

**REVIEW OF FULL RETAIL  
CONTESTABILITY FOR  
NORTHERN TERRITORY  
ELECTRICITY CUSTOMERS**

**DRAFT REPORT**

**OCTOBER 2009**



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## **Request for submissions**

This Draft Report sets out the Utilities Commission's draft assessment of the issues and recommendations for the Review of Full Retail Contestability for Northern Territory Electricity Customers.

Written submissions are invited from interested parties on issues raised in this Draft Report.

Submissions can be sent electronically to [utilities.commission@nt.gov.au](mailto:utilities.commission@nt.gov.au).

Alternatively, submissions can be mailed to:

Executive Officer  
Utilities Commission  
GPO Box 915  
DARWIN NT 0801

The closing date for submissions is **Monday 23 November 2009**.

## ***Confidentiality***

The Commission intends making submissions publicly available to facilitate an informed and transparent consultative process. However, if a person 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.

## ***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.

Information about the role and current activities of the Commission, including copies of reports, papers and submissions, can also be found on the Commission's website.

## ***Inquiries***

Inquiries about the Draft Report or about lodging submissions should be directed to the Executive Officer on (08) 8999 5480.



**CHAPTER****1****EXECUTIVE SUMMARY****Introduction**

- 1.1 In August 2009 the Treasurer approved Terms of Reference (ToR) for the Utilities Commission (Commission) to undertake a review of Full Retail Contestability (FRC) for Northern Territory electricity customers. The purpose of the review is to generate options for the implementation of FRC in the Territory on 1 April 2010 and assess the merits of each.

**Scope of Inquiry**

- 1.2 The Commission is to report on the objectives of FRC in the Territory context, the conditions necessary for competition to develop in the Territory, and the prudent actions Government should take to encourage the development of competition. The inquiry is to present the various options for the design and rules of FRC arrangements for electricity in the Territory and make an assessment of the likely costs, benefits, and feasibility of each.
- 1.3 The Commission is required to make recommendations as to the most efficient option. In making its assessment, the Commission is required by its ToR to consider:
- both the costs of FRC and the likelihood that FRC will confer benefits to consumers;
  - the option of further postponement of contestability of some or all remaining tranches;
  - the context of the existing market arrangements, potential market structure reforms and efforts to improve consistency between Australian energy markets;
  - the Territory's commitments under the Competition Principles Agreement, Australian Energy Markets Agreement, and Council of Australian Governments (COAG); and
  - developments in other jurisdictions and in particular the National Energy Customer Framework (NECF) being developed by the Ministerial Council on Energy.
- 1.4 The inquiry is also to report on appropriate terms and conditions for potential standard supply contracts and the contract design most likely to promote an efficient outcome.
- 1.5 An Issues Paper was prepared for the purpose of soliciting comment from interested parties on options for implementing FRC in the Territory. This draft report considers the submissions received in response to the Issues paper and provides recommendations.

## Objectives of FRC in the Northern Territory Context

- 1.6 FRC was a requirement of the National Competition Council (NCC) for certification of the Territory's third party access regime under the Trade Practices Act in 2000. Certification was considered desirable by the Territory Government because it establishes a legal avenue for third parties to access network infrastructure. Thus one objective of introducing FRC in the Territory is retention of a certified third party access regime.
- 1.7 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.
- 1.8 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 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.
- 1.9 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.

## Necessary Conditions for Development of Competition

- 1.10 Research into contestable retail markets worldwide shows that the major determinants of competitive activity are:
  - efficiency and sufficiency of wholesale markets;
  - extensive unbundling (i.e. separation) of retail, distribution and generation; and
  - sufficient price float, volatility and margins.
- 1.11 Elsewhere, FRC has been introduced following substantial reform of markets and industry structure. At the time FRC was introduced, such reform had either resulted in some wholesale market competition providing retailers with a number of wholesale electricity procurement options, or with the prospect of such a situation developing over a reasonable timeframe. An objective of FRC in these cases was to provide for the benefits of upstream reform to be passed onto electricity end users.
- 1.12 In the case of the Territory, where there has been limited wholesale market reform, no industry structural reform, and no development of wholesale or retail market competition, an important question is whether to proceed to introduce FRC without first undertaking some additional market, industry structural, and retail tariff reforms.
- 1.13 Assuming that at the time FRC is introduced in the Territory there is no competition in the supply of wholesale electricity, any retail competition will be on the basis of retailers' cost to serve. However, in view of current regulated retail prices not providing a positive retail margin it will be problematic for new entrant retailers to compete on this basis.
- 1.14 The introduction of FRC in the Territory albeit in the absence of prior and accompanying market and industry structure reforms will result in a larger directly



contestable market providing the possibility of a competitor to PWC developing generation to support its own retail operations. However this possibility will not become a commercial opportunity while the allowance for wholesale energy in retail tariffs remains below the new entrant generation cost.

## Encouraging the Development of Competition

- 1.15 Considering the necessary conditions for the development of competition, there are a number of actions that 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, 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.
- 1.16 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.

## Options for FRC

- 1.17 The ToR require the Commission to make recommendations as to the most efficient option. In considering the efficiency of the options, the Commission has had regard not only to the costs and benefits, but also to the objectives of FRC in the Territory context. These include implementation of FRC as a foundation for further reform to align the Territory market with national energy markets.
- 1.18 The classes of options the Commission has considered relate to timing and preparation for FRC, together with consideration of systems which might be appropriate for each option. They are broadly:
- A – Proceed to implement FRC on 1 April 2010 or as soon as practicable thereafter. In the absence of accompanying reforms, the prospect of significant competition is low and it is considered appropriate to use existing systems for customer transfer and market settlements until there is further market development. A program of additional reforms to support the development of competition could be developed and initiated after FRC is in place.
- B – Reschedule FRC and adopt a program of additional reforms to support the development of competition. Under this option, Territory-specific systems for market settlements and customer transfers might be appropriate but adoption of NEM systems would be preferable to enable national retailers to operate from established and familiar systems. Systems are developed to provide for a higher level of activity than under option A.
- C – Postpone FRC until conditions more favorable to competition develop (without committing to an additional program of reform).
- 1.19 Option B is considered in two forms – B1, which assumes that systems for managing FRC are developed and operated locally, and B2, which assumes that the

Australian Energy Market Operator (AEMO) is retained to provide FRC management services and to the extent possible the AEMO's NEM FRC systems are used (without the Territory necessarily joining the NEM or adopting the NEM style of wholesale market settlement). The implementation of FRC under option B is preceded by a particular prior reform aimed at addressing wholesale energy price transparency by requiring PWC to offer standard wholesale energy contracts to retailers. These standard contracts become the basis for wholesale market settlements and procedures are specified to deem the parameters relevant to the contract prices from accumulation meter readings (a form of load profiling).

- 1.20 On the basis of a high level review of the costs of establishing and operating FRC under these arrangements, it is estimated that FRC could be established under option A for around \$500 000. It seems reasonable that under this option the annual cost of supporting a level of activity of up to three requests per day would be around \$150 000. To support a level of activity of up to 30 requests per day it may be necessary to examine process improvements and undertake some limited automation. At a higher level of activity a more substantial investment in systems would be required. One-off capital expenditure on systems in excess of \$1 million and an increase in annual operating cost of a similar amount would not be unrealistic.
- 1.21 Establishment costs are higher for option B1 than for option A and are estimated at around \$1.5 million with annual operating costs of around \$1 million.
- 1.22 Under B2 AEMO performs the FRC management role. This avoids the cost of establishing this function and associated systems locally. Establishment cost under this option is estimated at around \$750 000 with annual operating cost of a similar amount.
- 1.23 With respect to timing, assuming that the FRC start date is announced on 1 January 2010, estimated delivery times for options A, B1 and B2 are six months, twenty-one months and fifteen months respectively. This corresponds to start dates of 1 July 2010, 1 October 2011, and 1 April 2011 respectively.
- 1.24 It should be noted that none of the cost estimates is based on fully automated FRC systems. Given the small size of the Territory market, it is unlikely that fully automated FRC systems would be required.<sup>1</sup>
- 1.25 Clearly option C has no associated costs.
- 1.26 The Commission considers that the public benefit of introducing FRC in the Territory is small as it is unlikely that retail competition will emerge in the absence of a number of other prior reforms. In other jurisdictions, the absence of public benefit associated with low prospects for the development of competition has been the basis for deferring FRC (option C). Importantly the objective of FRC in these jurisdictions has been achieving retail competition rather than retail contestability (with 'in principle' competition).
- 1.27 However one objective of FRC in the Territory context is to maintain certification of the Territory's access regime, with a further objective of laying a foundation for further reform by demonstrating a commitment in principle to retail competition in electricity supply. Option A meets these objectives at relatively low cost and with a relatively short implementation time. Once FRC is introduced under this option, the Commission believes that the issues of cost-reflective and transparent retail and wholesale energy pricing should be pursued as a basis for undertaking reforms to

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<sup>1</sup> Under Queensland's Minimalist Transitioning Approach, Ergon Energy uses manual systems that must support up to 40 NMI creation requests per day which is equivalent to annual churn of 10 per cent in the Territory context. Discussions with Ergon based on the experience of that business with FRC so far suggest that a fully manual system could have been put in place for a cost of between \$1 million and \$2 million.

further improve the prospects of new entry in the Territory market and the development of competition.

- 1.28 Options B1 and B2 include elements designed to improve the prospects of competition developing but it is uncertain whether the value of the benefits associated with these improved prospects exceeds the additional cost over option A. Should Government choose to implement FRC under option A, it would retain the possibility of pursuing the desirable features of B1 and B2 at a later date.

## Recommendations

- 1.29 The Commission is required to report on the objectives of FRC in the Territory context, the conditions necessary for competition to develop in the Territory, prudent actions the Territory Government should take to encourage the development of competition and to recommend the most efficient option for the design and rules of FRC.
- 1.30 The Commission recommends that if FRC is introduced in the Territory, Option A would appear to be the most efficient, with removal of the legislative barrier to competition from April 2010 or soon thereafter. Relevant considerations include:
- Scope of FRC – that contestability be extended to all customers located in the three regulated networks with the exclusion of un-metered loads.
  - Requirement for interval metering – that interval metering not be mandatory for customers with annual consumption below 160 megawatt hours (MWh).
  - Customer transfer systems – existing PWC systems be used for customer transfer but as part of the rules of FRC, a threshold level of retail market activity should be specified such that if it is exceeded, PWC will be required to upgrade its systems to cater for a specified higher activity level.
  - Customer protection – that Government either extend the scope of the Territory Government Ombudsman to act on complaints in relation to electricity retailers, or approve the establishment of an industry Ombudsman.
  - Standard supply contracts (retail) – that the design be based on the model terms and conditions specified under the NECF and that the design be subject to further consultation along with the other documents, codes, rules and procedures necessary to support FRC in the Territory.
  - In negotiating with retailers in the capacity of wholesale electricity supplier, PWC should be prohibited from stipulating interval metering of customers with annual consumption less than 160MWh as a condition for entering a contract.
- 1.31 The Commission considers that the prudent actions Government should take to encourage the development of competition include:
- discovery and publication of the wholesale price component of retail tariffs;
  - a study of wholesale and retail costs and prices to identify cross subsidies inherent in the PWC pricing system and to establish a transition to cost reflective prices with Territory Government subsidies to give effect to social and economic policy objectives;
  - PWC to commence a study of load profiling in anticipation of other generators participating in the Territory's balancing arrangement without the need for interval metering of its sub 160MWh per annum customers, and to improve its knowledge of customer characteristics;
  - the Territory Government, the Commission and PWC should continue with the policy of adopting, where practical and appropriate for the Territory, NEM-style

regulatory systems and practices. Although in the short term and until cost-reflective tariffs are developed the existing PWC systems for settlements and retail market processes are appropriate, in the longer term, and for effective competition to develop, NEM-style processes and systems will be preferred to reduce barriers to entry for national retailers; and

- the Territory Government to investigate whether, in the longer term, a structural reform of PWC for the further promotion of competition and investment would deliver a net benefit to the Territory.

## CHAPTER

## 2

## INTRODUCTION

## Background

- 2.1 Under National Competition Policy (NCP), all Australian jurisdictions are committed to introducing competition in the electricity generation and retail market sectors. Full retail contestability (FRC) has now been fully implemented in all jurisdictions apart from the Territory, Western Australia and Tasmania.
- 2.2 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 Trade Practices Act in 2000. 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.
- 2.3 Table 1 shows the Territory electricity customer tranches by date of introduction of contestability and minimum annual consumption.

**Table 1: Introduction Dates for Contestability in the Northern Territory**

Tranche	Date of Introduction	Minimum Annual Consumption (MWh)
1	1 April 2000	4,000
2	1 October 2000	3,000
3	1 April 2001	2,000
4	1 April 2002	750
5	1 April 2010 (scheduled)	160
6	1 April 2010 (scheduled)	0

- 2.4 Since April 2000, tranche 1 to 3 customers (large to medium business, Defence and government customers) have progressively become contestable in the Territory and pay tariffs determined by commercial negotiation. Tranche 4 customers are also contestable, but most pay retail tariffs capped by the Territory Government.
- 2.5 Tranches 5 and 6 (typically small businesses and households) are currently non-contestable. Such customers can only be supplied by the Power and Water Corporation (PWC) and pay subsidised retail electricity tariffs that are uniform regardless of location and cost of supply.
- 2.6 Tranche 5 and 6 customers were originally to become contestable in 2003 and 2005 respectively. However in February 2003 the Government postponed contestability for these customer tranches for 5 years, due to the lack of competition. In October

2007, the 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.

- 2.7 At the present time, despite the fact that the larger customers have been contestable for a number of years, PWC is the sole retailer to Territory customers and the sole wholesale supplier to the regulated networks.

### Scope of Inquiry

- 2.8 In August 2009 the Treasurer approved Terms of Reference (ToR) for the Utilities Commission (Commission) to undertake a review of FRC for Territory electricity customers. The purpose of the review is to generate options for the implementation of FRC in the Territory on 1 April 2010 and assess the merits of each. The Commission is to report on the objectives of FRC in the Territory context, the conditions necessary for competition to develop in the Territory, and the prudent actions Government should take to encourage the development of competition. The inquiry is to present the various options for the design and rules of FRC arrangements for electricity in the Territory and make an assessment of the likely costs, benefits, and feasibility of each.
- 2.9 The Commission is required to make recommendations as to the most efficient option. In making its assessment, the Commission is required by its ToR to consider :
- both the costs of FRC and the likelihood that FRC will confer benefits to consumers;
  - the option of further postponement of contestability of some or all remaining tranches;
  - the context of the existing market arrangements, potential market structure reforms and efforts to improve consistency between Australian energy markets;
  - the Territory's commitments under the Competition Principles Agreement, Australian Energy Markets Agreement, and Council of Australian Governments (COAG); and
  - developments in other jurisdictions and in particular the National Energy Customer Framework (NECF) being developed by the Ministerial Council on Energy.
- 2.10 The inquiry is also to report on appropriate terms and conditions for potential standard supply contracts and the contract design most likely to promote an efficient outcome.
- 2.11 The timetable guiding the Commission's consultation process is set out below.

