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

FINAL REPORT

September 2010



Level 9, 38 Cavenagh Street DARWIN NT 0800
Postal Address GPO Box 915 DARWIN NT 0801
Email: utilities.commission@nt.gov.au
Website: www.utilicom.nt.gov.au

Table of Contents

Overview	1
Introduction	1
Proposed retail price monitoring regime	1
Introduction	5
Background.....	5
Developing an electricity retail price monitoring regime	6
Conduct of the Review	8
Objectives of price monitoring	10
Price monitoring arrangements	10
The case for price monitoring in the Territory	11
Objectives of price monitoring in the Territory.....	12
Proposed price monitoring arrangements	16
Key design features	16
Monitoring market behaviour and pricing outcomes.....	17
Proposed information disclosure arrangements.....	23
Customer complaint mechanism.....	28
Implementation considerations	32
Implementation of proposals	32
Legislative head of power	32
Timing	33
Confidential information	33
Data quality provided to the Commission.....	34

Confidentiality

The Commission will make submissions publicly available. A person not wanting their submission to be public must clearly specify that the document (or any part of the document) should be kept confidential. A version of the submission suitable for publication (i.e. with any confidential material removed) should be provided.

Public access to submissions

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

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

Inquiries

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

Utilities Commission
GPO Box 915
DARWIN NT 0801

Telephone: 08 8999 5480

Fax: 08 8999 6262

Email: utilities.commission@nt.gov.au

CHAPTER 1

Overview

Introduction

- 1.1 The Commission is required to review and report on options for the development of an effective electricity retail price monitoring framework, and the associated reporting and disclosure arrangements. The purpose of the review is to recommend options for a framework to increase transparency in retail electricity pricing, and ensure that retail prices reflect the cost of supply.

Proposed retail price monitoring regime

- 1.2 The Commission considers that a retail price monitoring regime would be appropriate in the Territory to give customers confidence that the terms and conditions of supply offered by the Power and Water Corporation (PWC) are reasonable, while PWC holds a dominant market position in the electricity generation and retail sectors.
- 1.3 The Commission considers that the objective of a retail price monitoring regime in the Territory should be to support the effective operation of the electricity market by:
- giving customers the key information necessary for them to be confident that the terms and conditions of supply (price/service performance) offered by PWC Retail are reasonable;
 - giving customers and industry participants the key information necessary to make informed investment and consumption decisions; and
 - establishing better incentives for PWC to strive to maintain and improve service performance, and to keep costs and prices to a minimum, while there is no effective competition in the generation or retail sectors.
- 1.4 The Commission expects the proposed retail price monitoring arrangements would establish reliable and consistent data on pricing outcomes. Such data should assist large customers to assess whether the contract prices offered by PWC are reasonable, and reflect the cost of supply. Further, the data would provide the Commission with a baseline for monitoring of PWC's revenues, prices, costs and performance, against relevant targets, as part of any future possible assessment of whether PWC's pricing outcomes are reasonable or efficient.

Monitoring of market behaviour and pricing outcomes

- 1.5 PWC is effectively the only supplier of electricity generation and retail services in the Territory, and has the ability to exercise market power in the Territory electricity market. The potential for market entry and the development of effective competition is not great, at least in the next few years.
-

-
- 1.6 The Commission recommends the introduction of arrangements to monitor PWC's market behaviour and pricing outcomes, until there is effective competition in the Territory electricity market, involving:
- periodic detailed investigation of PWC's costs, prices and revenues (at each point of the electricity supply chain) disaggregated by customer class to ensure that customer charges are cost reflective, and that the costs involved represent no more than the reasonable long run cost of supplying electricity; and
 - regular reporting of PWC's pricing outcomes which could include:
 - the oversight of prices for customers on market contracts; and
 - any other useful monitoring tools that are appropriate to the circumstances, such as price indices and benchmarks.
- 1.7 The Commission notes that the periodic detailed investigation of PWC's costs, prices and revenues would be a similar exercise as required for assessing and advising on the level of 'standing offer' retail tariffs for small customers, which is a function commonly performed by regulators elsewhere in Australia.

Disclosure of a wholesale electricity reference price

- 1.8 The Commission considers that customers assessing the terms and conditions of supply offered by a retailer require relevant price and performance information, including wholesale price information.
- 1.9 The Commission notes that there is very limited information on wholesale costs and prices available to customers and the market. Wholesale energy represents about 40 per cent of the total cost of energy (for small customers) in the national electricity market (NEM) and about 70 per cent of the total cost of energy (for large customers) in the Territory.
- 1.10 To provide customers and market observers with more information about a key component of the retail price, the Commission recommends that consideration be given to developing a framework for the disclosure of a wholesale electricity reference price, involving publication of the wholesale reference price (and associated energy sent out), at the generation facility gate, for defined intervals after a reasonable period.
- 1.11 The Commission considers that a wholesale reference price would provide customers with relevant information with which to measure wholesale price movements over time and estimate future price movements.
- 1.12 The Commission considers that disclosure of a wholesale reference price in the Territory could provide valuable support to the Commission's proposed retail price monitoring regime as it would increase transparency and accountability of pricing outcome, by:
- providing customers with consistent, auditable and public information on movements in wholesale prices;
 - signaling potential generation investment opportunities to market entrants and market observers;
 - providing large customers with a point of reference on wholesale prices for comparison with terms and conditions offered by PWC in negotiations; and
-

- supporting monitoring of potential misuse of market power.

