if so, what further changes if any should be made to the structure of Power and Water prior to introduction of FRC?

The fact that Power and Water is a vertically integrated Generator, Distributor and Retailer places the organisation in a position of market power and will deter the entry of new players. As stated in the issues paper, the current organisation already uses internal cross subsidies to meet the cost of providing power to the NT. As a matter of principle this situation must be resolved to remove any likely barriers to competitors entering the NT market. Disaggregation or ring-fencing (if there is no disaggregation) of Power and Water present two possible solutions to this, or perhaps separating the upstream, transmission/distribution and retail

business functions. A range of possible models for this exists among the eastern/southern states in terms of their electricity and gas utilities, many of which still remain under common State Government ownership.

(3) What actions might the Government take to provide the retail margins required to improve the prospects for competition?

AEMO has no detailed comment on this issue at this time, but other jurisdictions have dealt with this issue – in particular, Victoria in preparation for privatisation of its electricity and gas retail businesses.

(4) Should the introduction of FRC be staged on a regional basis? Should unmetered loads be contestable as part of FRC?

It is possible to stage the introduction of FRC and this has been the common approach adopted by many jurisdictions, typically by customer size or category, rather than on a regional basis. In considering a regionally staged approach, care would need to be taken to ensure this does not create an unintended disincentive for new entrants or unintentionally result in the relocation of businesses.

Provided there is adequate development of suitable algorithms or an estimation methodology, then there is no clear reason to preclude unmetered loads from contestability.

(5) Should mandatory interval metering be a precondition of retail contestability? Is there any need to defer FRC until NSMP requirements and any implementation in the Territory have been considered?

FRC has been successfully implemented for electricity and gas markets across the eastern states of Australia (& elsewhere in the world), without the deployment of smart meters. This demonstrates that FRC is not dependent and does not require smart metering to be implemented in the first instance. The Northern Territory should only consider mandating smart meters where there is a demonstrated cost benefit case for that jurisdiction and its consumers.

AEMO does however recommend a study be conducted to determine the appropriate consumption level at which 'interval' metering be mandated to ensure reliable load profiles can be calculated that equitably apportions the accumulation meters across the wholesale pricing periods. Without this, large loads without interval meters on the network have the potential of "skewing" the profile that would be used to apportion accumulation meters.

(6) Is the current bi-lateral contract market an impediment to FRC and should reform of this market be considered prior to introducing FRC?

Bi-lateral contract markets in themselves are not an impediment to FRC, with existing jurisdictions in the NEM operating under various models, for example NSW has introduced FRC through government mandated rules. There are examples in the gas industry where FRC has been introduced on top of a wholesale supply side that is managed under bi-lateral contracts (see comments above re the STTM being implemented in NSW and SA in June 2010).

That said however, there may be benefits in reforming current contract arrangements to facilitate an optimum market design for NT FRC. This is a decision that should be taken after careful consideration of the proposed implementation conditions to facilitate FRC and any associated market arrangements, and would need to consider the implications of enforcing changes to pre-existing bi-lateral contracts.

(7) Should Power and Water generation's wholesale pricing be subject to oversight and what form should this oversight take?

It is AEMO's view that in the interests of the future development of the Northern Territory power arrangements, and consistent with the regulatory regime as has been implemented for the national energy market, Power and Water's pricing arrangements and behaviours in the competitive market (along with that of its competitors) should be subject to oversight by the AER.

(8) Should Power and Water Generation be required to publish firm prices for specific terms and products?

In so far as Power and Water continues to be a regulated monopoly provider of energy it should be treated in the same way as other regulated monopoly service providers and be required under a regime overseen by the AER to publish its regulated service and related pricing.

(9) Do you have any comments on the load profiling regime proposed for use in the Northern Territory – i.e. simple net system load profiles defined for each regulated network?

A simple NSL profile is only viable in any discrete network so long as it has been implemented after a study into and the implementation of an appropriate threshold of consumption above which interval meters are mandated. Large loads with poor load factors can have a significant impact on the shape of a NSL profile and therefore has the potential of "skewing" the allocations of the broader population in the network relying on accumulation meters.

(10) Are there any Territory specific terms you think should be included in the standard contract?

AEMO has no comment to make on this issue, other than to say that if Northern Territory arrangements are different to other jurisdictional arrangements it may potentially generate unintended barriers for retailers to create products and consumer benefits.

(11) Should an electricity ombudsman's office be established at the time FRC is introduced?

AEMO has no firm view on this matter, but offers the observation where in other jurisdictions the introduction of an Ombudsman has provided a valuable service in curbing questionable behaviours from participants by providing oversight and making effective mechanisms available for considering customer complaints.

(12) Do you have comments on these options and are there other options this review should consider?

A – Implementation of FRC on 1 April 2010 or as soon as practicable thereafter.

B – Reschedule FRC and adopt a program of additional reforms to support the development of competition.

C – Postpone FRC until conditions more favourable to competition develop.

Option A: As stated in the paper, without conducting a review of electricity framework reform options, there is a risk that FRC may be enabled without appropriate processes or systems being in place, and create a greater risk of stifling competition. The additional costs associated with a new entrant trying to establish a presence in the market will discourage new entrants and potentially delay the benefit of FRC developing.

In addition, if the systems and processes are not defined at market opening, new entrants will be reticent to enter as they would not be able to cost their internal systems and processes needed to be in place and therefore cost their products.

Option B: AEMO supports Option B, as this option would allow:

An opportunity to review and determine appropriate profiling arrangements for the accumulation meters and a threshold for interval metering at the large consumer end of the market; and

A opportunity to assess options to provide wholesale pricing transparency and the implementation of appropriate arrangements prior to the opening of the last two tranches

Option C: AEMO supports full retail competition consistent with NEM Objectives to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers. AEMO supports deregulation and reform of the electricity market to ensure a suitable framework is in place to support competitive pricing, quality, safety, reliability and security of supply of electricity to consumers.