Due Date	Event
25 September 2009	submissions on the Issues Paper due
October 2009	publication of the Commission's Draft Report
23 November 2009	submissions on the Draft Report due
31 December 2009	Final Report provided to the Minister

## Overview of Submissions to the Issues Paper

- 2.12 The Commission released an Issues Paper for the purpose of soliciting comment from interested parties on options for implementing FRC in the Territory on 28 August 2009. The Issues Paper was directed at testing the assumed outcomes of a number of specified options and also identifying any further options. This draft report details the Commission's consideration of the views expressed in the submissions received, and provides recommendations in respect of the options.
- 2.13 In response to its Issues Paper the Commission received six public submissions and one confidential submission. Public submissions were received from:
- Energy Supply Association of Australia (ESAA);
  - Northern Territory Major Energy Users (NTMEU);
  - Australian Energy Market Operator (AEMO);
  - Power and Water Corporation (PWC);
  - Somerville Community Services Inc and UnitingCare Wesley Adelaide (SCSI & UCWA); and
  - Northern Territory Treasury (NTT).
- 2.14 An overview of the public submissions is provided here. Comments made by interested parties in relation to the specific issues raised in the Issues Paper and the Commission's responses to these comments are included later in the relevant sections of this Draft Report.

### ***Energy Supply Association of Australia***

- 2.15 Citing the present lack of competition for the existing contestable customer tranches, ESAA considers that there is little merit in following the present FRC schedule without further reform. ESAA considers further that "an important initial reform area is regulated retail tariffs" and that "for prospective retailers to enter regulated markets confidently, it is imperative that pricing determinations enable retailers to recover the efficient costs of supply." The ESAA considers there is merit in exploring the potential for other reforms (achieving greater wholesale price transparency and stronger ring fencing of PWC's businesses) to promote competition and be of net benefit. With respect to broader reforms (including structural reform and adoption of NEM wholesale market arrangements), while supporting firmly national regulatory frameworks, ESAA counsels "a strong rationale and detailed analysis to ensure that expected benefits outweigh expected costs"

### ***Northern Territory Major Energy Users***

- 2.16 This submission focuses on the absence of "effective electricity wholesale or retail competition in the Territory at any level of usage" and states the view that this is unlikely to change while PWC continues as a vertically integrated business. The NTMEU considers that moving to FRC without significantly increasing competition will result in greater hardship for electricity consumers and considers there may be merit in reducing FRC as this will enable large users to discuss their concerns directly with Government.

### ***Australian Energy Market Operator***

- 2.17 The AEMO submission is based on its experience as an operator of competitive electricity and gas markets and deals mostly with implementation issues. However it does comment on a number of other issues pointing out that their resolution is important to remove barriers to prospective retailers entering the market. AEMO does not consider that a lack of wholesale price transparency is an "insurmountable

barrier” to retail competition and cites the introduction of FRC into the gas markets of NSW, ACT, SA and Queensland (in the case of Victoria AEMO operates a spot market). However it states that in its experience in implementing gas and electricity markets throughout Australia, “full price transparency provides significant benefits in facilitating competition and greater participation of FRC”. It also considers that the market power and vertically integrated structure of PWC will deter the entry of new players. With respect to implementation options, the submission highlights the risk that proceeding with FRC without systems and processes defined would in itself deter the entry of retailers.

#### ***Power and Water Corporation***

- 2.18 According to its submission, PWC’s principal concern is “ensuring it has the necessary capability and systems to support whichever implementation option is ultimately chosen by Government”. PWC states that it presently has a very low capability to transfer customers and that the development of greater capability would entail “significant delays and costs”.

#### ***Somerville Community Services Inc and UnitingCare Wesley Adelaide***

- 2.19 This submission concentrates on the issue of electricity affordability particularly for lower income and disadvantaged households. The submission presents analysis of the income sensitivity of the cost of electricity to households showing that “while actual electricity use increases with income, the proportion of household income spent on that electricity decreases sharply with income”. In support of its concern over the future affordability of electricity, the submission also refers to the fact that Australian electricity prices have risen, on average, at “a significantly higher rate” than the consumer price index (CPI) over the last decade, and cites drivers for further price increases. The observation is also made that “the introduction of competition into electricity markets, through FRC, has not reduced energy costs for customers in either Victoria or South Australia, generally regarded as the most competitive electricity markets in the world”.
- 2.20 The submission considers that “the best approach to FRC in the Territory is to defer consideration of its introduction for residential and small business customers, until at least the attainment of effectively competitive markets for large business customers”. The submission was supportive of further enhancing customer protection in the electricity market and expressed the concern that owing to its comparatively small size, the residential electricity market of the Territory is unlikely to benefit from the application of competition principles.

#### ***Northern Territory Treasury***

- 2.21 NTT states its supports for the principle of FRC while recognising the practical difficulties and limitations around its introduction in the small Territory market. NTT is of the view that given the current regime of regulated electricity tariffs in the Territory, a key objective of FRC, being lower retail prices resulting from increased retail competition, is unlikely to emerge.
- 2.22 According to NTT, FRC could be introduced with initially manual systems to handle churns, with an evaluation of benefit of developing automated systems once “competition becomes a reality and customer churn reaches a predetermined level.”
- 2.23 NTT states that it would support the introduction of FRC if it could be introduced “cost effectively with a net public benefit”. NTT considers it “highly unlikely” that a net public benefit could be demonstrated at the present time. NTT considers that “the recommendation around developing appropriate rules and procedures for operation under FRC while not developing systems, has merit “ and further “this option recognises the ‘in principle’ benefits of competition, while simultaneously recognising the constraints to retail competition deriving from the very small Territory market.” According to NTT, this option establishes the legal framework for



FRC, maintains network access certification, and “moves the Territory some way along the reform process without incurring very large upfront establishment costs.” NTT also envisages that as result of establishing contestability, “currently non-contestable customers would move to standard contracts and the government or independent regulator would establish a maximum price until effective competition emerges.”

- 2.24 NTT considers that there is little merit in rescheduling FRC in order to undertake prior reforms. According to NTT “the reforms themselves have the potential to be very costly and take place over a lengthy time frame”.

#### ***A national retailer’s view of preconditions for FRC***

- 2.25 As no submissions were received from retailers, it may be appropriate to refer briefly to Origin Energy’s submission to the Tasmanian public benefit assessment of full retail competition. This submission emphasised the full ring-fencing of retail and network functions (suggesting the separation of the distribution and retail businesses), the unwinding of pricing cost subsidies and establishment of cost reflective pricing prior to FRC and (referring to the possibility of adopting “minimalist approaches” to systems), the use of “the fully automated systems and procedures used in other NEM jurisdictions including the full suite of business to business protocols”. While stating that it seeks FRC in every jurisdiction “as the best framework for customers to receive a choice of suppliers offering a range of energy products and services”, Origin Energy submitted that “Tasmania should concentrate on establishing a suitable market framework that will allow competition to thrive rather than contemplate the further release of additional customer sub tranches”. With respect to the issue of adequate market liquidity, Origin Energy suggested “restricting any new and ongoing government ownership of generation assets”. The Origin Energy submission also emphasised the importance to prospective retailers of having national consistency and a low cost of entry.

### **Objectives and Prospective Benefits of FRC in the Northern Territory**

- 2.26 The Commission is required to report on the objectives of FRC in the Territory context, the conditions necessary for competition to develop in the Territory and the prudent actions Government should take to encourage the development of competition.
- 2.27 FRC was a requirement of the NCC for certification of the Territory’s third party access regime under the Trade Practices Act in 2000. Certification was considered desirable by the Territory Government because it establishes a legal avenue for third parties to access network infrastructure. Thus one objective of introducing FRC in the Territory is retention of a certified third party access regime.
- 2.28 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.
- 2.29 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 systems, and the vertically integrated structure of 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.
- 2.30 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.

- 2.31 Assuming that at the time FRC is introduced in the Territory there is no competition in the supply of wholesale electricity, any retail competition will be on the basis of the retailers' cost to serve. However, current regulated retail prices do not provide a positive retail margin (that is to say current retail prices do not fully cover PWC generation and network costs). Further retention of the vertically integrated structure of PWC, which provides some flexibility in transferring profits and losses between the various arms of the total business, will make it problematic for new-entrant retailers to compete unless subsidies are applied in a consistent and transparent manner.
- 2.32 The existence of a larger directly contestable market provides the possibility of a competitor developing generation to support its own retail operations rather than looking to PWC as its supplier of energy. However without cost reflective retail tariffs, this possibility falls short of being a commercial opportunity for a new entrant.

### Options for FRC

- 2.33 The classes of options the Commission has considered relate to timing and preparation for FRC, together with consideration of systems which might be appropriate for each option. They are broadly:
- 2.34 A – Proceed to implement FRC on 1 April 2010 or as soon as practicable thereafter. In the absence of accompanying reforms, the prospect of significant competition is low and it is considered appropriate to use existing systems for customer transfer and market settlements until there is further market development. A program of additional reforms to support the development of competition could be developed and initiated after FRC is in place.
- 2.35 B – Reschedule FRC and adopt a program of additional reforms to support the development of competition. Under this option, Territory-specific systems for market settlements and customer transfers might be appropriate but adoption of NEM systems would be preferable to enable national retailers to operate from established and familiar systems.
- 2.36 C– Postpone FRC until conditions more favourable to competition develop (without committing to an additional program of reform).
- 2.37 Option B is considered in two forms – B1, which assumes that systems for managing FRC are developed and operated locally, and B2, which assumes that the AEMO is retained to provide FRC management services and to the extent possible the AEMO's NEM FRC systems are used (without the Territory necessarily joining the NEM or adopting the NEM style of wholesale market settlement). The implementation of FRC under option B is preceded by a particular prior reform aimed at addressing wholesale energy price transparency by requiring PWC to offer standard wholesale energy contracts to retailers. These standard contracts become the basis for wholesale market settlements and procedures are specified to deem the parameters relevant to the contract prices from accumulation meter readings (a form of load profiling).

**CHAPTER****3****ELECTRICITY MARKET REFORM IN AUSTRALIA AND THE NORTHERN TERRITORY**

- 3.1 This section considers the context within which the proposal to introduce FRC is being made. It takes account of:
- commitments by the Territory Government and the history of reform in the Territory;
  - the experience of other Australian jurisdictions in implementing FRC and the prior prospects for FRC to be beneficial; and
  - the Territory's experience to date with retail competition for larger customers.
- 3.2 A discussion of electricity market reform in Australia and the Territory electricity market is provided as background.

**Electricity Market Reform in Australia**

- 3.3 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.

***National Competition Policy***

- 3.4 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.

- 3.5 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.
- 3.6 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>2</sup> In part, NCP requires:
- competitive neutrality to ensure that publicly owned businesses do not enjoy any net competitive advantage arising from their public ownership;
  - 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.
- 3.7 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>3</sup>

#### ***Ministerial Council on Energy***

- 3.8 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>4</sup>
- 3.9 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>5</sup>

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

- 3.10 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>6</sup>
- 3.11 Subsequently, all Australian governments entered into the Australian Energy Market Agreement (AEMA) in June 2004 to give effect to the MCE 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

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<sup>2</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>3</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>4</sup> Ministerial Council on Energy, December 2003, Report to CoAG on Reform of Energy Markets, page 3.

<sup>5</sup> Sourced from [www.mce.gov.au](http://www.mce.gov.au), on 10 October 2005.

<sup>6</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.

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>7</sup>

- 3.12 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, Australian Competition and Consumer Commission (ACCC), the Australian Energy Market Commission (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.

### **Exemptions**

- 3.13 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>8</sup>
- 3.14 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 AEMC; and
  - establishing a timeframe for the phase out of retail price controls, subject to effective competition.
- 3.15 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>9</sup>
- 3.16 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

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<sup>7</sup> Australian Energy Market Agreement, section 2.1.

<sup>8</sup> Council of Australian Governments, Australian Energy Market Agreement, 30 June 2004.

<sup>9</sup> The independent authority will be the AEMC in all jurisdictions except Western Australia, which will use its Economic Regulatory Authority (ERA).

Victoria, determining competition to be effective in both jurisdictions. At its meeting in Darwin in July 2009, the MCE directed AEMC to review the effectiveness of retail competition in the ACT in 2010, New South Wales in 2011, Queensland in 2012 and Tasmania in 2013.<sup>10</sup>

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

- 3.17 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.
- 3.18 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.
- 3.19 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.
- 3.20 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>11</sup>

### ***National Smart Metering Program (NSMP)***

- 3.21 In April 2007 COAG committed to a national mandated roll-out of electricity smart meters (SM) to areas where benefits outweigh costs, as indicated by the results of a cost-benefit analysis taking account of different market circumstances in each state and territory and the circumstances of different groups of consumers.<sup>12</sup> The cited paper explains that MCE will review the progress of pilots and business cases which are established under the program annually, starting in June 2009. A review of findings, including any resulting revision in the cost and benefits for each jurisdiction or specific businesses, will occur by June 2012, at which point MCE will further review jurisdictional deployment plans and any requirement for further analysis. In the interim, jurisdictions may choose to consider implications for a range of existing jurisdictional policies, such as new and replacement interval metering and existing direct load control arrangements, to optimise the transition to smart metering.
- 3.22 On 13 June 2008, the MCE decided it would further develop with stakeholders a consistent national framework for smart metering in the NEM recognising that

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<sup>10</sup> MCE Communiqué, Darwin, 10 July 2009.

<sup>11</sup> MCE Communiqué, Darwin, 10 July 2009.

<sup>12</sup> Smart Meter Decision Paper, MCE, 13 June 2008.

consistency between NEM and non NEM jurisdictions will also be sought where beneficial given different market arrangements. Objectives of the NSMP include:

- defining a regulatory framework for the NEM to underpin SM, and consideration of arrangements in Western Australia and the Territory;
- developing specifications and proposals for changes to NEM and other jurisdictional rules and procedures (including consideration of arrangements in the Western Australian market), and to establish and implement other elements of the framework; and
- coordinating and reporting on SM pilots as part of an overall plan for the potential deployment of SM services in the NEM, and considering arrangements for SM pilots and deployments in other jurisdictions (including in Western Australia).

3.23 Stakeholder leadership to the NSMP is provided by the National Stakeholder Steering Committee (NSSC), with secretariat and project support from AEMO.

3.24 The regulatory framework<sup>13</sup> is intended to cater for the provision of SM in the following circumstances –

- by distributors directed by a jurisdictional Minister to roll-out a defined minimum functionality of SM infrastructure (mandated roll-out); and
- by a party other than pursuant to a direction by a jurisdictional Minister (discretionary rollout).

3.25 A discretionary roll-out may be adopted in the following circumstances –

- for a smaller or more targeted customer base than a mandated roll-out and parties may wish to include functionality beyond the minimum requirements; and
- by parties after the end of a mandated roll-out, including the possibility of contestable provision of SM (post mandated roll-out period).