1.13 Further, this proposal would be consistent with facilitating alignment with NEM sport market arrangements.

Customer complaint mechanism

1.14 The Commission considers that any changes to the customer complaint mechanism require further investigation of the operation of the complaint mechanism and regulatory options. The Commission may consider reviewing the customer complaint mechanism and the introduction of customer pricing guidelines independently of this review.

Implementation

- 1.15 The Commission considers that a reference from the Treasurer under the *Utilities Commission Act* [s.6(1)(g)] is the fastest way of implementing the retail price monitoring framework. However, the Commission considers that legislation is appropriate in the longer term, whether a new Regulation or amendment to the *Electricity Reform Act*, as this would provide regulatory certainty, and a clear signal to customers and PWC of the purpose and scope of the retail price monitoring arrangements. Further, the Commission considers that a clear statutory framework would facilitate consistent, accountable and transparent operation of the regime.
- 1.16 The Commission considers that the timing of implementation, and the start of retail price monitoring activities, would be determined by the method of establishing the retail price monitoring framework.
- 1.17 If the framework were implemented by a reference to the Commission from the Treasurer, the Commission considers that the earliest the retail price monitoring activities could start is July 2011, with the first reports available about four to six months later.
- 1.18 A detailed building block assessment of PWC's unbundled retail costs and prices could be conducted in parallel with an assessment for the Treasurer of the level of retail tariffs for small customers prior to the expiry of the current Pricing Order on 30 June 2013. This exercise would probably take up to 12 months.
- 1.19 The Commission considers that an effective retail price monitoring regime for the Territory should ensure that electricity industry participants and customers have access to key information necessary to make informed investment and consumption decisions. This requires increased disclosure of information on prices and costs than is currently available.
- 1.20 The Commission recognises that the treatment of information, and the public disclosure of information, requires consideration of the effect on the market, such as the potential for providing customers with more information (and bargaining power) or providing new entrants with a competitive advantage through insight into the incumbent's business practices.
- 1.21 The Commission considers that clear rules may be required to confirm the treatment of information that might be deemed confidential or commercially sensitive, but should be available for public release to support the effective operation of the proposed retail price monitoring arrangements.
-

1.22 The most effective way to provide certainty about the treatment of information would be to specify in the legislative framework established to implement the retail price monitoring arrangements the information that might be released, and the process for dealing with situations where the need to release information is contested.

CHAPTER 2

Introduction

Background

- 2.1 The electricity supply industry in the Northern Territory is regulated by the *Electricity Reform Act*, *Electricity Networks (Third Party Access) Act*, *Utilities Commission Act* and associated legislation. This statutory framework was introduced on 1 April 2000.
- 2.2 The statutory framework is primarily focused on regulating the activities of electricity industry participants and customers in the Darwin-Katherine, Alice Springs and Tennant Creek power systems – referred to as the market systems. Key elements of the statutory framework are:
- third party access to the Darwin-Katherine, Alice Springs and Tennant Creek electricity networks;
 - staged introduction of retail contestability, with all customers becoming contestable from 1 April 2010; and
 - an independent economic regulator, the Utilities Commission, to regulate monopoly electricity services, licence market participants and enforce regulatory standards for market conduct and service performance.
- 2.3 The Power and Water Corporation (PWC) is the main participant in the market systems, generating the majority of electricity, operating the network and supplying retail services to all customers. PWC also provides water supply and sewerage services to customers throughout the Territory.
- 2.4 PWC is a vertically integrated electricity service provider, with generation, network and retail business units operating as separate businesses.¹ The commercial relationship and transactions between each unit is subject to oversight and regulation by the Commission.² PWC is owned by the Territory Government, and is also subject to oversight by a shareholding Minister (currently the Treasurer) through the *Government Owned Corporations Act*.
- 2.5 In the three market systems, PWC is currently the sole electricity retailer, supplying electricity to 74 021 customers at 30 June 2010.³ PWC is also the main electricity generator, with almost 91 per cent of generation capacity. There are four other firms generating electricity for the Darwin-Katherine and Alice Springs systems. However,

¹ This paper refers to the separate business units as PWC Retail, PWC Networks and PWC Generation.

² Regulatory instruments include the licensing framework and the Northern Territory Electricity Ring-Fencing Code.

³ Power and Water Corporation, 2009-10 Licence Return.

these businesses generate electricity under contract for PWC rather than selling directly to an electricity retailer, and PWC provides the fuel used for electricity generation.⁴

- 2.6 PWC operates the Darwin-Katherine, Alice Springs and Tennant Creek networks, and is responsible for system control.⁵ The networks are not interconnected, and are separated by long distances. The networks in the market systems comprise 666 kilometres (km) of high voltage transmission lines and 5156 km of low voltage distribution lines.⁶
- 2.7 Electricity supply in regional and remote centres of the Territory is mainly managed by the Territory Government and a service provider through a contract for service model. These systems include the 72 communities and 82 outstations where essential services are provided through the Territory Government Indigenous Essential Services program; three mining townships (i.e. Nhulunbuy, Alyangula and Jabiru), where electricity is supplied by the associated mining firm; and eight remote townships (e.g. Elliott, Yulara and Ti-Tree).

Developing an electricity retail price monitoring regime

- 2.8 The Commission is required to review and report on options for the development of an effective electricity retail price monitoring framework, and the associated reporting and disclosure arrangements. The purpose of the review is to recommend options for a framework to increase transparency in retail electricity pricing, and ensure that retail prices reflect the cost of supply.
- 2.9 Price monitoring in Australia is generally used to address public concerns about pricing outcomes by requiring a firm in a market with significant market power to provide, at a minimum, price data at regular intervals. Specific cost and profit data may also be required. Market performance may be monitored for a defined period of time, to allay public concerns about misuse of market power, or to determine if more intrusive regulation, such as regulation of maximum prices, may be warranted.
- 2.10 However, ongoing concerns about misuse of market power are managed through the national access regime or industry specific legislation.⁷ For markets with ongoing monopoly characteristics (e.g. the network sector of the electricity industry), price monitoring regulation may become a permanent feature of the market rules. 'Standing offer' retail tariffs for small electricity customers may be regulated until effective competition develops.

⁴ These generators are located at Pine Creek (between Darwin and Katherine), Shoal Bay (at the Darwin City Council dump) and Brewer Estate (in Alice Springs).

⁵ The System Controller is located in the PWC networks business unit, and is responsible for monitoring and controlling the operation of the power system to ensure the system operates reliably, safely and securely in accordance with the System Control Technical Code.

⁶ Power and Water Corporation, 2009-10 Licence Return.

⁷ Productivity Commission, August 2001, Review of the Prices Surveillance Act 1983: Inquiry Report, Report No 14, page 49.

-
- 2.11 The market frameworks for the national electricity market (NEM), Western Australia and the Territory are established through industry specific legislation, and include information disclosure and monitoring arrangements to measure price and service performance outcomes. A key aspect of electricity market arrangements is oversight of firms by an independent regulator, such as the Commission.
- 2.12 The level of scrutiny of price/performance outcomes is determined by the level of competition in the market sector. For example, electricity networks are natural monopoly businesses, and subject to regulation of revenue, price and service performance. In contrast, generators and retailers are generally subject to less intrusive regulation of price/performance due to the incidence or the prospect for competition being greater.
- 2.13 In a competitive market, customers not satisfied with the electricity price/performance bundle offered by a retailer can generally obtain the information to determine if there is a better offer available, and are able to move to another retailer. Competitive disciplines encourage retailers and generators to strive to maintain and improve service performance, and keep prices as low as possible.
- 2.14 In this context, the Commission considers that developing an effective retail price monitoring regime for the Territory involves:
- providing electricity industry participants and customers with the information necessary to make informed investment and consumption decisions, and to determine if the terms and conditions of supply (price/performance) are reasonable; and
 - providing incentives for electricity service providers to strive to maintain and improve service performance, and keep costs to a minimum, while there is no effective competition in the generation or retail market sectors.

Summary of terms of reference

- 2.15 The terms of reference for this review require the Commission to:
- examine the options for a retail price monitoring regime for electricity customers in the Territory;
 - propose design options, reporting and disclosure arrangements for a retail price monitoring regime that complements the existing complaints mechanism available under the *Electricity Reform Act*; and
 - recommend a preferred option for the design of a retail price monitoring regime, and provide plans for the implementation of the proposal.
- 2.16 In undertaking the review the Commission is to take into account:
- the objective of a retail price monitoring regime in the Territory context;
 - the longevity of the regime and the market conditions that would warrant monitoring to cease, or monitoring arrangements to be revised;
 - the practical implementation requirements of a retail price monitoring regime; responsibility for oversight of the regime, and arrangements for collecting and reporting data, with an emphasis on the treatment of commercially sensitive data;
 - interstate experience of price oversight in contestable markets; and
-

- all relevant economic and policy developments, including current and forecast economic conditions, the proposed national emissions trading scheme and the expanded renewable energy target.

Conduct of the Review

Issues Paper

- 2.17 The Commission released an Issues Paper on 20 February 2010 to initiate the review and to obtain comment from interested parties on the options and considerations for developing a retail price monitoring regime.
- 2.18 The Commission held a stakeholder forum on 17 March 2010, to facilitate discussion of the issues associated with developing a retail price monitoring framework for the Territory.
- 2.19 The Commission received submissions to the Issues Paper from the Energy Users Association of Australia (EUAA), the Northern Territory Major Energy Users (NTMEU) and PWC.
- 2.20 NTMEU proposed the following options for a retail price monitoring framework for the Territory:
- improved disclosure of financial and planning information;
 - price monitoring accompanied with the threat of further action in the event of price monitoring is proved to be ineffective; and
 - establishing a dispute resolution mechanism, with the Commission as a mediator/arbitrator.
- 2.21 The EUAA expressed the view that establishing effective competition, by focusing on the structural reform of the Territory electricity industry, was the most appropriate way of counteracting PWC's monopoly position. In the absence of competition, the EUAA considered that comparative cost benchmarking could assist firms in assessing whether efficient outcomes were achieved.
- 2.22 PWC suggested that existing regulatory arrangements were satisfactory for dealing with potential abuse of market power, and expressed concerns that the disclosure of potentially commercial information may result in unfair competitive advantage to new market entrants. PWC proposed that the Commission continue with the existing arrangements, with the option of reintroducing the contestable pricing guidelines which were withdrawn in 2007 and the generation price monitoring regime that operated to 2005.⁸

⁸ For further details on contestable pricing guidelines and generation price monitoring, refer to the Utilities Commission's Issues Paper on the Review of Options for the Development of a Retail Price Monitoring Regime for Contestable Electricity Customers, February 2010, pages 11 and 47.

Draft Report

2.23 The Commission released a Draft Report on Friday 18 June 2010 with proposals for the implementation of a retail price monitoring regime for contestable electricity customers in the Territory.