3.26 A number of smart metering trials and pilots are being conducted under the program with the intent of informing the development of recommendations on the technical and operating regulatory framework to support the implementation of smart meters for small customers and validating business cases for rollouts. A rollout of smart meters (450 sites – 150 with photovoltaics) is underway in Alice Springs as part of the Solar Cities trials.<sup>14</sup>

3.27 The 3 July 2009 Exposure Draft of the National Electricity (South Australia) (Smart Meters) Amendment Bill 2009 sets out proposed requirements for Ministerial metering determinations (pilot and smart meter rollout).

## Northern Territory Electricity Market

3.28 The Territory electricity market currently consists of three separate regulated networks in the Darwin/Katherine region, Alice Springs and Tennant Creek. A 132 kV transmission line connects Darwin and Katherine. No other systems are interconnected. The competitive electricity market regime is in force for those customers deemed contestable (i.e. consuming over 750 MWh a year) in the

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<sup>13</sup> SM NEM Regulatory Architecture Paper, 19 June 2009, Regulation Work Stream, National Smart Metering Program.

<sup>14</sup> Pilots and Trials 2008 Status Report to the Ministerial Council on Energy, National Stakeholder Steering Committee, National Smart Meter Program, 12 June 2009.

- regulated Darwin/Katherine, Alice Springs and Tennant Creek systems and elsewhere.
- 3.29 Additionally, there are a large number of un-regulated, small stand alone systems supplying remote indigenous communities and non-gazetted tourist and mining townships.
- 3.30 Power in the regulated systems is 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 contract by PWC.
- 3.31 Electricity for 72 remote indigenous communities is provided by a Government appointed service provider (presently the PWC subsidiary company Indigenous Essential Services (IES) through the Budget funded IES program. Remote tourist and mining townships are provided electricity either on a contractual basis by a Government appointed service provider or by the associated mining firm.<sup>15</sup> Power generation in these communities is fuelled largely by distillate.
- 3.32 With 2008-09 electricity demand of nearly 1,900 GWh p.a. and 82,889 customers, the market for electricity in the Territory is small compared to other Australian jurisdictions. For example the smallest NEM jurisdiction in terms of customer numbers and demand is Tasmania where there are some 273,000 small businesses and domestic customers consuming 2,680 GWh per annum.<sup>16</sup>
- 3.33 Relevant statistics pertaining to the Territory electricity market are published annually by the Commission. Table 2 below shows information on electricity market demand from the publication for the year ending 30 June 2009. From the viewpoint of introducing FRC, a small market presents two major issues. The first is the smaller number of customers over which the fixed costs of FRC systems can be recovered resulting potentially in higher per customer FRC 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.

**Table 2: Electricity Demand (regulated and non-regulated networks)**

	Regulated	Non-regulated	Total
<b>Contestable</b>			
Energy Usage (GWh pa)	515	143	658
No. Customers	174	4	178
<b>Non-contestable</b>			
Energy Usage (GWh pa)	1,069	144	1,213
No. Customers	71,963	10,748	82,711
<b>Total</b>			
Energy Usage (GWh pa)	1,584	287	1,871
No. Customers	72,137	10,752	82,889

<sup>15</sup> The Power and Water Corporation is currently the Government appointed service provider for the IES program.

<sup>16</sup> Public Benefit Assessment for Electricity Retail Competition in Tasmania, Office of the Tasmanian Energy Regulator, May 2008.



## Government commitments and history of reform in the Territory

- 3.34 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 Trade Practices Act;
  - instigation of a timetable for phased introduction of full retail competition; 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.
- 3.35 However, since that time no new market entry has occurred and the Territory electricity supply industry continues to operate under a monopoly market structure.
- 3.36 In 2006 and 2007, Northern Territory Treasury conducted a review of the electricity market regulatory framework to identify impediments to the associated policy objectives of efficient and reliable electricity supply.
- 3.37 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.
- 3.38 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.
- 3.39 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.
- 3.40 In May 2008, the Territory Government 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.
- 3.41 Submissions made to the draft policy paper were generally supportive of the paper's findings and Northern Territory Treasury commenced preparation of a final policy paper for consideration by the Territory Government.
- 3.42 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, prompted Government to commission an independent review of the financial sustainability of PWC in February 2009.

- 3.43 The review, which was conducted by Mr Andrew Reeves and finalised in April 2009, found that:
- on current projections revenue from tariffs and community service obligation funding will not be sufficient to sustain viability and fund infrastructure investment over the five year SCI period; and
  - the significant capital expenditure planned by PWC would lead to substantial increases to interest charges such that by 2010-11 it would be necessary to borrow to fund interest payments.
- 3.44 As a result, the review recommended substantial increases in revenues from tariffs and a more detailed review of the PWC's capital investment program.
- 3.45 In response, Government announced the following tariff increases in regulated retail electricity, water and sewerage tariffs, from 2009-10.

**Table 3: Increases in regulated retail electricity, water and sewerage tariffs**

<b>Tariff Increase</b>	<b>2009-10</b>	<b>2010-11</b>	<b>2011-12</b>	<b>2012-13</b>
Electricity	18%	5%	CPI	CPI
Water	20%	20%	20%	CPI
Sewerage	20%	20%	20%	CPI

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

### **Experience of other Australian jurisdictions**

- 3.48 In Australia and elsewhere, the introduction of FRC in electricity 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 had developed prior to the commencement of FRC.

- 3.49 The NEM commenced in December 1998 with New South Wales, Victoria, Queensland and South Australia as participating jurisdictions. With physical connection in prospect, Tasmania joined in 2005.
- 3.50 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 full retail competition 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.
- 3.51 In Tasmania, FRC had been scheduled for introduction in July 2010. However this was subject to the findings of a public benefit assessment<sup>17</sup> which proposed, in a Draft Report that “competition should be extended to all small business and residential customers at such a time as the Government is confident that the structural and market arrangements in the electricity supply industry are able to support high levels of activity in mass market electricity retailing”. Specific conditions were identified as being access to competitively priced wholesale energy, a wholesale energy market that would be responsive to upstream competitive pressures arising from retail competition, and the cost of the systems required to support retail contestability not imposing an unreasonable burden on electricity consumers. The assessment found that “current circumstances and experience to date suggest that these conditions are not likely to be satisfied by 1 July 2010”. Tasmania has not yet confirmed a date for the implementation of FRC.
- 3.52 In Western Australia the retail electricity market has been progressively opened to competition since 1999. From 1 January 2005, all electricity customers consuming more than 50MWh per annum have been eligible to choose an electricity retailer. Section 55 of the Electricity Corporations Act 2005, requires the Western Australian Government to conduct a review to ascertain the benefits associated with full retail competition in electricity. It is a requirement that this review be initiated after April 2009. However FRC was considered as part of a wider electricity retail market review process. At the present time final recommendations have been made in respect of electricity tariff arrangements only. The report found that current electricity tariffs are not cost reflective and recommended that Government select a glide path for the residential and small customer electricity tariffs to reach forecast cost reflective levels. In relation to FRC, the point was made that:

*“Cost reflective retail tariffs are essential for the development of a competitive electricity retail market. If retail tariffs do not reflect the cost of supplying electricity, including an appropriate margin, then retailing electricity will not be a viable business activity. New entrants will be unlikely to enter the market, and existing retailers may exit.”<sup>18</sup>*

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<sup>17</sup> Public Benefit Assessment for Electricity Retail Competition in Tasmania, Office of the Tasmanian Energy Regulator, Draft Report, May 2008.

<sup>18</sup> Government of Western Australia, Office of Energy, Electricity Retail Market Review, Final Recommendations Report, Review of Electricity Tariff Arrangements, January 2009.

## Experience in the Northern Territory to date

- 3.53 Only one firm has entered the Territory electricity market to compete with PWC. NT Power Pty Ltd 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% 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 firm surrendered its generation and retail licences and totally withdrew from the market in November 2002.<sup>19</sup>
- 3.54 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 other applications.

## Wholesale Market Arrangements

- 3.55 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. An overview of the corresponding NEM arrangements is provided for comparison and will be useful subsequently when the systems to support FRC are discussed.

### *National Electricity Market (NEM)*

- 3.56 The centre piece of the 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 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.

### *Northern Territory – Regulated Systems*

- 3.57 Third-party access to the services provided by prescribed electricity networks in the Territory is currently governed by the Network Access Code which is a schedule to the Electricity Networks (Third Party Access) Act. Part 2 of the Code establishes the terms and conditions under which access to an electricity network is to be granted to third parties and lays down the processes to be followed in negotiating and implementing access agreements and resolving access disputes.
- 3.58 When retail competition was introduced in the Territory in April 2000, it was not considered feasible to establish a wholesale electricity pool.<sup>20</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

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<sup>19</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.

<sup>20</sup> "Implementing Economic Dispatch, Background Paper", Utilities Commission, January 2002.

(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.

- 3.59 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.

### ***Northern Territory - Non-Regulated Systems***

- 3.60 Electricity for the 72 remote indigenous communities is provided by a Government appointed service provider through the Budget funded IES program. There is a formal agreement between PWC’s subsidiary company Indigenous Essential Services Pty Ltd and the Department of Local Government, Housing and Sport which sets out the terms and conditions of supply (including price), effectively overriding the provisions of the Electricity Reform Act.
- 3.61 The non gazetted remote tourist and mining townships are provided electricity either by PWC or by the associated mining firm.
- 3.62 For those townships serviced by PWC, electricity is supplied under PWC’s standard customer contract at the gazetted uniform retail tariffs set by Government.
- 3.63 For those townships serviced by an associated mining firm, the terms and conditions of supply are a matter for negotiation between that mining firm and electricity users (usually employees of that mining firm).
- 3.64 In some instances, PWC will source supply of electricity from the mining firm for on-supply to government users in the township or for on-supply to nearby indigenous communities. Such agreements are commercially negotiated between the mining firm and PWC, with PWC on-supplying to government customers under its standard contract or to indigenous communities under its contractual arrangements.

## **Retail Contestability Arrangements**

### ***National Electricity Market (NEM)***

- 3.65 Retail contestability arrangements in NEM jurisdictions consist of the NEM FRC systems and customer transfer processes and local jurisdictional requirements largely concerned with customer protection (protection against unfair practices, dispute resolution, and monitoring and enforcement). For instance among NEM jurisdictions different approaches have been taken to the regulation of off-business premises sales including the terms and permissibility of door to door sales, telephone marketing agreements and non-contact sales agreements. With respect to customer protection, the NECF aims at achieving consistency at a national level.
- 3.66 In general, the introduction of FRC in the NEM jurisdictions has been accompanied by local customer protection measures including the establishment of an ombudsman’s office, the requirement that incumbent retailers continue to supply customers in the event that they choose not to go onto a market contract with their

current or another retailer, and the requirement that they act as a retailer of last resort in the event that other retailers discontinue serving the customer.

- 3.67 For example in Victoria, electricity retail contestability has been governed by three major codes – Energy Retail Code (ERC), Code of Conduct for Marketing Retail Energy (marketing code), and Electricity Customer Transfer Code (ECTC). Other consumer protection measures include Guideline on Explicit Informed Consent, Guidelines on Credit Assessment, Guideline on Product Disclosure, and under the Electricity Industry Act, wrongful disconnection payment legislation, and hardship policies legislation.
- 3.68 The ERC provides that retailers must bill customers for electricity at least every three months, that bills must include information including whether the bill is based on actual or estimated use and that meters must be read at least once every twelve months. The ERC also provides for retailer obligations in respect of payment difficulties including installment plans and stipulates that disconnection must be preceded by the issue of a reminder notice and disconnection warning.
- 3.69 The marketing code addresses the training, product and code knowledge of marketing representatives and personal and telephone contact with consumers. Specifically it requires marketers to give customers a date from which the retailer will be responsible for the electricity service to the address and advice that the transfer will take some time.
- 3.70 The ECTC operates in conjunction with the retail transfer processes performed by AEMO. It sets out Victoria’s NMI (National Meter Identifier) standing data requirements and the process for customer transfer. It is also concerned with cooling off protections providing that proposed transfers must be initiated as soon as practicable after the expiry of the cooling off period.
- 3.71 Within the NEM, AEMO provides the systems and processes to support competition and choice for end-users in the retail electricity market. These systems enable the transfer of customers between registered NEM retailers and perform wholesale market settlements between AEMO and retailers based on the actual and deemed time-of-use consumption of customers for each retailer at each transmission connection point (TNI). To support these functions AEMO also maintains metering installation level standing data together with a reference NMI.
- 3.72 As suggested by its name, MSATS (Market Settlements and Transfer Solution), AEMO’s FRC system is integrated with the NEM’s wholesale market settlement function. Indeed its end objective can be considered to be the calculation of the wholesale cost of energy for a retailer at each TNI where it has customers. Accordingly, essential information associated with each NMI would be the financially responsible retailer, the TNI (to which the relevant regional reference price is referred for calculating the cost of energy), billed consumption, and the type of meter indicating, where consumption is not metered on an interval basis, which load profile to apply to the billing period consumption. With this information, MSATS performs NEM billing producing aggregated half-hourly data at each TNI for each retailer.
- 3.73 A principal issue for a jurisdiction introducing FRC is the population of AEMO’s CATS (Customers Administration and Transfer System) with standing data and MDM (Meter Data Management System) with historical meter reads. This is an activity for the distribution businesses as they have this data initially. The most important part is the association of street addresses with NMIs. In going about to build a customer base organically, a new-entrant retailer will usually start with a street address and then require the NMI in order to obtain additional information including consumption data. This process is called “NMI discovery”. An important consideration for implementation of FRC is whether to fully populate CATS prior to the commencement of FRC so as to provide for fully automated NMI discovery, or opt for a less automated discovery and populate as interested retailers request

information. This was part of the “Minimalist Transitioning Approach” adopted by Ergon Energy in agreement with the Queensland Government as part of Queensland’s FRC arrangements. The “Minimalist Transitioning Approach” was developed on the basis of an expectation of low churn in the Ergon distribution supply area, where, as a result of Queensland’s uniform tariff policy, it would not be profitable for new-entrant retailers to supply customers.

### ***Northern Territory***

- 3.74 Part 3 of the Electricity Reform (Administration) Regulations sets out the basis on which a customer is classified as contestable. Customers are classified as contestable solely on the basis of their electricity consumption. The Regulations make no distinction between customers located on regulated networks and customers on non-regulated networks. In theory, any customer anywhere in the Territory could be contestable if they satisfy the electricity usage benchmark, even those in indigenous communities.
- 3.75 PWC is currently the only electricity supplier holding a retail licence authorising the sale of electricity to non-contestable customers. PWC’s non-contestable (franchise) retail business is ring-fenced from its contestable retail business.
- 3.76 PWC Franchise Retail is required by licence conditions to:
- take reasonable steps to identify when its non-contestable customers will or could become contestable customers and to give those customers at least 28 days notice of that fact and specifying the manner in which the notice is to be given; and
  - request these non-contestable customers to give written consent to the electricity entity providing their names, addresses and other contact details from time to time to the Commission and the Commission providing that information to other electricity entities holding licences authorising the selling of electricity;
  - to offer to sell electricity to contestable customers on the same terms and conditions including same tariff schedule that applied to those customers immediately before becoming contestable customers for a period specified in the Regulations after they become contestable customers – the period specified in regulations is 2 years and referred to the ‘grace period’;
  - requiring the electricity entity to take reasonable steps to give the customers at least 28 days notice of the date on which the specified period will expire.
- 3.77 At the commencement of the current regime, in the interests of ensuring a level playing field, PWC’s contestable retail business agreed that it would not approach contestable customers to negotiate supply arrangements until it was formally notified of their contestability status by the Commission at the same time as other third-party retailers.
- 3.78 Contestable customers must negotiate with a licensed retailer for supply of electricity. Terms and conditions of supply, including price, are a matter for commercial negotiation between the customer and the retailer. (If a customer has not negotiated contestable supply arrangements by the end of their 2 year grace period, PWC Franchise will continue to supply them as a ‘default customer’ but generally at a higher tariff than the gazetted tariff. Default terms and conditions are required under its licence to be ‘fair and reasonable in the circumstances’ and are published on PWC’s website.)
- 3.79 The Territory currently has a ‘straight line’ supply chain, with the retailer contracting with the network provider on its customers’ behalf, rather than the ‘triangular’ relationship where a customer has a direct contract with the network provider.