2.24 In summary, the Commission proposed:

- regular monitoring and reporting of PWC's pricing outcomes;
- periodic detailed investigation of PWC's costs, prices and revenues to ensure that customer tariffs are cost reflective, and that the costs involved represent no more than the reasonable long run cost of supplying electricity. This type of analysis would be undertaken by the Commission as a result of triggering events such as a customer complaint;
- the publication of a wholesale electricity reference price, at the generation gate and for defined intervals after a reasonable period; and
- a revised customer complaint mechanism to address non-price matters, especially contrary negotiation behaviour, with introduction of customer pricing guidelines.

2.25 The Commission received submissions to the Draft Report from NTMEU and PWC.

2.26 PWC was supportive of the Commission's proposed changes and agreed that greater transparency about generation price would address the concerns of customers. However, it expressed some concern about disclosure of commercially sensitive information which could undermine its commercial position, should there be a new market entrant in the Territory.

2.27 NTMEU was supportive of the proposals put forward by the Commission.

CHAPTER 3

Objectives of price monitoring

Price monitoring arrangements

- 3.1 Price monitoring involves the publication of relevant information to increase scrutiny of prices and market performance where there is little competition. This information disclosure enhances market transparency and improves community understanding of the workings of the market.
- 3.2 Price monitoring generally takes two forms, depending on the level of competition in the market:⁹
 - to support regulation of a firm with dominant market power. Public reporting of key information encourages firms to achieve formal or informal price, profit and quality targets, or face more intrusive action by an independent regulator (e.g. price controls) if outcomes are not considered acceptable; or
 - to observe and understand the performance of a firm or market where there is competition, but a perception of misuse of market power. Public reporting of key information is intended to allay concerns about perceptions of misuse of market power through greater scrutiny of a firm's performance.
- 3.3 Price monitoring in Australia is generally used to measure market performance for a defined period of time, to address public concerns about pricing outcomes and potential misuse of market power in markets with monopoly characteristics. Firms are required to provide specific cost, profit and price data at regular intervals. Industries where price monitoring arrangements have applied include airports, petrol retailing and stevedoring.
- 3.4 However, ongoing concerns about the potential for misuse of market power in a market are more commonly managed by regulation through the national access regime or industry specific legislation.¹⁰
- 3.5 The electricity industry is an example, with generation, network service providers and retailers required to comply with price and service performance targets, and report key information. The type and detail of information disclosed is defined in the market framework (e.g. the National Electricity Rules in the NEM or *Electricity Reform Act* in the Territory), and is expected to facilitate the effective and efficient operation of the market. Electricity industry participants and customers should have sufficient

⁹ Productivity Commission, August 2001, Review of the Prices Surveillance Act 1983: Inquiry Report, Report No 14, pages 47-8.

¹⁰ Ibid, page 49.

information to understand the workings of the market, and make informed investment and consumption decisions.

The case for price monitoring in the Territory

- 3.6 The Commission considers a competitive electricity market with multiple generators and multiple retailers vying for market share has been demonstrated as the most effective way of achieving the price and performance outcomes preferred by customers.
- 3.7 As noted by the Australian Energy Market Commission (AEMC) when assessing competition in electricity and gas retail markets in South Australia:¹¹
- Markets are better able to process complex and rapidly changing information, particularly in relation to changes in costs, in a timely manner and coordinate the actions of market participants. When competition is effective, markets maintain prices in line with real costs of supply as they adjust to changing conditions.*
- 3.8 There are multiple generators and multiple retailers competing in the NEM and Western Australia electricity market. Customers may compare the price/performance bundle offered by competing retailers, and may move to another retailer if they consider the offer is more favourable to their circumstances.
- 3.9 The competitive disciplines in the NEM (in particular) encourage retailers and generators to strive to maintain and improve service performance, and keep prices as low as possible to retain and gain market share. Further, this competition lessens the need for more intrusive regulation to ensure no firm is misusing market power, and that pricing outcomes are reasonable.
- 3.10 The Commission considers that the situation in the Territory is quite different to the NEM. PWC has an effective monopoly in the notionally competitive electricity retail and generation sectors. Moreover, the Territory market framework does not require disclosure of the type or detail of information that is available in the NEM (or Western Australia). In particular, there is no regular publication of a wholesale electricity reference (spot) price, and limited system planning information.
- 3.11 In response to the Issues Paper, PWC expressed the view that the existing market and regulatory arrangements were designed to provide customers and the Territory Government with confidence that PWC was operating in a fair and reasonable manner. PWC expressed concern about price monitoring adding costs and requiring significant resources for little benefit to customers.¹²
- 3.12 The Commission considers that the existing market and regulatory arrangements are not consistent with the market environment. This undermines the confidence of customers and stakeholders that PWC is operating in a manner consistent with good

¹¹ Australian Energy Market Commission, December 2008, Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in South Australia, Second Final Report, page 25.

¹² Power and Water Corporation, April 2010, Review of Retail Price Monitoring for Contestable Electricity Customers – Power and Water’s Response to Issues Paper, pages 8 and 2.

industry practice and is the primary reason for the Territory Government's decision to initiate the series of reviews the Commission is undertaking, including this review.