- 3.80 [Currently, licensed generators in the Territory are only authorised to sell wholesale electricity to electricity entities holding a retail licence or a generation licence. Thus an end-use customer cannot buy directly from a generator and makes its own arrangements with the network provider for transport of electricity through the system. (NT Power had separate generation and retail licences, as does PWC).]
- 3.81 Owing to the relatively small number of contestable customers, PWC's systems for contestable customers are rudimentary and largely manual. Further, since there are currently no active or even licensed retailers other than PWC, these systems are not used.



**CHAPTER****4****CONDITIONS FOR RETAIL COMPETITION****Overview**

4.1 The conditions for retail competition have been reviewed in a number of jurisdictional issues papers and public benefit assessments concerned with the introduction of FRC as well as papers reporting research into customer switching. The Utility Customer Switching Research Project<sup>21</sup> monitors customer switch rates and trends in over 50 competitive energy retail markets worldwide. In its 2007 year world ranking, it reports Australia as the most active region in the world rating Victoria and South Australia as “Hot” (highest ranking with annual switching 15% or higher) and New South Wales and Queensland as “Warm Active” (second highest ranking with annual switching between 9.5% and 15%). This research identified the following as the top ten macro determinants of switching :

- efficiency and sufficiency in wholesale markets;
- extensive unbundling of retail, distribution and generation;
- sufficient price float, volatility and margins;
- new market entrants (gen-retailers if necessary);
- powerful autonomous competition oriented regulators;
- depleted incumbent advantages;
- switching desensitisation;
- switching momentum;
- political devolvement; and
- time.

4.2 Of these, the first three are considered the most important and are discussed further here.

**Efficiency and sufficiency in wholesale markets**

4.3 Arguably this condition can be considered to have been achieved in the NEM regions of Victoria, South Australia, New South Wales and Queensland where wholesale electricity contracts are actively traded and contract prices quoted by brokers and on exchanges. There is relatively less activity in the Tasmanian region (which does not have full retail competition) where despite being physically

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<sup>21</sup> Utility Customer Switching Research Project, World Energy Retail Market Ranking, Fourth Edition, October 2008.

connected to the NEM, there are few if any providers of wholesale contracts other than the dominant generator Hydro Tasmania. However the Tasmanian regional reference price does serve to provide some transparency as its relative to the Victorian regional reference price is a potential basis for the pricing of wholesale contracts. In Western Australia, where a wholesale market has been established and is operating in the South-West, the issue is whether there are a sufficient number of players to support competition and the need to ensure development of market mechanisms that facilitate short and longer term trading and contracting.<sup>22</sup> Price transparency in this market is provided by STEM (Short Term Energy Market) and reserve capacity prices published by the Independent Market Operator (IMO).

- 4.4 In the Territory there is an absence of transparency in the wholesale electricity market with no public disclosure of either spot or contract wholesale electricity prices. As a consequence of the vertically integrated structure of PWC, wholesale electricity prices exist only internally to PWC as transfer prices between business units. Prior to introducing FRC, greater transparency of wholesale electricity pricing could be provided by establishing and publishing spot prices (either by creating a spot market as a component of wholesale market reform or requiring System Control to output spot prices (ex-ante or ex-post) as part of their dispatch process) and / or by having PWC regularly publish prices for wholesale electricity contracts for different terms and durations (which could be imposed by amending the Ring-fencing Code).
- 4.5 The Northern Territory Ring-fencing Code (Third version, 1 January 2009) specifies that at a minimum, an electricity entity carrying on a prescribed business<sup>23</sup> in the Territory must establish and maintain a separate set of financial accounts and reports in respect of each prescribed business and the electricity business as a whole; and allocate any costs that are shared between a prescribed business and a related contestable business in a manner that complies with applicable cost allocation procedures or is otherwise fair and reasonable.
- 4.6 The issue in the Territory of wholesale price transparency concerns the relationship between two of PWC's contestable businesses (generation and retail) and is therefore not addressed by these minimum requirements. However the stated objectives of the Ring-fencing Code are wider and include the prevention of the misuse of monopoly power, and simulation of the behaviour and outcomes likely to exist in a competitive market in addition to ensuring that an entity's "related contestable businesses" are not treated by its prescribed businesses in a manner that confers a non-commercial discriminatory price or non-price advantage on the related contestable business as compared to an arm's length third party in the same commercial circumstances.
- 4.7 The Issues Paper sought comment from interested parties as to whether the current lack of wholesale transparency was considered to be an impediment to FRC, and if so what should be done, if anything to provide greater wholesale price transparency in the Territory prior to introducing FRC.
- 4.8 NTMEU claims a lack of transparency in PWC retail and generation activities and states that in the absence of competition, transparency is essential to assess offers made by PWC to customers.
- 4.9 SCSi & UCWA responded that "transparency is a crucial element of effective markets, irrespective of their structure" and suggested greater disclosure of all prices in the electricity value chain.

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<sup>22</sup> Government of Western Australia, Office of Energy, Electricity Market Review Issues Paper, December 2007, p.39.

<sup>23</sup> Defined in the Code as operating an electricity network or network access business or selling electricity to non-contestable customers.

- 4.10 AEMO does not consider that a lack of wholesale price transparency is an “insurmountable barrier” to retail competition and cites the introduction of FRC into the gas markets of NSW, ACT, SA and Queensland (in the case of Victoria AEMO operates a spot market). However it states that in its experience in implementing gas and electricity markets throughout Australia, “full price transparency provides significant benefits in facilitating competition and greater participation of FRC”. Transparency can be provided by the establishment of spot and longer term trading markets. AEMO expresses its willingness to assist the Territory in considering options in this regard.
- 4.11 PWC does not consider the lack of transparency to be an impediment to FRC, but does recognise that greater transparency and some oversight of its pricing may be sought by retailers. PWC points out that as a result of reforms undertaken in April 2000, potential new-entrant retailers have been able to negotiate wholesale electricity supply prices with PWC. PWC also states that “current wholesale market settlement arrangements between the Generation and Retail businesses are based on maximum demand for contestable customers, relative to system peak demand, and therefore can be extended to new retailers if and when they choose to operate in the Territory”.
- 4.12 The Commission believes that this issue needs to be considered in the context of what might be a realistic assessment for retail competition at the current time. The Commission agrees largely with AEMO that while greater wholesale price transparency would facilitate greater competition and participation in FRC, it is not an “insurmountable barrier” to retail competition, and is not a barrier to the objective of achieving a contestable retail market where competition is prospective rather than actual. In assisting the further development of competition, the Commission is of the view that next to removing the legislative barriers to retail competition, the pursuit of greater wholesale electricity price transparency, and cost reflective wholesale and standard retail tariffs are likely to be the most fruitful areas of reform.

### **Extensive unbundling of retail, distribution and generation**

- 4.13 Separation of generation and retail occurred in all existing NEM jurisdictions prior to market entry and the introduction of retail competition. Where retail and generation businesses have remained in government ownership, separation of retail and distribution has been effected by means of ring fencing. Outside of government ownership, the preference has been to separate retail and distribution largely as a result of the different funding requirements and investor appeal of the two types of businesses – merchant and regulated respectively. However outside of government ownership there has been a tendency to pursue vertical integration of generation and retail as a business strategy. Victoria and South Australia have previously disaggregated and privatised the state owned generation and retail businesses prior to introducing full retail competition. New South Wales undertook a more limited disaggregation of generation into three large portfolio businesses and has retained generation and retail under government ownership. Queensland disaggregated and divested its government owned retail business in south-east Queensland prior to introducing full retail competition. Tasmania separated retail from generation but retained the generation sector as one entity. In Western Australia, separation of business functions was also effected with Western Power responsible for distribution and transmission, Synergy responsible for retail, and Verve Energy for generation. Verve Energy faces competition from Alinta, Griffin Power and New Gen.<sup>24</sup>

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<sup>24</sup> Independent Market Operator, Statement of Opportunities, July 2009.

- 4.14 Higher activity in fully contestable retail markets in Victoria and South Australia compared to New South and Queensland might be explained in part by the fact that disaggregation of the generation sector in the former jurisdictions was more extensive than the latter and was followed by privatisation. In the latter jurisdictions, generation was retained under common government ownership. In the case of New South Wales, an arrangement called ETEF (Electricity Tariff Equalisation Fund) has also been considered to be an impediment to retail competition as it has served to provide the government owned retail businesses in that state with a more effective form of wholesale price hedging than new-entrant retailers could obtain from the hedge market at a competitive price.
- 4.15 In Queensland, prior to the introduction of FRC, the prospects for active retail competition were considered to be high in the South-East where retail tariffs provided positive margins after deducting wholesale energy and networks costs. Consequently the Queensland Government opted to restructure its retail businesses and divest the two entities with customer bases located in the South-East by trade sale. The effect was to remove the risk to these businesses of potentially large losses of customers to competitors with experience gained in other NEM jurisdictions. This approach also had the effect of providing new entrant retailers with blocks of load sufficiently large to influence hedge negotiations with generators and support the introduction of physical hedges by means of generation and potentially load management.
- 4.16 New South Wales is the only NEM jurisdiction to have introduced FRC without first removing the exposure of Government to the fully contestable retail market. However the sale of the three Government-owned electricity retail businesses (and the trading rights to the generators) are part of its Energy Reform Strategy.<sup>25</sup> According to the NSW Government, “the exit of Government from energy trading activities and a strong market presence by the private sector are essential pre-conditions to those same companies delivering investment in new power stations”.<sup>26</sup>
- 4.17 Outright divestment of retail businesses has not been the only approach. In the case of the Australian Capital Territory, the ACT Government acted early to reduce its exposure to the risk of competitive wholesale and retail electricity markets. This was achieved in October 2000 by having ACTEW Corporation enter a utility joint venture with energy retailer AGL.
- 4.18 Separation of business functions has not been attempted in the Territory with PWC continuing to provide network, retail and generation services to the Territory's customers. A number of small independent power producers sell their production to PWC by means of power purchase agreements. However, as discussed previously, prescribed and contestable businesses are subject to requirements specified in the Ring-fencing Code.
- 4.19 In reviews undertaken by Treasury in 2005 and 2006, the retention of PWC as a vertically integrated entity was considered to be justified on the basis of arguments of economies of scale and scope. In particular it has been noted that significant economies of scope are captured through the sharing of resources across common areas such as information technology, billing systems, corporate overheads, field operations and call centres.
- 4.20 In the Issues Paper, interested parties were invited to respond to the question of whether the current structure of PWC is an impediment to FRC and if so, what further changes, if any should be made to the structure of PWC prior to the introduction of FRC.

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<sup>25</sup> Energy Reform Strategy : Defining an Industry Framework, New South Wales Government, March 2009.

<sup>26</sup> [www.nsw.gov.au/energy/](http://www.nsw.gov.au/energy/)

- 4.21 NTMEU consider that the current structure is an impediment and states that “there must be structural separation of PWC’s generation, network, and retail business and additional competition implemented”.
- 4.22 SCSI & UCWA suggest that the current structure of PWC is reasonable for the short to medium terms as, in its view, the ‘first best’ market structure for residential electricity in the Territory – competitive markets enabled through FRC, is not possible due to lack of ‘scale’ and the ‘second best’ is for an independently regulated, vertically integrated monopoly business.
- 4.23 AEMO considers that the vertically integrated nature of PWC provides the incumbent with a position of market power which will deter the entry of new players and refers to the different models used in other jurisdictions as possible means to resolve this issue noting that many of these retain the feature of common government ownership.
- 4.24 PWC contends that its current structure is not an impediment to FRC and that no changes should be made to its structure prior to introducing FRC. It points out that in the context of the small size of the Territory electricity market there are significant economies in centralising many of its operations and that these economies are reflected in retail prices to customers.
- 4.25 The Commission considers that aspects of PWC’s current structure serve to deter new entrants from entering the market and that this industry structural issue is one of a number of major impediments to competition in the small Territory market. However the Commission accepts that structural reform of PWC would be costly, entailing loss of scale and scope benefits, and would be unlikely by itself to significantly increase the prospects of competition. In the Commission’s view, the retention of the existing PWC structure is not incompatible with making the retail market fully contestable but does remain a barrier to competition subsequently developing.

### **Sufficient price float, volatility and margins**

- 4.26 Retailers are drawn to participate in a market when, having in view a target market<sup>27</sup> (characterised for example by annual consumption and consumption profile) a comparison between the existing retail price and the cost at which they are able to procure wholesale electricity suggests they are able to offer a discount to customers on their existing prices while exceeding a profitability threshold. The term “headroom” is frequently used to refer to the extent to which the retail price exceeds the total cost to serve. Full retail competition in New South Wales was initially characterised by low switching rates. Subsequent retail price determination in that jurisdiction by the Independent Pricing and Regulatory Tribunal (IPART) was guided by the desirability of creating headroom to facilitate retail competition. In Victoria and South Australia, headroom has been created by falling wholesale prices as a result of competition in the generation sector.
- 4.27 In Western Australia, it has been recognised that “cost reflectivity of tariffs will be a major driver in development of a competitive retail electricity market”. The December 2007 Electricity Retail Market Review Issues Paper stated the view that “it would be inappropriate to implement FRC whilst tariff levels are not fully reflective of supply costs.”<sup>28</sup> While final recommendations are yet to be made to the

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<sup>27</sup> Of course the target market (assessed as the product of the total number of customers and the proportion who might be induced to switch) will need to be sufficiently large to cover set up costs.

<sup>28</sup> Government of Western Australia Office of Energy, Electricity Retail Market Review, Issues Paper, December 2007, p.39

Western Australian Government on FRC, it seems likely that the timing of FRC will be made contingent on tariffs achieving full cost reflectivity.

- 4.28 In the Territory retail prices have been set by and subsidised by Government and are therefore at the present time not fully cost reflective. For retail competition to be beneficial to customers, the presence of adequate retail margins (headroom) in initial retail tariffs is a prerequisite for effective retail competition. Government might consider the removal of subsidies prior to the introduction of FRC, the postponement of FRC until retail prices become cost reflective, or the retention of subsidies but provided through lower network tariffs or other means, so that all eligible customers would receive the appropriate subsidy independent of their choice of retailer.
- 4.29 In 2009, the Territory Government commissioned a review to address concerns regarding the financial and commercial sustainability of the PWC.<sup>29</sup> The review identified a shortfall in the revenue requirements of the electricity business, estimating that average prices would need to increase by 35 per cent and tariff prices for tariff customers would need to increase by some 55 per cent for PWC to reach 'financial sustainability'. Further increases would be required to allow tariffs to reach levels that reflect full economic costs, including a commercial return on assets. These conclusions were subject to considerable caveats, but nevertheless indicate the substantial gap between 2008-09 tariffs and cost-reflective levels.<sup>30</sup>
- 4.30 Acting on the findings of this review, Government raised prices for tariff customers (Tranche 4 and 5 customers) from July 2009. The Order made by Government runs until 30 June 2013 and provides a nominal price increase over the period of less than 30 per cent. The annual price increases established by the Order are shown in Table 4.

**Table 4: Electricity Tariff price path – tranche 4 and non-contestable customers**

<b>Tariff Increase</b>	<b>2009-10</b>	<b>2010-11</b>	<b>2011-12</b>	<b>2012-13</b>
Electricity	18%	5%	CPI	CPI

- 4.31 Although tranche 4 electricity customers are contestable, the tariff increases for these customers are largely regulated by pricing orders.
- 4.32 The Issues Paper invited interested parties to comment on actions Government might take to provide the retail margins required to improve the prospects for competition.
- 4.33 NTMEU notes that other jurisdictions have implemented some "head room" above reasonable costs to allow for retail competition but sees this by itself as inadequate to encourage new entrant retailers since they will need to source generation from PWC. NTMEU is of the view that there must be a "clear segregation" between PWC Retail and Generation and competition to PWC Generation if there are to be new retail entrants.
- 4.34 PWC states that a lack of cost reflectivity in existing tariffs presents a significant barrier to entry for retailers adding that "on average it makes a loss in supplying franchise customers" and that overall retail margins are negative. It explains that

<sup>29</sup> Review of Power and Water Corporation Financial Sustainability, Andrew Reeves, March 2009.

<sup>30</sup> Financial sustainability means generating sufficient revenues to meet operating and debt servicing costs and depreciation of assets without a return on capital. Commercial sustainability is defined as earning sufficient revenues to meet operating and debt servicing costs with a return of and on capital (source above report).

this loss is covered by an annual community service obligation (CSO) payment it receives from Government. It also states that “some customer classes in some locations are profitable to serve, while others are not” and points out that as new entrant retailers will only target profitable customers, the CSO paid to PWC will have to increase. It is understood that this is because the “loss making” customer is subsidised not entirely by the CSO, but is also partly cross-subsidised by revenue from profitable customers. Accordingly PWC suggests that “retail tariff reform could also consider a relaxation of uniform tariff policy”.

- 4.35 In its Tasmanian submission, Origin Energy stated that “the establishment of effective FRC requires that retail tariffs are set up, prior to competition, on a cost reflective basis with appropriate allowance for margin and headroom”. In the Commission’s view the lack of cost reflectivity in existing tariffs is the principal impediment to competition developing once the market is declared contestable.
- 4.36 The Commission notes PWC’s view regarding cross subsidies under the current tariff regime. Once the market becomes fully contestable, new entrant retailers could be expected to target the most profitable customers and Government may have to increase the CSO payment to maintain PWC’s financial sustainability.
- 4.37 The Commission notes the risk that the introduction of FRC may result in the Government having to increase CSO payments to PWC to the extent that ensuing competitive activity results in the unwinding of cross-subsidies and believes that further investigation of the materiality of this issue is warranted.

## CHAPTER

## 5

## IMPLEMENTATION OPTIONS FOR THE NORTHERN TERRITORY

### Scope of FRC

#### *Regional Scope*

- 5.1 Table 5 shows electricity use and number of customers for each of the three regulated networks – Darwin-Katherine, Alice Springs, and Tennant Creek, the non-regulated networks, and the Territory as a whole.<sup>31</sup>

**Table 5: Electricity use and customer numbers by region 2008-2009.**

	Electricity use (GWh)	Number of customers
Darwin-Katherine	1,341	58,319
Alice Springs	216	12,109
Tennant Creek	26	1,709
Regulated	1,583	72,137
Non-regulated	286	10,752
Total	1,869	82,889

- 5.2 The question arises as to whether contestability would be extended to all electricity customers in
- the Territory;
  - the three regulated networks; or
  - the Darwin-Katherine Interconnected System (DKIS)
- 5.3 The question occurs in anticipation of the likely differences in results if a cost-benefit analysis were applied to each of the three regional options. The prospect of wholesale electricity competition would appear to be greater in the DKIS than the other regulated systems. Furthermore assuming the continuation of uniform tariff policy, cost reflective tariffs would be likely to be achieved earlier in the DKIS where the cost of generation is lower than elsewhere.
- 5.4 With respect to FRC systems, it is envisaged that these would be developed for the regulated networks only. If FRC is applied to all Territory electricity customers, customers in the non-regulated networks would be contestable without processes

<sup>31</sup> Utilities Commission, Northern Territory Electricity Market, Year ending 30 June 2008.



being in place to effect their transfer among retailers. It would be necessary for any retailer intending to supply customers in these networks to seek access on a case by case basis.

- 5.5 The Issues Paper asked interested parties to comment on whether the introduction of FRC should be staged on a regional basis.
- 5.6 NTMEU agrees that FRC should be staged on a regional basis but considers that a number of other preconditions must be implemented before FRC should be considered.
- 5.7 AEMO states that “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”.
- 5.8 PWC argues that based on a consideration of the higher cost of supply in Alice Springs and Tennant Creek, customers in these locations will be considerably less attractive to new entrant retailers. It adds that while there may be merit in a staged approach to FRC, this will not materially lessen PWC’s preparation costs. In its submission PWC has specifically requested that the Commission “clarify that FRC is not currently being considered for application in non-regulated network areas.”
- 5.9 SCSi & UCWA consider that it is too early to introduce electricity FRC in the Territory however should the decision be made, it would be sensible to start with the DKIS. As part of its response, SCSi & UCWA highlighted the importance of maintaining price parity for residential customers across the Territory.
- 5.10 Noting the submissions, the Commission retains the view that, as a primary objective of introducing FRC is retention of certification of network access regimes, contestability should be extended to the three regulated networks. The Commission recommends excluding customers in the non-regulated network areas from contestability.

#### ***Un-metered Loads***

- 5.11 Another scope related issue concerns the contestability of un-metered loads (principally street lighting and traffic lights). The issue in the NEM was that special arrangements had to be developed for each class of un-metered load in order that interval data (half-hourly data) would be available for market settlement. For this purpose it was considered necessary to develop load and inventory tables which would be subject to the approval of the jurisdictional metrology coordinator. The methodology applied in the NEM for the calculation of energy volumes at un-metered connection points is described in the NEM Metrology Procedure (Type 7 Metering Installation). Load Tables are published by AEMO under Schedule 12 of the NEM Metrology Procedure.
- 5.12 With respect to un-metered loads the options are to i) exclude them from contestability, ii) make them contestable and proceed to develop load and inventory tables for each class as new entrant retailers express interest in supplying them or iii) make them contestable and develop load and inventory tables prior to the introduction of FRC.
- 5.13 The Issues Paper asked interested parties to comment on whether un-metered loads should be contestable as part of FRC.
- 5.14 NTMEU supports the contestability of un-metered loads while SCSi & UCWA suggest regarding un-metered loads as community service obligations and having the charge declared by regulation. AEMO states that “provided there is adequate development of suitable algorithms or an estimation methodology, there is no clear reason to preclude un-metered loads from contestability.” Citing low retail headroom and administrative complexity, PWC does not support the contestability of un-metered loads at the time FRC is introduced.

- 5.15 Taking into account these submissions, the Commission is of the view that if a decision is made to implement FRC on 1 April 2010, or as soon as practicable thereafter, un-metered loads be excluded from contestability.

### Requirement for Smart Metering

- 5.16 Prior to introducing FRC, other Australian jurisdictions have considered the question of whether interval metering should be mandated for all contestable customers or only for those contestable customers with annual consumption exceeding a specified threshold. While in the interests of promoting demand-side response through innovative tariff design, there has been jurisdictional and national support for programs to roll out interval (and otherwise “smart”) metering, the requirement that a customer have interval metering as a precondition for being contestable has been recognised as an impediment to competition. The practical issue of deeming a non-interval metered customer’s consumption profile for the purpose of wholesale settlement has been dealt with by load profiling.
- 5.17 It is suggested that in the Territory there be no mandatory requirement for interval metering associated with contestability. While there may be substantial benefits of smart metering for managing network peak loads, the relative lack of volatility of the Territory system loads compared to the highly temperature sensitive system loads of some NEM regions suggests there is less prospect for innovative tariff design aimed at encouraging customers to alter profiles on the basis of wholesale price signals. Further, the NEM provides half-hourly price signals to which retailers and other market customers (some large industrial customers) are potentially exposed. In the Territory, current contestable customers with appropriate metering face peak / off-peak pricing but for residential and commercial customers, prices are not time of use. Arguably in the Territory, owing to the composition of the generation system based largely on the use of natural gas, there is relatively little difference in the variable cost of generation between peak and off-peak times. The difference in peak and off-peak generation transfer prices is largely the result of the allocation of capital costs.
- 5.18 As part of the NSMP, the Territory should consider opportunities for SM rollout. However SM rollout is not considered necessary in order to implement FRC or ensure the implementation is beneficial.
- 5.19 The Issues Paper asked interested parties to comment on whether mandatory interval metering should be a precondition of retail contestability and whether there is any need to defer FRC until NSMP requirements and any implementation in the Territory have been considered.
- 5.20 NTMEU notes that FRC has been achieved in other jurisdictions in the absence of interval metering and refers to the resultant cross subsidisation between consumers. It notes also that current network usage charges in the Territory also are not reflective of usage and contributes to cross subsidisation. It gives in principle support to mandatory interval metering but only on the basis of a detailed cost benefit assessment.
- 5.21 SCSi & UCWA suggest that FRC be delayed until any national NSMP issues and NECF issues have been identified and resolved. It notes that this should occur in the next 12 to 24 months.
- 5.22 According to AEMO, the successful implementation of FRC in many markets without the deployment of smart meters demonstrates that FRC does not require smart metering to be implemented in the first instance. However AEMO does recommend a study be conducted to determine the appropriate consumption level at which interval metering be mandated explaining that large loads without interval meters have the potential of skewing the profile used to apportion accumulation meters.

- 5.23 PWC expresses a concern that the lack of mandatory interval metering (as a condition for customer transfer) could be detrimental to its business if a particular market settlement approach is pursued. PWC considers that the outcome of the NSMP is not essential to the decision to proceed or not to proceed with FRC.
- 5.24 The Commission considers that mandating interval metering as a condition of customer transfer for small customers is an impediment to competition and that for this reason the imposition of this requirement was avoided in other jurisdictions. The Commission also notes that load profiling, while not cost reflective, is facilitative of competition and can serve to maintain some uniformity of pricing within the profile area and that this might be considered desirable. The Commission shares PWC's view that the outcome of the NSMP is not essential to the decision to proceed or not to proceed with FRC. The Commission agrees with AEMO that a study should be undertaken to establish the appropriate consumption level at which interval metering will be mandated. In terms of option A, this will need to be undertaken in close consultation with PWC as the materiality of this issue will depend on PWC's proposed generation pricing arrangements. The Commission recommends that there be no mandated requirement for interval metering of customers with annual consumption below 160MWh.

### **Management of FRC**

- 5.25 The function of the FRC manager is to manage the customer transfer process and the transfer of information between businesses. In the NEM, AEMO provides the FRC management role. In Territory, prior to NEM-entry, the FRC management role would need to be provided by either a specially constituted local body, or a suitably ring-fenced part of PWC (presumably the Metering Services Unit of Power Networks). Alternatively, AEMO could be retained to provide these services prior to or irrespective of whether the Territory ultimately joins the NEM.

### **Customer Transfer System**

- 5.26 Retailers will seek to acquire customers by inducing them, typically by offering a discount to their current tariff rate, to enter a market contract.
- 5.27 Upon signing a customer, a retailer will need to contact the FRC Manager and advise a transfer date. The FRC Manager will record the details of the transfer, arrange a final meter reading and contact the existing retailer (PWC Retail) to prepare and issue a final bill.
- 5.28 In the NEM AEMO operates a customer transfer system as part of its FRC management role. The retention of AEMO as FRC Manager for the Territory retail electricity market would obviate the need to design and develop a similar system locally.

### **Business to Business Data Transfer Systems**

- 5.29 In the NEM, retailers are required to purchase electricity from the pool. The retailer settles with the market manager AEMO in respect of electricity purchased by the retailer on behalf of the customer. However the current wholesale market arrangement in the Territory is based on bilateral contracting between generators and retailers. For this reason, if FRC is introduced in the Territory without changing financial settlement processes for wholesale energy purchases, generators will also need to be advised of details of customer transfers and subsequently deemed or actual customer consumption.

- 5.30 When the meter is read, the retailer is advised of the metered quantity and bills the customer. As explained, the generator also needs to be advised of the metered quantity in order to bill the retailer unless a NEM style of settlement process is established.
- 5.31 Based on initial discussions with AEMO, it would appear feasible for AEMO to perform the settlement calculations between Territory generation businesses (initially PWC) and retailers using either regulated spot prices or PWC Generation's contract prices in lieu of the spot prices that under NEM would originate from NEMDE (National Electricity Market Dispatch Engine).
- 5.32 The Issues paper asked interested parties to comment on whether the current bilateral contract market is an impediment to FRC and whether reform of this market should be considered prior to introducing FRC.
- 5.33 Citing the United Kingdom as an example of where FRC operates in the context of a balancing market for "unders and overs", NTMEU does not think that the current bilateral contract market in the Territory is an impediment to FRC and does not consider that reform of this market is necessary. NTMEU submits that until there is competition at the generation level, retail contestability should not be implemented adding that "if large consumers of power have effectively no competition in their electricity supplies, it is hard to imagine that small consumers will be beneficiaries of FRC."
- 5.34 AEMO agrees the bilateral contract markets are not in themselves an impediment to FRC. However it believes that there may be benefits in reforming the current arrangements "to facilitate an optimum market design for Territory FRC".
- 5.35 PWC also does not consider that the current bilateral market is an impediment to FRC. It recognises that a generator supplying a retail load made up of customers on accumulation meters creates an issue for the balancing requirements and suggests this could be accommodated by requiring that second tier retail customers be interval metered.
- 5.36 The Commission considers that there are issues with the current bilateral contract market that suggest it may not serve retail competition as effectively as a NEM-like wholesale market arrangement. In particular the Commission would be concerned if new entrant retailers backed by non-PWC generation would be required to install interval meters at small customer premises in order to comply with balancing arrangements. However in general the Commission does not believe that introduction of FRC need be conditional on reform of this market.