Objectives of price monitoring in the Territory

- 3.13 The Commission considers that the objective of a retail price monitoring regime in the Territory is to support the effective operation of the electricity market by:
- giving customers the information necessary for them to be confident that the terms and conditions of supply (price/performance) offered by PWC Retail are reasonable;
 - giving customers and industry participants the key information necessary to make informed investment and consumption decisions; and
 - establishing adequate incentives for PWC to strive to maintain and improve service performance, and to keep costs and prices to a minimum, while there is no effective competition in the generation or retail market sectors.
- 3.14 The Commission notes that the objectives of the Territory's regulatory framework include to:¹³
- promote efficiency and competition in the electricity supply industry;
 - promote the safe and efficient generation, transmission, distribution and selling of electricity; and
 - protect the interests of consumers of electricity.
- 3.15 The Commission is of the view that an effective retail price monitoring regime in the Territory should be transparent, flexible and for a defined period. The information provided should be consistent and relevant, and there should be consideration of the cost to service providers of providing information, relative to the benefits to the users.
- 3.16 In particular, the Commission considers that a retail price monitoring regime should facilitate greater information disclosure to assist customers understand the workings of the market, and the relationship between prices and costs. In turn, this would facilitate commercial negotiations between large customers and PWC (as the dominant supplier) on the terms and conditions of supply contracts.
- 3.17 Further, the Commission is of the view that a retail price monitoring regime in the Territory could provide information that might assist alternative electricity service providers to assess the merits of market entry. Given PWC's current effective monopoly in generation and retail sectors, greater information disclosure is an important step in the development of competition, or establishing a credible threat of competition, in the Territory electricity industry.
- 3.18 PWC is effectively the only supplier of electricity generation and retail services in the Territory, and has the ability to exercise market power in the Territory electricity market. The potential for market entry and the development of effective competition is not great, at least in the next few years. As such, price monitoring in the Territory is partly a

¹³ *Electricity Reform Act*, s3.

response to market conditions and dominant market position (at this time) of PWC, and partly about adopting what is accepted practice elsewhere in Australia.

Draft recommendation

- 3.19 The Commission was of the view that PWC would continue to have significant market power in the generation and retail sectors for the short to medium term, at least until regulatory and market conditions in the Territory were more conducive to market entry by alternative generators and retailers, and competition.
- 3.20 In this environment, the Commission considered that there was a case for a set of arrangements to measure the performance of the Territory's electricity industry, and price/performance outcomes, until there was effective competition in the Territory electricity market.

Views in submissions

- 3.21 PWC expressed support for a workable regime which sets out initiatives addressing customer concerns.
- 3.22 PWC argued that the recommendations in the Draft Report were based on the premise that PWC would retain its dominant market position in the short to medium term. PWC had concerns about the release of commercially sensitive information which could have a negative impact on the incumbent, should there be a new entrant entering the market. The promotion of competition was better addressed through regulatory reforms, such as the implementation of full of retail competition (FRC), rather than the disclosure of commercially sensitive information. PWC argued that the Commission had justified the public release of information on the grounds of competition and net public benefit. However the Commission had not acknowledged that competition does not always achieve lower prices for consumers.
- 3.23 PWC also asked the Commission to clarify its position as to whether retail price monitoring would apply equally to market entrants.
- 3.24 Finally, PWC considered that price monitoring should not be intrusive or onerous on the business. Where competition is emerging or about to emerge, light-handed regulation was more appropriate.
- 3.25 NTMEU argued that under the current framework, large customers deemed to be contestable are worse off as they have little negotiating powers when dealing with a vertically integrated monopoly. NTMEU agreed with the Commission's view, that there was a strong likelihood of PWC remaining the sole supplier in the Territory electricity market for the next few years.

Response to views in submissions and further analysis

- 3.26 The Commission notes that the regulatory reform to establish clear, workable and relevant market rules has been a necessary pre-condition of competition in the NEM and Western Australia. However, it is not of itself sufficient where market conditions are not immediately conducive to competition. A small market with a dominant incumbent presents a different environment to elsewhere in Australia. A different approach is therefore appropriate. The Commission considers that the lack of key information available to market participants is a factor that impedes market entry and effective
-

competition, and also reduces the ability of (large) customers to understand the workings of the market.

- 3.27 The Commission is of the view that, given PWC's market dominance and the market conditions, there is a case for regulation to ensure information is available to the market and customers. In its submission to the Issues Paper, NTMEU held the view that firms in a monopoly situation tend to treat all information as commercially sensitive to avoid information disclosure.¹⁴
- 3.28 The Commission agrees with PWC's comment that the introduction of competition may not result in lower prices to consumers.¹⁵ However, the Commission considers that the effect of competition (or a credible threat of competition) is to place greater incentives on service providers to keep costs and prices as low as possible while maintaining or improving service performance. Higher prices might be justified if such services are cost reflective, efficiently delivered and of a quality that meets consumers' expectations. The focus of competitive electricity markets is to ensure the price is right, an outcome which may not necessarily result in lower prices
- 3.29 The Commission acknowledges that non-intrusiveness and cost effectiveness are relevant underpinning principles of a retail price monitoring regime. However, these principles need to be balanced against transparency, relevance and consistency, and the extent to which some principles are given effect may be constrained by other principles.¹⁶ The weight given to some principles over others depends on the circumstances and the objectives of the regime. The Commission is of the view that a retail price monitoring regime in the Territory should involve the increased disclosure of information by PWC until there is competition to mitigate PWC's market power.

¹⁴ Northern Territory Major Energy Users, March 2010, Utilities Commission's Review of Options for the Development of a Retail Price Monitoring Regime for Contestable Electricity Customers – Comments on the Issues Paper, page 37.

¹⁵ Power and Water Corporation, August 2010, Review of Options for the Development of a Retail Price Monitoring Regime for Contestable Electricity Customers – Submission by Power and Water in response to Draft Report by the NT Utilities Commission, page 4.

¹⁶ Utilities Commission, February 2010, Review of Options for the Development of a Retail Price Monitoring Regime for Contestable Electricity Customers – Issues Paper, page 23.

Final recommendation

- 3.30 The Commission recommends establishing a retail price monitoring regime in the Territory, with reporting and monitoring requirements applying to PWC for so long as it maintains its market dominance.
- 3.31 The objective of a retail price monitoring regime in the Territory should be to promote efficiency and competition in the electricity sector and to protect the interests of consumers.
- 3.32 The regime should be based on the disclosure of certain information, and monitoring and reporting of PWC's costs, prices and performance.
-

CHAPTER 4

Proposed price monitoring arrangements

Key design features

- 4.1 The Commission considers that a retail price monitoring regime is appropriate in the Territory, to give customers confidence that the terms and conditions of supply offered by PWC are reasonable and to enhance information disclosure to facilitate informed investment and consumption decisions.
- 4.2 The Commission considers that price monitoring arrangements for the Territory should involve:
 - monitoring of market behaviour and pricing outcomes; and
 - disclosure of key information, with the intention to facilitate alignment with NEM arrangements where applicable.
- 4.3 The Commission considers that the retail price monitoring arrangements should establish reliable and consistent data on pricing outcomes. These data should assist large customers to assess whether the contract prices offered by PWC are reasonable, and reflect the cost of supply. Further, the data will provide the Commission with a baseline for monitoring of PWC's revenues, prices, costs and performance, against relevant targets, as part of any future possible assessment of whether PWC's pricing outcomes are reasonable or efficient.
- 4.4 The Commission notes that retail tariffs for small customers for 1 July 2009 to 30 June 2013 are set in a Pricing Order made by the Territory Government.¹⁷ Industry regulators elsewhere in Australia have a role in advising governments on the level of retail tariffs for small customers, and this advice is commonly given subject to detailed terms of reference defining the scope of the exercise and considerations. This may be appropriate in the Territory.
- 4.5 Although the tasks are not directly related, assessing the level of retail tariffs for small customers in the Territory would involve a similar exercise as required to monitor PWC's market behaviour and pricing outcomes. In particular, both would probably require examination of PWC's disaggregated financial accounts and may require additional data from PWC. Consequently, the Commission considers that a role in advising on retail tariffs for small customers could

¹⁷ The Treasurer may issue an order regulating the sale of electricity under the *Electricity Reform Act* s44(1).

effectively occur in parallel with monitoring of PWC's market behaviour and pricing outcomes, an activity important to larger customers.

Monitoring market behaviour and pricing outcomes

- 4.6 The Commission considers that PWC has market power in the supply of electricity generation and retail services, and the ability to exercise market power in the Territory electricity market. Further, the Commission considers that the potential for market entry and the development of effective competition is not great, at least in the next few years.
- 4.7 In this context, the Commission proposes monitoring of market behaviour and pricing outcomes to assure customers and market observers that the price and performance outcomes in the Territory electricity market are reasonable, and that PWC is not misusing its market power.

Options for assessing costs and prices

- 4.8 The Commission has identified two main approaches to assessing the prices and costs of firms with significant market power:
- regular comparison of the firms' costs and prices relative to peers elsewhere or relative to efficient benchmarks; and
 - a forward looking building blocks analysis of costs to indicate if the cost of supply is efficient.

Comparison of costs and prices

- 4.9 A number of monitoring regimes measure movement in prices using price indices based on a weighted tariff basket. The tariff basket is usually constructed for various customer profiles to account for differences in demand patterns.¹⁸
- 4.10 The advantages of the index based technique are that it is a relatively low cost way of summarising information, and focuses on trend performance over time. Additionally, index based methods make it possible to examine the extent to which an increase in profit is attributable to higher output prices, as opposed to improved productivity and/or lower costs.¹⁹
- 4.11 For example, the price oversight of PWC's electricity generation by the Commission in 2003 was conducted with the objective of assessing the reasonableness of generation prices for large contestable customer. The Commission focused on the relationship between the average generation price

¹⁸ For further details, refer to Productivity Commission, 2001, Electricity Prices and Cost Factors.

¹⁹ Productivity Commission, 2004, Review of the Gas Access Regime.

per kilowatt hour for each of the selected customer tranches and an estimated reasonable long run cost of wholesale energy.

- 4.12 Alternatively, a revenue yield approach can be used as a proxy to measure price movements. The revenue yield approach is where average prices are calculated by dividing total revenue received from all customers by the total number of units sold.

Building block analysis

- 4.13 Building block analysis refers to the rigorous assessment by an independent party of a firm's costs and prices to determine if the costs are prudent and efficient. The approach is used for electricity network regulation in Australia, and to assess retail tariff levels for small customers.
- 4.14 For example, the Queensland Competition Authority (QCA) undertakes a yearly assessment of the regulated retail tariff (for small customers) at the direction of the Queensland Government. The approach adopted by QCA is based on the analysis of changes in underlying costs of a retailer and determines an allowable percentage change in the retail tariff.
- 4.15 The Benchmark Retail Cost Index (or the BRCI) has three components: the cost of (wholesale) electricity, distribution and transmission network costs, and retail costs. Network and generation costs account for 91 per cent of the total cost of supplying energy.
- 4.16 The calculation of the generation cost component of the BRCI in a particular year is based on the QCA's view of the likely total cost of purchasing energy to supply the NEM load in that year. The QCA estimates the long run marginal cost (LRMC) of energy in that part of Queensland connected to the NEM, and the actual cost of purchasing energy to meet the NEM load in the tariff year, and then calculates a weighted average of these two costs. The estimated LRMC is based on a hypothetical economically efficient combination of generating technologies in Queensland.
- 4.17 The estimated transmission costs are based on the revenue cap determined by the AER. The distribution costs are based on the revenue requirements determined by the regulator for the local distribution network service providers.
- 4.18 In considering retail costs and margin, the QCA is required to consider costs to a representative retailer, rather than an actual retailer, that already has a significant share of the market. Retail costs comprise retail operating costs, customer acquisition and retention costs (customer churn) and a retail margin estimated of five per cent providing for the various risks inherent with the business.²⁰

²⁰ Queensland Competition Authority, June 2009, 2009-10 Benchmark Retail Cost Index.