### **Metrology / Load Profiling Systems**

- 5.37 In the current pre-NEM Territory, where there is no power pool and no wholesale electricity market competition, the retailer will need to obtain wholesale electricity prices from PWC Generation for each region (i.e Darwin-Katherine, Tennant Creek, and Alice Springs). Retailers could seek to obtain prices by negotiation however, while PWC Generation remains the only supplier, there is a case for some oversight of PWC Generation's wholesale pricing to ensure that pricing is fair and non-discriminatory. The Treasurer has recently requested the Commission to develop a detailed work program to review and report to the Treasurer on an effective retail price oversight framework for contestable customers and associated reporting and disclosure arrangements.
- 5.38 The Issues Paper asked interested parties to comment on whether PWC Generation's wholesale pricing should be subject to oversight and what form this oversight should take.

- 5.39 NTMEU states that “until there is true competition at the generation level, PWC generation pricing must be transparent and subject to dispute resolution by UC.”
- 5.40 SCSI & UCWA state that PWC Generation’s wholesale pricing should be subject to Commission oversight and the wholesale price component of small customer standing contracts published.
- 5.41 AEMO states the view that “in the interests of the future development of the Territory power arrangements, and consistent with the regulatory regime as has been implemented for the national electricity market, PWC’s pricing arrangements and behaviour in the competitive market should be subject to oversight by the AER.”
- 5.42 PWC notes that the Commission has previously undertaken reviews of the generation component of electricity prices and submits that if the Commission elects to pursue wholesale pricing oversight, it should be light-handed in order to minimise costs to PWC and ultimately consumers.
- 5.43 The Commission recognises the need to undertake wholesale electricity price oversight while competition is absent in the generation sector and will give further consideration to the appropriate form of oversight. The Commission has undertaken reviews of generation costs in the past, and notes that particularly in the Territory context these are problematic to conduct and as a result not fully effective. However the Commission does not consider that the introduction of FRC need be contingent on the establishment of a fully effective wholesale price oversight regime.
- 5.44 It is assumed that the wholesale energy prices offered by PWC Generation to retailers would be the generation transfer prices applicable to the current franchise load in each of the regions. The Issues Paper asked interested parties to comment on whether PWC Generation should be required to publish firm prices for specified terms and products.
- 5.45 NTMEU supports this requirement and states that it was a previous recommendation from NTMEU to Treasury.
- 5.46 AEMO states the view that “in so far as PWC 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.”
- 5.47 According to PWC, “the issue of wholesale market pricing and wholesale market settlement is a complex one which PWC strongly suggests should be a primary focus of the Commission prior to detailed consideration of FRC.” PWC suggests that there are difficulties in pricing energy for multiple retailers as compared to a single retailer (PWC Retail).
- 5.48 The Commission recognises that PWC’s existing transfer pricing arrangements were not developed with the requirements of FRC in mind. The Commission notes that under option A, market settlement is left as a matter for negotiation between PWC Generation and retailers and is not intended to be centrally facilitated. In the case of options B1 and B2 where PWC is required to offer standard wholesale contracts, it will be necessary to review and most likely redevelop the current transfer pricing arrangements. The Commission also considers it appropriate to point out here that the retention of AEMO as the FRC manager in option B2 should not necessarily be taken to imply the adoption of NEM style market settlements. What is contemplated is the possible application of the settlement software to the calculation of wholesale electricity payments between generators and retailers should this prove practicable.
- 5.49 In the NEM, wholesale electricity market settlements for non-interval metered loads are calculated using regional net system load profiles. These regions correspond to distribution area networks. Broadly, in the NEM, a net system load is calculated ex-post as the difference between the metered load at the distribution area network

boundary and the sum of the interval metered loads within the distribution boundary adjusted for losses.

- 5.50 Some jurisdictions have metrology procedures that provide for “peeling off” certain separately metered loads from the net system load profile. This is done through the provision of controlled load profiles for South Australia, each distribution network area in New South Wales and two for the Energex distribution area in Queensland.
- 5.51 At present, generation transfer pricing within PWC distinguishes between peak and off-peak usage. It is understood that out of 58,000 franchise meters in the Darwin-Katherine system, there are 2,000 meters which can be configured to record peak and off-peak usage separately. This is a small proportion of the total.
- 5.52 For customers with meters capable of recording the cumulative energy use over the billing period only, it will be necessary to “deem” their peak / off-peak usage. This could be done on the basis of the “net system load” either ex-ante using forecasts or ex-post using metered load data. The latter is obviously more data intensive and requires additional data processing.
- 5.53 Further, in the NEM, regional reference prices (spot prices) are adjusted according to site specific loss factors. In the current pre-NEM Territory, the generator would price presumably on a “total production at the generator basis”. The retail customer’s metered or billed energy will need to be converted to energy produced at the generator according to a loss factor. Again the loss factor can be determined on an ex-ante or ex-post basis.
- 5.54 In the Issues Paper it was suggested that the load profiling regime to support retail competition in the Territory could be based on simple net system load profiles (i.e. with no provision for separately metered loads) defined for each of the regulated networks. Comment was sought from interested parties.
- 5.55 NTMEU refers to the cross subsidisation between consumers that results from simple load profiling.
- 5.56 According to AEMO, the viability of a simple net system load profile depends on a prior study into and the implementation of an appropriate threshold of consumption above which interval meters are mandated.
- 5.57 PWC points out a number of the issues of load profiling including the risks it can impose on the host retailer. It also states that “net system load profiling is a complex exercise which may not be justifiable in the context of few churning customers”.
- 5.58 The Commission recognises that the load profiling requirement depends on the market settlement regime. In the case of the NEM, readings from accumulation meters must be profiled on a half-hourly basis. Clearly this is not necessary if market settlement is on the basis of peak and off-peak time periods for example. While the Issues Paper suggested “simple net system load profiles defined for each regulated network”, it was not intended that it would be necessary to construct a half-hourly system load profile for each network. What was intended was that it would be necessary to “deem” in some way the relevant wholesale pricing parameters – whether peak billing period demand or energy used by peak and off-peak period in the event they are not metered directly. To clarify, in the Territory context, the issue of load profiling is about the deeming of relevant wholesale pricing parameters. Accordingly in the case of option A, the deeming of these parameters from accumulation meter readings would be a matter for negotiation between the retailer and PWC Generation. In the case of options B1 and B2, the profiling requirement will need to reflect the standard wholesale energy contracts PWC is required to offer. In the case of option A it is noted that as a particular load profiling solution is not specified, no provision has been made for a generator entering the market and intending to supply customers on accumulation meters.

The current bilateral market arrangements would appear to require the generator to meter its customer load on a real time basis.

- 5.59 The Commission also considers it appropriate to point out here that the retention of AEMO as the FRC manager in option B2 should not be taken to imply the necessary adoption of NEM style market settlements. What is contemplated is the possible application of the settlement software to the calculation of wholesale electricity payments between generators and retailers should this prove practical.
- 5.60 The Commission recommends that PWC commence a study of load profiling in anticipation of other generators participating in the Territory's balancing arrangement without the need for interval metering of its sub 160MWh per annum customers. In making this recommendation, the Commission notes that such information would be beneficial in improving PWC's knowledge of customer characteristics.

## Customer Protection Systems

### *Standard Supply Contract*

- 5.61 At the time FRC is introduced, it is usual for customers who decide not to enter a market contract with their existing or another retailer to be supplied with electricity by their existing retailer under a Standard Form Customer Supply Contract (standard contract). Under the standard contract, customers are charged for the electricity they consume at regulated prices.
- 5.62 In jurisdictions where FRC has been introduced, maximum prices have been specified by the jurisdictional regulator or by Government following independent inquiry, until it has been considered that there is effective competition.
- 5.63 The standard contract sets out the terms on which the standard retailer will supply electricity and other services to the customer. The contract does not cover network services which are provided by the customer's distribution network service provider with whom the customer will have a separate customer connection contract.
- 5.64 The current EnergyAustralia Standard Form Customer Supply Contract (Amendment No.4 June 2009) details the services provided under the contract as i) arranging for customer connection services to be separately provided, ii) arranging the provision of metering services, and iii) supplying electricity to the customer's premises.
- 5.65 Provision for payment of a security deposit is included as a precondition to supply of electricity. The contract refers to the published regulated prices as the basis for charges for services provided, and in an attachment sets out how consumption will be metered and estimated. The contract also specifies the standard retailer's rights to disconnect or discontinue supply and the customer's rights to terminate the contract in both cases, together with associated notice and other requirements.
- 5.66 Under this contract the standard retailer communicates customer advice of supply disruption to the distribution network service provider for remedy. The contract provides for any dispute or complaint to be referred to the Energy and Water Ombudsman (EWON) with contact details included. The contract deals with disclosure of customer information and provides the standard retailer's privacy statement as an attachment. The contract provides for green energy offers as part of the standard supply contract (with the customer electing to make additional payments for a number of proportional green energy mixes).
- 5.67 In 2002, the Commission started to develop a Contestable Customer Supply Code. It sought to codify the obligations of the franchise retailer, the 'default' retailer and contestable retailers (with these obligations currently imposed via licence

conditions) and to set out customer transfer procedures. A draft Code was released for discussion in June 2002, but was not proceeded with due to NT Power leaving the market and some doubt as to the power of the Commission to promulgate such a Code.

- 5.68 PWC provides a Customer Contract (applying to urban centres and surrounding services rural areas) setting out the customer's rights and obligations and details of PWC's standards of service (included as a schedule). The key points of this contract are summarised in a Customer Charter. The contract contains PWC's commitment to comply with its legal obligations with respect to the Electricity Reform Act (under which it holds an electricity retailer's licence) and the Utilities Commission Act (under which its quality of service is subject to monitoring and review). As stated in the contract, customers have the right to refer complaints to the Ombudsman of the Northern Territory. There is broad correspondence between the contents of the Customer Contract and the standard supply contracts in use in the NEM (refer to Appendix 3).
- 5.69 The Issues Paper asked interested parties to comment on whether there are any Territory specific terms that should be included in the standard contract.
- 5.70 NTMEU refers to the difficulties of negotiating a commercial contract with a monopoly provider and concludes that until there is competition in generation and retail, there is a sound basis for the UC to assess the PWC standard conditions of supply as well as the price PWC can offer.
- 5.71 SCSi & UCWA suggest that a minimum set of protections will be specified by the NECF when finalised. Specifically it is suggested that a shortened billing cycle i.e monthly rather than quarterly might be adopted to obviate a security charge deposit requirement. The importance of maintaining a regulated price path for standard contract customers is also noted.
- 5.72 PWC did not consider the development of a standard contract as a major issue in comparison with wholesale market settlement and generation pricing. However it did urge the Commission to have regard to the significant work undertaken in other jurisdictions in relation to such contracts.
- 5.73 The Commission's position is that the Territory standard contract will draw substantially from the NECF process.

### **Ombudsman**

- 5.74 It is noted that the Ombudsman is appointed pursuant to the *Ombudsman Act* to receive complaints from members of the public who feel they have been treated unfairly or inappropriately by Territory Government departments, statutory authorities or local government or community councils, Northern Territory Police or Correctional Services. To fulfill the requirements of customer protection created by FRC, the role would need to be generalised to deal with complaints about licenced electricity retailers or alternatively consideration given to setting up an ombudsman's office to deal specifically with the electricity industry. In Tasmania, the Tasmanian Ombudsman which was established under the Ombudsman Act 1978 to deal with complaints in relation to the actions of public authorities, is also required to investigate complaints under the Energy Ombudsman Act 1998. A benefit of establishing an industry funded ombudsman such as the Energy and Water Ombudsman Victoria (EWOV) is that by charging fees when customers make complaints, businesses are given incentives to comply with consumer protection.<sup>32</sup> Membership of the ombudsman scheme is a condition of the licence to retail electricity.

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<sup>32</sup> Consumer Protections in the National Electricity Market – The Need for Comprehensive Energy-Specific Consumer Protections, Consumer Action Law Centre, November 2006.



- 5.75 The Issues paper asked interested parties to comment on whether an ombudsman's office should be established at the time FRC is introduced.
- 5.76 NTMEU supports the establishment of an ombudsman's office and considers that in the absence of competition, the office should also have the ability to examine price. NTMEU believes the UC could perform the ombudsman role.
- 5.77 SCSi & UCWA also strongly support the establishment of an electricity ombudsman's office and suggest the function might also include water. According to AEMO, the introduction of an ombudsman has provided a valuable service in other jurisdictions.
- 5.78 PWC suggests that "any amendment of the existing *Ombudsman Act* or any decision to set up an independent electricity industry ombudsman's office should have strong regard to the best practice elements of similar models undertaken in other jurisdictions where FRC has been implemented."
- 5.79 The Commission considers that in the interests of customer protection, the ombudsman's role must be performed from the commencement of FRC. It would seem cost-effective to extend the existing Ombudsman's jurisdiction to include private sector electricity retailers. Alternatively Government might consider the establishment of an industry specific ombudsman's office as preferable to enacting legislative change.

## Options

- 5.80 The classes of options the Commission has considered relate to timing and preparation for FRC, together with consideration of systems which might be appropriate for each option. They are broadly:
- A – Proceed to implement FRC on 1 April 2010 or as soon as practicable thereafter. In the absence of accompanying reforms, the prospect of significant competition is low and it is considered appropriate to use existing systems for customer transfer and market settlements until there is further market development. A program of additional reforms to support the development of competition could be developed and initiated after FRC is in place.
- B – Reschedule FRC and adopt a program of additional reforms to support the development of competition. Under this option, Territory-specific systems for market settlements and customer transfers might be appropriate but adoption of NEM systems would be preferable to enable national retailers to operate from established and familiar systems.
- C– Postpone FRC until conditions more favourable to competition develop (without committing to an additional program of reform).
- 5.81 Option B is considered in two forms – B1, which assumes that systems for managing FRC are developed and operated locally, and B2, which assumes that the AEMO is retained to provide FRC management services and to the extent possible the AEMO's NEM FRC systems are used (without the Territory necessarily joining the NEM or adopting the NEM style of wholesale market settlement). The implementation of FRC under option B is preceded by a particular prior reform aimed at addressing wholesale energy price transparency by requiring PWC to offer standard wholesale energy contracts to retailers. These standard contracts become the basis for wholesale market settlements and procedures are specified to deem the parameters relevant to the contract prices from accumulation meter readings (a form of load profiling).