- 4.19 The Australian Capital Territory regulator, the Independent Competition and Regulatory Commission (ICRC), adopts a similar approach for determining retail tariffs for small customers as used by QCA. However, the ICRC focuses on estimating the costs incurred by the incumbent retailer, rather than a representative retailer.²¹

Draft recommendation

Regular monitoring

- 4.20 The Commission proposed regular reporting of PWC's pricing outcomes, based on the previous generation price oversight methodology and, possibly, the use of price indices and benchmarks.
- 4.21 The price oversight model would focus on:
- the average revenue per unit of electricity recovered from customers attributable to PWC Generation, PWC Networks and PWC Retail; and
 - the relationship between the indicator of average price and estimates of the reasonable long run cost of wholesale electricity.
- 4.22 The Commission would also compare the firms' costs and prices relative to similar firms elsewhere or relative to efficient benchmarks.
- 4.23 This approach would allow comparison of prices between customer groups, and would allow monitoring of price movements on a consistent basis over time, but it would not inform customers as to whether prices are reasonable.

Detailed investigation

- 4.24 The Commission proposed investigation of PWC's costs and prices to ensure that customer tariffs are cost reflective, and that the costs involved represent no more than the reasonable long run cost of supplying electricity. The Commission expected that the assessment would involve a building block analysis of each component of the average retail price.
- 4.25 A detailed investigation would enable the Commission to assess the appropriate price levels based on the analysis of each business component: generation, networks and retail. It would provide assurance to customers that PWC's pricing outcomes are fair and reasonable. It would also address customers' concerns about pricing conduct and anti-competitive market behaviour.
- 4.26 The results of this investigation could be made public to support confidence in the wholesale electricity reference price disclosure mechanism.

²¹ Independent Competition and Regulatory Commission, April 2010, Retail Prices for Non-contestable Electricity Customers 2010-2012, Report 5 of 2010.

Views in submissions

- 4.27 PWC expressed concern about the potential for customer confusion from the disclosure of additional information without any comment or opinion about whether prices were reasonable. PWC echoed the views of NTMEU who had previously argued that, without the Commission expressing a view as to the reasonableness of the prices, disclosure of information would be of little use to customers.²²
- 4.28 PWC supported the Commission's intention to benchmark PWC's costs and prices against similar firms. However, PWC suggested that there is no comparable firm in Australia, due to the particular fuel supply arrangements and investment planning criteria for power stations. PWC suggested that the Commission take these specific characteristics into account, should a benchmarking approach be adopted.
- 4.29 There was no comment on the Commission's proposed detailed investigation of PWC's costs and prices.

Response to views in submissions and further analysis

- 4.30 The focus of monitoring market behaviour and pricing outcomes is to:
- assess whether costs are efficient;
 - monitor the reasonableness of prices; and
 - provide relevant information to stakeholders.
- 4.31 This could be achieved by conducting detailed investigations which would enable the Commission to determine if the costs are prudent and efficient. The approach would be based on a building block analysis. A similar approach is used by the Commission when conducting the price determination of network services. The Commission also notes that detailed building block analysis is used by other Australian jurisdictions when determining regulated retail tariffs for small customers.
- 4.32 Regular monitoring of PWC's pricing outcomes would be based on the previous generation price oversight methodology and, if possible, the use of prices indices and benchmarks. The information provided to stakeholders and customers would enable them to make informed investment or consumption decisions. The Commission considers that this approach should be flexible and provide different perspectives of the PWC's prices and costs. As a result the Commission would expect to make changes to the approach over time depending on the circumstances and availability of information.

²² Northern Territory Major Energy Users, March 2010, Utilities Commission's Review of Options for the Development of a Retail Price Monitoring Regime for Contestable Electricity Customers-Comments on the Issues Paper, page 31,

- 4.33 The Commission considers that an appropriate approach to the regular monitoring of retail prices would be to assess the average revenue recovered by PWC (Generation, Networks and Retail) for each large customer tranche in the market systems relative to the efficient long run cost of a new entrant retailer.
- 4.34 PWC has advised the Commission that it has developed a Generation Transfer Pricing report identifying electricity prices, quantities and total transfer pricing revenue by customer, tranche and region.²³ Given that the wholesale energy component represents a substantial portion of a customer bill, the Commission is of the view that the monitoring of wholesale generation prices would provide greater assurance to large customers that PWC Generation recovers over time no more than the efficient long run cost of supplying them.
- 4.35 The Commission acknowledges that individual customer costs may vary from the range of values for the indicative average generation cost, as individual customer costs are expected to vary depending on their time of use, load factor and location. The aim of the regular price monitoring is to provide assurance that, on average, the unbundled prices charged to customers on negotiated contracts are not inconsistent with the estimated long run cost of energy and supply. The Commission is of the view that this difference could be used during the negotiation process to further discussions of how the offered generation and final prices were derived.