***A- Implementation of FRC on 1 April 2010 or as soon as practicable thereafter***

- 5.82 This option is concerned solely with the removal of the legislative barrier to retail market contestability. It is not intended to address the existing impediments to competition or tackle the issues of wholesale price transparency and the level of retail prices. As a result it is very unlikely that there will be any activity following introduction of FRC on 1 April 2010 or soon after. On the basis of this expectation, FRC could be implemented by developing rules and procedures but not proceeding to develop the systems required to support an active retail market. Assuming that contestability without competition is a worthwhile objective, this option might possibly be achieved at low cost. However it has the associated risks that procedures and systems may prove inadequate should the market subsequently become more active, and that intending new entrants may lack confidence in what has been put in place.
- 5.83 Since with this option the expectation is of little or no activity, it is somewhat problematic to specify minimum requirements to support it. Clearly however detailed procedures will need to be developed to enable customer transfer and wholesale energy billing (or at least the metrology procedure that supports it) in the event that some activity occurs. So at a minimum, procedures are required for customer transfer and metrology. Customer transfer procedures would be developed largely on the basis of those in use in the NEM. Wholesale energy billing will be a matter for negotiation between PWC Generation and the retailer.
- 5.84 With respect to customer protection, again it is problematic to specify minimum requirements where the expectation is of little or no activity. A standing offer contract is required however it does not appear that the terms of this would need to differ substantially from PWC's existing customer contract. Based on experience elsewhere it would be appropriate to adopt an energy retail code, an energy marketing code, and set up an ombudsman scheme. These codes could be based largely on PWC's existing commitments to customers and the codes in use in the NEM.
- 5.85 Again based on the expectation of little or no activity, under this option, it would seem to be lower cost and therefore more appropriate for FRC to be managed within PWC than by an external service provider namely AEMO.

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

- 5.86 Under this option, FRC is rescheduled and a specific program of additional reforms committed to with the aim of improving the prospects for active retail competition from the time FRC is introduced. Apart from the particular nature of the reform program committed to, this option differs materially from the previous one in that it requires systems to be developed on the basis of an expectation of some retail market activity. Furthermore, since it will take time to complete the reform program, time will also be available to develop fully functional and robust systems.
- 5.87 These systems could be designed, built and operated locally or AEMO could be engaged to provide the required services using the FRC systems it operates and maintains in the NEM. The advantage of using the NEM systems is that they are proven and retailers in other jurisdictions trust and are familiar with them. Even if the market turns out to be reasonably active, its small size would limit the number of requested transfers and hence the transaction to be processed. It seems reasonable to suppose that standing data would be set up progressively after FRC is in operation and generally in response to retailer requests, reducing set up costs. The cost of using AEMO's FRC systems is subject to discussion with AEMO. However it is noted that if the Territory were part of the NEM, on the basis of AEMO's Scheduled Participant Fees for 2009-2010, active retailers in the Territory

would pay to AEMO around \$160,000 a year.<sup>33</sup> The use of AEMO's FRC systems would result in a customer transfer process identical to that used in the NEM and notwithstanding the different wholesale electricity market arrangements of the Territory, the market settlement system (MSATS) appears capable of assisting with wholesale energy billing.

### ***C - Postpone FRC until conditions more favourable to competition develop***

- 5.88 Previously retail contestability has been delayed on the grounds of a lack of competition. Arguably the situation has not improved. Other impediments could be cited in support of the decision including the fact that retail prices do not reflect the full cost of electricity. Under this option FRC is postponed without committing to an additional program of reform.

### ***Possible Additional Reforms***

- 5.89 There is a range of reforms that could be undertaken to improve the prospects for retail competition some of which are able to be implemented more easily and quickly than others.
- 5.90 In the absence of competition at the wholesale level, prospects for competition would benefit from enhanced wholesale price transparency. For instance the Ring-fencing Code could be strengthened to require PWC Generation to offer contracts to new entrant retailers on the same terms as to PWC Retail and to publish these contract prices in advance. This could be implemented relatively quickly whereas adopting the NEM wholesale trading arrangements would be a lengthy process and probably not justified solely in terms of enhanced wholesale price transparency.
- 5.91 Without fully cost-reflective retail tariffs, new entrant retailers lack a commercial incentive to develop generation to supply retail customers. To improve the prospects of competition in generation, retail tariff reform could be undertaken with the objective of introducing FRC at the time tariff prices become fully cost reflective. This presupposes a commitment by Government to transition prices to cost reflective levels over a specified timeframe.
- 5.92 In the absence of cost reflective tariffs, subsidies to bridge the gap between regulated standing offer prices and cost-reflective prices could be provided on a non-discriminatory basis through subsidised network charges for eligible tranche customers. Thus customers would continue to receive subsidised prices, irrespective of their choice of supplier. While this of itself would do nothing to directly improve the prospects of competition in generation, it would provide for retail competition on the basis of the cost to serve.
- 5.93 More far reaching reforms that might be considered include structural reform of the industry and wholesale market reform for example by the adoption of the NEM wholesale trading arrangements.
- 5.94 The Issues Paper asked interested parties to comment on these options and to state whether there are other options the review should consider.
- 5.95 According to NTMEU, the priority is to establish the conditions for wholesale competition. With respect to the possibility of adopting NEM-like arrangements, NTMEU expresses reserve and advocates the undertaking of research "to assess the optimal approach to establishing a Territory market structure".
- 5.96 SCSi & UCWA consider that the primary objective of FRC, and any other market reform to the Territory electricity market should be the provision of a reliable electricity supply at a price that all customers can afford. It is suggested that

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<sup>33</sup> This estimate assumes 1,869GWh of retail customer load and a total FRC fee (establishment and operating) of \$0.08775/MWh.

government adopt as a policy position the statement that “no customer should be disconnected from electricity supply due to an inability to pay”. It is also suggested that it would be useful to establish a customer reference group to provide advice on impacts on low income and disadvantaged households. SCSi & UCWA do not consider it to be in the best interests of Territory electricity consumers to move to the introduction of FRC for electricity markets in the near future, adding that deferral should be at least until the attainment of effectively competitive markets for large business customers. Finally in view of the likelihood of significant electricity price rises in the future, SCSi & UCWA consider it beneficial to enhance residential customer protections by reviewing and strengthening customer concessions, reviewing hardship policies and consumer protections against the NECF, and establishing a utilities ombudsman.

- 5.97 AEMO believes that systems and procedures must be clearly defined prior to introducing FRC and considers that otherwise retailers will be reticent to enter.
- 5.98 PWC responded at some length to the options canvassed in the Issues Paper. In relation to these options, PWC highlighted the distinction between “Full Retail Contestability” and “Full Retail Competition” being in the first case a contestable market where no retailers other than the incumbent are operating and in the second a contestable market where multiple retailers are operating. As PWC points out, option A aims at the objective of contestability whereas options B and C are focused on achieving at least some level of competition. PWC further considers that, on the basis of this distinction, in preparing for contestability, systems and capability investment by PWC can be avoided because there are no other retailers operating in the market” whereas in preparing for competition, with multiple retailers operating “systems and capability investments by PWC are required.
- 5.99 PWC states that its “principal concern is in ensuring that it has the necessary capability and systems to support whichever Implementation Option is ultimately chosen by Government”. PWC states further that “under any approach, PWC’s costs will be determined by the difference between its current capability in relation to the ‘building blocks’ and that which is required at the start of the new market”. Reporting that all of the systems that it currently has in place are manual, PWC claims to have “limited capability to transfer currently contestable customers, and no current capability to transfer a franchise customer with an accumulation meter installed”.
- 5.100 In its submission Northern Territory Treasury states a preference for option A. It considers option B to have little merit on the basis of a reluctance to reschedule FRC and the potential for competition enhancing reforms to be costly. It states that there is “limited appeal” in postponing FRC (option C).
- 5.101 Treasury expressed the view in its submission that “a key objective of FRC, being lower retail prices resulting from increased retail competition, is unlikely to emerge in the Territory”. It also expressed the view that “at this stage, given the size of the Territory market, it is considered unlikely that a net public benefit could be demonstrated (for the introduction of FRC)”. While agreeing with these views, it is the Commission’s opinion, that in other jurisdictions, views of this nature would form the basis for a decision to reschedule or indefinitely postpone FRC since they state or imply that the usual objectives of FRC, as adopted elsewhere are unlikely to be achieved.
- 5.102 It is clear that in expressing a preference for one implementation option over another, respondents are applying different objectives. NTMEU and AEMO respond on the basis of the usual competition objective. On the other hand SCSi & UCWA consider that the primary objective should be the provision of a reliable electricity supply at a price that all customers can afford and respond accordingly. PWC is largely concerned about cost. As expressed in its submission, Treasury’s objectives are retention of access regime certification, the introduction of standard contracts,

and incremental progress with reforms. The introduction of FRC under option A is seen as likely to satisfy these objectives at low cost.

- 5.103 The Commission retains some concern that the introduction of FRC under option A creates the risk of outcomes which may subsequently prove difficult to manage. Leaving aside the unlikely event that a new entrant retailer will build its own generation to support its retail operations, any churn (as compared to no churn) would imply that new entrant retailers have successfully identified profitable customers and are able to offer them a discount to their standing contract price. However as discussed earlier, the benefit to the customer results from the removal of a cross-subsidy to another customer. Competition therefore will not be on the basis of any advantages new suppliers might have in access to lower wholesale electricity costs or scale benefits in retail operations but on the basis of removing existing cross-subsidies which Government may need to cover by increasing CSO payments to PWC. If Government intends to retain the existing cross subsidies as a matter of policy, FRC has the potential to work against it. If on the other hand Government elects to wind back cross-subsidies, then there is a case for it to be done in a managed rather than an uncertain way. There is however a question of whether a retailer would enter the market on the basis of inflated prices, which might be adjusted by PWC to cost reflective levels at any time.
- 5.104 The Commission is of the view that while there remain a number of significant impediments to the development of competition in the small Territory market, there is no reason not to proceed to remove the legislative barriers to full retail contestability. It further considers that while it has some associated risks, option A satisfies the incremental reform objective, providing 'in principle' competition benefits which, while difficult to evaluate, are obtained at relatively low cost. Once FRC is introduced, the Commission believes that the issues of cost-reflective and transparent retail and wholesale energy pricing should be examined as a basis for undertaking reforms to further improve the prospects of competition developing.

### ***Analysis of Options***

- 5.105 The ToR require the Commission to make recommendations as to the most efficient option. In making its assessment, the Commission is to consider:
- both the costs of FRC and the likelihood that FRC will confer benefits to consumers;
  - the option of further postponement of contestability of some or all remaining tranches;
  - the context of the existing market arrangements, potential market structure reforms and efforts to improve consistency between Australian energy markets;
  - the Territory's commitments under the Competition Principles Agreement, Australian Energy Markets Agreement, and Council of Australian Governments (COAG); and
  - developments in other jurisdictions and in particular the National Energy Customer Framework being developed by the Ministerial Council on Energy.
- 5.106 In considering the efficiency of the options, the Commission has had regard not only to the costs and benefits, but also to the objectives of FRC in the Territory context.
- 5.107 On the basis of a high level review of the costs of establishing and operating FRC in the Territory, it is estimated that FRC could be established under option A for around \$500 000. It seems reasonable that under this option the annual cost of supporting a level of activity of up to three requests per day would be around

\$150 000. To support a level of activity of up to 30 requests per day<sup>34</sup> it may be necessary to examine process improvements and undertake some limited automation. At a higher level of activity a more substantial investment in systems would be required. One-off capital expenditure on systems in excess of \$1 million and an increase in annual operating cost of a similar amount would not be unrealistic.

- 5.108 Establishment costs are higher for option B1 than for option A and are estimated at around \$1.5 million with annual operating costs of around \$1 million.
- 5.109 Under B2 AEMO performs the FRC management role. This avoids the cost of establishing this function and associated systems locally. Establishment cost under this option is estimated at around \$750 000 with annual operating cost of a similar amount.
- 5.110 With respect to timing, assuming that the FRC start date is announced on 1 January 2001, estimated delivery times for options A, B1 and B2 are six months, twenty-one months and fifteen months respectively. This corresponds to start dates of 1 July 2010, 1 October 2011, and 1 April 2011 respectively.
- 5.111 It should be noted that none of the cost estimates is based on fully automated FRC systems. Given the small size of the Territory market, it is unlikely that fully automated FRC systems would be required<sup>35</sup>.
- 5.112 Clearly option C has no associated costs.
- 5.113 The Commission considers that the public benefit of introducing FRC in the Territory is small as it is unlikely that retail competition will emerge in the absence of a number of other prior reforms. In other jurisdictions, the absence of public benefit associated with low prospects for the development of competition has been the basis for deferring FRC (option C). Importantly the objective of FRC in these jurisdictions has been achieving retail competition rather than retail contestability (with 'in principle' competition).
- 5.114 However, one objective of FRC in the Territory context is to maintain certification of the Territory's access regime, with a further objective of laying a foundation for further reform by demonstrating a commitment in principle to retail competition in electricity supply. This commitment is an important consideration, consistent with a transition to improved consistency with national energy markets. Option A meets these objectives at relatively low cost and with a relatively short implementation time. Once FRC is introduced under this option, the Commission believes that the issues of cost-reflective and transparent retail and wholesale energy pricing should be pursued as a basis for undertaking reforms to further improve the prospects of new entry in the Territory market and the development of competition.
- 5.115 Options B1 and B2 include elements designed to improve the prospects of competition developing but it is uncertain whether the value of the benefits associated with these improved prospects exceeds the additional cost over option A. Should Government choose to implement FRC under option A, it would retain the possibility of pursuing the desirable features of B1 and B2 at a later date.

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<sup>34</sup> In the Territory, 30 transfer requests per day equates to an annualised churn rate of around 10%.

<sup>35</sup> Under Queensland's Minimalist transitioning Approach, Ergon's manual systems are required to support up to 40 NMI creation requests per day which equates to in excess of 10% annual churn in the Northern Territory context. Discussions with Ergon based on that businesses experience with FRC so far, suggest that a fully manual system could have been put in place for a cost of between \$1M and \$2M.

## Recommendations

5.116 The Commission recommends that if FRC is introduced in the Territory, Option A would appear to be the most efficient, with removal of the legislative barrier to competition from April 2010 or soon thereafter. Relevant considerations include:

- Scope of FRC – that contestability be extended to all customers located in the three regulated networks with the exclusion of un-metered loads.
- Requirement for interval metering – that interval metering not be mandatory for customers with annual consumption below 160 megawatt hours (MWh).
- Customer transfer systems – existing PWC systems be used for customer transfer but as part of the rules of FRC, a threshold level of retail market activity should be specified such that if it is exceeded, PWC will be required to upgrade its systems to cater for a specified higher activity level.
- Customer protection – that Government either extend the scope of the Territory Government Ombudsman to act on complaints in relation to electricity retailers, or approve the establishment of an industry Ombudsman.
- Standard supply contracts (retail) – that the design be based on the model terms and conditions specified under the NECF and that the design be subject to further consultation along with the other documents, codes, rules and procedures necessary to support FRC in the Territory.
- In negotiating with retailers in the capacity of wholesale electricity supplier, PWC should be prohibited from stipulating interval metering of customers with annual consumption less than 160MWh as a condition for entering a contract.

5.117 The Commission has also been asked to report on prudent actions the Territory Government should take to encourage the development of competition. The Commission considers that prudent actions to encourage the development of competition include:

- discovery and publication of the wholesale price component of retail tariffs;
- a study of wholesale and retail costs and prices to identify cross subsidies inherent in the PWC pricing system and to establish a transition to cost reflective prices with Territory Government subsidies to give effect to social and economic policy objectives;
- PWC to commence a study of load profiling in anticipation of other generators participating in the Territory's balancing arrangement without the need for interval metering of its sub 160MWh per annum customers, and to improve its knowledge of customer characteristics;
- the Territory Government, the Commission and PWC should continue with the policy of adopting, where practical and appropriate for the Territory, NEM-style regulatory systems and practices. Although in the short term and until cost-reflective tariffs are developed the existing PWC systems for settlements and retail market processes are appropriate, in the longer term, and for effective competition to develop, NEM-style processes and systems will be preferred to reduce barriers to entry for national retailers; and
- the Territory Government to investigate whether, in the longer term, a structural reform of PWC for the further promotion of competition and investment would deliver a net benefit to the Territory.

**APPENDIX****A1****ESTIMATED COSTS FOR OPTIONS**

This appendix sets out high level cost estimates for the implementation options A, B1 and B2. Common to all options are costs which will be incurred in the following areas :

Amendments to legislation including:

- amendments to the *Electricity Reform Act* to reflect FRC,
- amendments to Electricity Retail Licence terms and conditions to include retailer of last resort provisions and the requirement to provide standard offer contracts,
- possible amendments to the *Ombudsman Act* to extend the ombudsman's role to handle complaints about electricity retailers, and
- amendments to the Ring-fencing Guidelines to provide for a ringfenced FRC manager to administer rules and manage customer transfers, and provide for ringfenced metering services.

Development of rules, codes and procedures to support FRC in the Territory including

- customer transfer procedure,
- meter data service provision,
- energy retail code,
- electricity customer transfer code, and
- retail energy marketing code.

Implementation of customer protection measures including

- development of standing offer contract, and
- as an alternative to extending the Ombudsman's role, the establishment of an industry ombudsman's office.

FRC Publicity

Other costs, essentially FRC management costs and costs incurred by PWC's component businesses depend on the implementation option. The figure on the following page has been included to highlight the principal changes to PWC's systems under the different options.

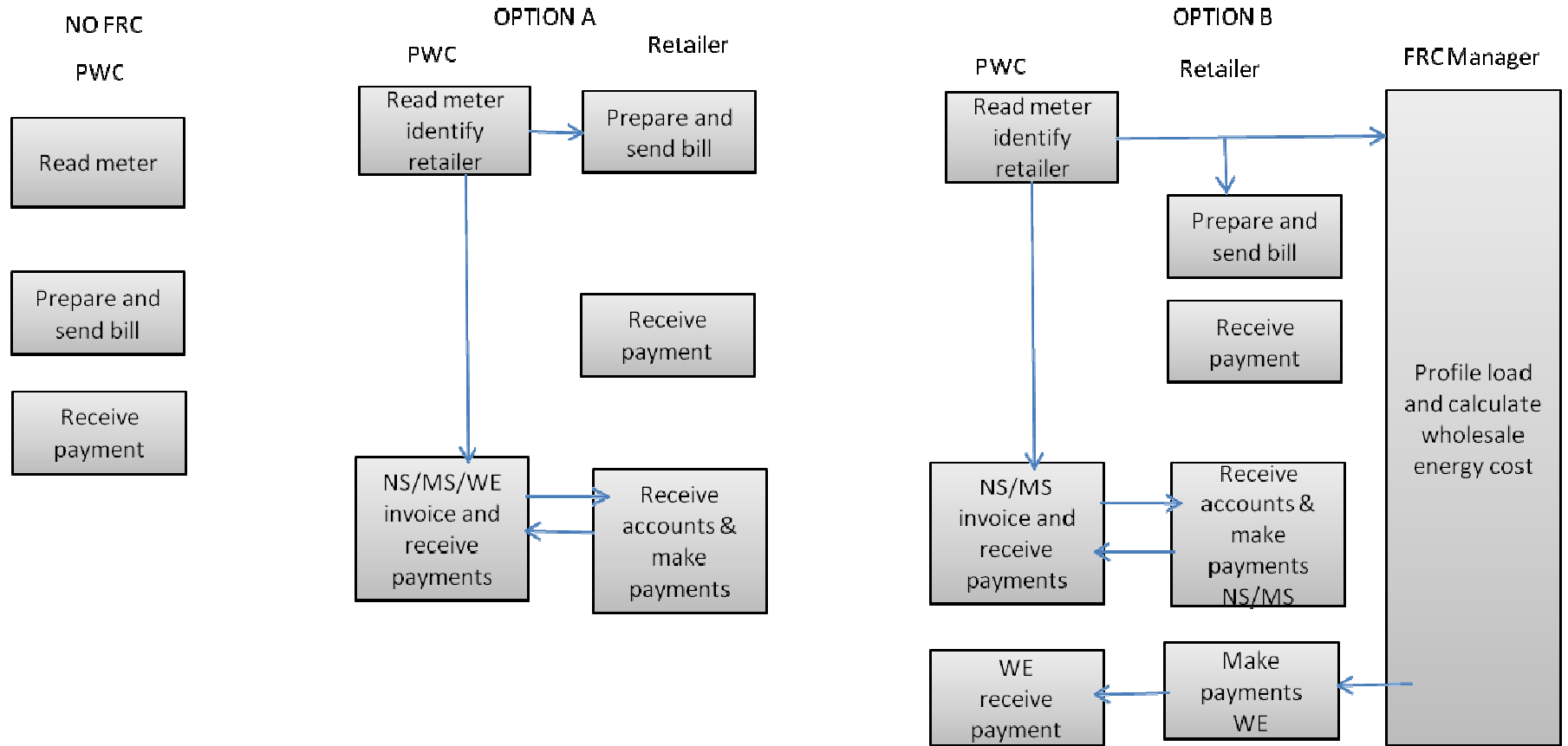
In the current environment where PWC is the only retailer, a meter read gives rise to an incremental quantity of usage for which the customer is to be billed and payments are subsequently processed. The allocation of revenue and costs to component PWC businesses is by means of internal transfer prices.

Under option A, PWC (as the FRC Manager) needs to determine which retailer is responsible for the meter (customer) and advise that retailer of the metered quantity. PWC will need to invoice the retailer for metering services (MS) and network services (NS). Assuming that the retailer is supplied by PWC Generation, PWC will also need to invoice



for wholesale energy (WE) based on arrangements agreed between PWC Generation and the retailer.

Under option B, standard terms and prices govern the supply of wholesale energy from PWC to the retailer. This provides for the centralisation of wholesale energy market settlement and the calculation of these by the FRC Manager.



The features of Option A most relevant to a consideration of costs are the following :

- FRC will be introduced without any prior or accompanying reforms.
- With respect to FRC systems, processes (largely concerning customer transfer) will be developed and documented but not built.
- PWC will be responsible for providing the FRC management function.
- Largely in view of the lack of headroom in existing tariffs, there is little or no expectation of churn.
- In addition to the common costs described above, in the case of option A, costs will also be incurred in establishing the FRC management function within PWC.

The establishment costs of FRC under option A, in the absence of activity in the retail market are estimated to be around \$500 000. In the absence of information and/or transfer requests, it is assumed that PWC will temporarily redeploy resources allocated to FRC management, however in the event of even a low level of activity (annualised churn of up to 1 per cent or 3 requests per day), the FRC management function will need to be resourced. To support this low level of churn, annual operating costs for FRC management are estimated at around \$150k. It is noted that this level of activity is higher than what PWC claims its current systems are capable of handling. If this is the case, then PWC may need to consider some process improvement and limited automation of some manual systems. Higher activity, say annualised churn of 10% or more would serve as a signal for investment in more automated systems. Apart from the customer transfer system, a higher level of activity would increase the requirement of PWC's wholesale energy and network billing systems. To remedy the limitation, one-off capital expenditure on systems in excess of \$1M and an increase in annual operating cost of a similar amount would not be unrealistic.

The annual cost of maintaining an industry ombudsman's office would be an additional cost of around \$150 000 in the event that the existing ombudsman's role is not extended.

With respect to option B1, features relevant to costing are as follows –

Prior reform around wholesale energy price transparency is undertaken.

Systems are largely manual, but are in place and developed for the start of FRC.

Databases are created but populated as transfers are requested.

FRC manager performs wholesale energy settlement function on the basis of PWC Generation's published contract prices.

Establishment costs are higher than for option A and are estimated at around \$1.5 million with annual operating costs of around \$1 million. The establishment cost includes prior reform around wholesale energy price transparency.

Option B2 differs from B1 in that AEMO performs the FRC management role. This avoids the cost of establishing this function and associated systems locally. Establishment cost is estimated at around \$750 000 with annual operating cost of a similar amount.

**APPENDIX****A2****ACTIVITY SCHEDULE FOR OPTIONS**

This appendix sets out activity schedules for the implementation options. Dates for delivery of FRC are calculated on the basis of FRC being announced on 1 January 2010.

**Option A**

- Amendments to legislation – 3 months
- Development of draft codes, rules and procedures – 3 months
- Consultation on draft codes, rules and procedures – 3 months
- Establishment of FRC management function within PWC – 6 months
- FRC start date – 1 July 2010 (6 months)

**Options B1**

- Review of wholesale price transparency – 6 months
- Development of standard wholesale energy contracts – 3 months
- Development of draft codes, rules and procedures – 3 months
- Consultation on draft codes, rules and procedures – 3 months
- Establishment of FRC management function within PWC – 6 months
- Development of systems – 6 months
- FRC start date – 1 October 2011 (21 months)

**Options B2**

- Review of wholesale price transparency – 6 months
- Development of standard wholesale energy contracts – 3 months
- Development of draft codes, rules and procedures – 3 months
- Consultation on draft codes, rules and procedures – 3 months
- Retention of AEMO as FRC service provider – 6 months
- FRC start date – 1 April 2011 (15 months)

**APPENDIX****A3****DESIGN OF STANDARD SUPPLY CONTRACT**

Standard supply contracts are the primary means of ensuring that small customers have access to power and a minimum level of service, and set out the terms and conditions of the contractual relationship between the designated retailer and customer.

The NECF includes model terms and conditions for a standard retail contract. The content of the contract is based on existing jurisdictional arrangements, including: requirements for billing, security deposits, disconnection (and reconnection) procedures, how charges are calculated, and complaints and disputes.<sup>36</sup>

The NECF expects that a standard retail contract will operate with reference to the relevant regulated retail tariff where jurisdictions chose to do so, with the retailer required to offer a “standing offer” tariff along with the standard retail contract.<sup>37</sup>

PWC has a Customer Contract setting out the customer’s rights and obligations and details of PWC’s standards of service (included as a schedule) for customers in urban centres and surrounding rural areas. The key points of this contract are summarised in a Customer Charter.

There is broad correspondence between the contents of the Customer Contract and the standard supply contracts in use in the NEM. The Customer Contract contains PWC’s commitment to comply with its legal obligations with respect to the Electricity Reform Act (under which it holds an electricity retailer’s licence) and the Utilities Commission Act (under which its quality of service is subject to monitoring and review). As stated in the contract, customers have the right to refer complaints to the Ombudsman of the Northern Territory.

The following table identifies correspondence between the section titles of the model standard retail contract from the schedule 1 of the National Energy Customer Framework First Exposure Draft, April 2009 with comparable sections of the PWC Customer Contract. The NECF provides model standard contracts for retail and distribution services separately. The PWC Customer Contract includes electricity (retail and distribution), water and sewerage services.

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<sup>36</sup> Ministerial Council on Energy Standing Committee of Officials, June 2008, A National Framework for Regulating Electricity and Gas (Energy) Distribution and Retail Services to Customers, page vi.

<sup>37</sup> Ibid.

<b>Model Standard Retail Contract</b>	<b>PWC Customer Contract</b>
1. The Parties	Becoming a PWC Customer
2. Definition and Interpretation	
3. Do these terms and conditions apply to you	Schedule 1 – coverage of the contract
4. What is the term of this contract ?	
5. Scope of this contract	
6. Your general obligations	Your responsibilities
7. Our liability	
8. Price for energy and other services	How much does it cost ?
9. Billing	Estimated readings
10. Paying your bill	Paying your account
11. Meters	Metering and access to your property
12. Undercharging and overcharging	Refunds of credit balance
13. Security deposits	
14. De-energisation of supply	Disconnection
15. Re-energisation after de-energisation	
16. Use of energy and illegal use	
17. Notices and bills	
18. Privacy and confidentiality	Confidentiality
19. Queries and complaints	Complaints – PWC, Ombudsman of the Northern Territory
20. Force majeure	
21. Applicable law	
22. Retailer of last resort event	
23. General	
24. Schedule 1 Dictionary	

**APPENDIX****A4****TERMS OF REFERENCE****REVIEW OF FULL RETAIL CONTESTABILITY FOR NORTHERN TERRITORY  
ELECTRICITY CUSTOMERS****Background**

Under National Competition Policy, all Australian jurisdictions committed to introducing competition in the electricity generation and retail market sectors. Full retail contestability (FRC) has now been fully implemented in all jurisdictions apart from the Northern Territory, Western Australia and Tasmania.

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 *Trade Practices Act* in 2000. Certification was considered desirable by the Northern Territory Government because it establishes a legal avenue for third parties to access network infrastructure and avoids costly legal disputes.

Since April 2000, tranche 1 to 3 customers (large to medium business, defence and government customers) have progressively become contestable in the Northern Territory and pay tariffs determined by commercial negotiation. Tranche 4 customers are also contestable but most pay retail tariffs capped by the Territory Government.

Tranches 5 and 6 (typically small businesses and households) are currently non-contestable. Such customers can only be supplied by the Power and Water Corporation (PWC) and pay subsidised retail electricity tariffs that are uniform regardless of location and cost of supply.

Tranche 5 and 6 customers were originally to become contestable in 2003 and 2005 respectively. However in February 2003 the Government postponed contestability for these customer tranches for 5 years, subject to a public benefit test, due to the lack of competition. In October 2007, the 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**

The purpose of this inquiry is to generate options for the implementation of FRC for electricity in the Northern Territory on 1 April 2010 and assess the merits of each.

**Scope of Inquiry**

The Commission is to report on the objectives of FRC in the Northern Territory context, the conditions necessary for competition to develop in the Territory and the prudent actions Government should take to encourage the development of competition.

The inquiry is to present the various options for the design and rules of FRC arrangements for electricity in the Northern Territory and make an assessment of the likely costs, benefits and feasibility of each.

The Commission is to make recommendations as to the most efficient option. In making its assessment, the Commission is to consider:

- a. both the costs of implementing FRC and the likelihood that FRC will confer benefits on consumers;
- b. the option of further postponement of contestability of some or all remaining tranches;
- c. the context of the existing market arrangements, potential market structure reforms and efforts to improve consistency between Australian energy markets;
- d. the Territory's commitments under the Competition Principles Agreement, Australian Energy Market Agreement and Council of Australian jurisdictions; and
- e. developments in other jurisdictions and in particular the National Energy Customer Framework being developed by the Ministerial Council on Energy.

The inquiry is to report on appropriate terms and conditions for potential standard supply contracts and the contract design most likely to promote an efficient outcome.

### **Timing and Process**

The inquiry is to commence as soon as possible.

In undertaking the inquiry, the Commission is to consult with key interest groups and affected parties and release an issues paper and draft report to facilitate consultation.

The Commission is to provide its final report by 31 December 2009.