Final recommendation

- 4.36 The Commission recommends the introduction of new arrangements to monitor PWC's market behaviour and pricing outcomes. The proposed arrangements would include:
- periodic detailed investigation of electricity supply costs and prices based on a forward looking building block analysis of costs; and
 - regular reporting of PWC's costs and prices using indices and benchmarks.
- 4.37 These arrangements should be progressively phased out when effective competition is evident in the Territory electricity market.

Detailed investigation

- 4.38 The Commission proposes that it undertake periodic detailed investigation of PWC's behaviour, costs and prices to ensure that customer tariffs are cost reflective. The Commission would adopt a building block analysis of each component of the retail price. Such an in-depth investigation would require

²³ Power and Water Corporation, April 2010, Review of Retail Price Monitoring for Contestable Electricity Customers – Power and Water's Responses to Issues Paper, page 10.

substantial time and resources (from the Commission and PWC) and should be undertaken if triggered by specific events such as a customer complaint or the Commission's suspicion of contrary conduct. The first assessment could be undertaken by the Commission in parallel with developing advice to the Territory Government on tariff levels for the next Pricing Order applying to small customers.

Regular monitoring

- 4.39 The Commission intends to monitor PWC's retail prices by focusing on the average revenue recovered from large customers by PWC per kilowatt hour. Customers would be grouped by customer size (by consumption) and the supply region (Darwin-Katherine or Alice Springs) in which they are located. Customer names would not be identified.
- 4.40 Alternatively, the average revenue per kilowatt hour could be compared to an estimate of the long run cost for a new entrant retailer, based on assumptions including:
- a reasonably efficient generator supplying the Darwin-Katherine, Alice Springs and Tennant Creek power systems;
 - the standard merit order generation cost modelling approach widely used by other regulators, including the same plant type, order of operation and fuel source as PWC and indicative wet/dry season system load profile;
 - estimates of fuel costs that a comparable generator would face. Given the estimates are dominated by the cost of gas, the Commission recommends using a lower and upper bound to reflect the range of gas costs that a comparable generator would face;
 - application of standard network access charges; and
 - application of standard retailing costs and margins.
- 4.41 The Commission also recommends regular reporting of PWC's pricing outcomes based on any other useful monitoring tools that are appropriate to the circumstances, such as:
- index of weighted average contract prices for each customer tranche to monitor average price trend over time;
 - benchmark retail margins; and
 - comparing movements in underlying operating costs to reveal trends in performance over time.
- 4.42 The Commission recognises the evolving nature of the electricity industry in the Territory and suggests that elements of the reporting arrangements should be flexible and adjusted to reflect market conditions as required.

Information Disclosure

- 4.43 Similar investigations elsewhere in Australia are conducted as public reviews which include public consultation. The Commission considers that transparent reporting of findings is desirable for the following reasons:
- it provides greater regulatory certainty;
 - it engages customers and stakeholders; and
 - it builds confidence in the regulatory framework.
- 4.44 In addition, the Commission notes that the Productivity Commission, following an inquiry reports on airport services and the *Price Surveillance Act 1983*, considered that it was appropriate for a regulator to collate and publish data provided by companies under a monitoring regime. Although the treatment of some data as being confidential would need to be considered on a case by case basis, as a general principle the Productivity Commission was of the view that ‘the more public the data, the greater is the accountability’.²⁴

Proposed information disclosure arrangements

- 4.45 The Commission considers that customers assessing the terms and conditions of supply offered by a retailer require price and performance information.
- 4.46 The price of electricity for an end user comprises the generation (wholesale) component, network (transport) component, and the retail (administration) component. In the NEM, the generation and network components are readily known to customers. Wholesale prices are published through the spot market mechanism, and the network component is fixed by the regulator (e.g. the AER, the national equivalent of the Commission). Retail competition has proved effective in most NEM jurisdictions, resulting in competitive retail contracts being negotiated between retailers and customers, particularly for large customers.
- 4.47 Effectively, large customers (without access to the customer protection arrangements available to households) can measure wholesale price movements over time, and make some estimates of wholesale prices in the future (which may include the use of published prices in the futures market for wholesale electricity). Customers also know that the network charge is set by the regulator for a five year period. With this information, customers have reference points to compare prices offered by retailers.
- 4.48 According to a 2009 study of electricity costs for small customers in Queensland, the proportion of the electricity price accounted for by each component, on average, is about 44 per cent for generation, 47 per cent for

²⁴ Productivity Commission, 2004, Review of the Gas Access Regime, pages 376-7.

networks, and 9 per cent for retail.²⁵ A similar study for the Australian Capital Territory in 2010 found that, on average, generation costs accounted for 47.3 per cent, network costs for 41.5 per cent, and retail costs for 6.5 per cent, of the electricity price for small customers.²⁶ PWC advised in its submission on the Issues Paper that generation costs represent about 75 per cent of the average price for large customers.²⁷

- 4.49 The price information available to customers in the NEM is not readily or regularly available for the Territory. Although the network component is fixed by the Commission, customers do not have access to a wholesale reference price, with which to measure price movements over time (e.g. hourly, daily, seasonally, yearly) or the ability to assess and compare retail margins (i.e. by comparing quotes from different retailers).
- 4.50 The Commission considers that the high proportion of the wholesale energy component in customer bills provides a case for greater transparency of generation prices in time and over time.

Disclosure of a wholesale electricity reference price

- 4.51 The Territory's market framework leaves decisions about wholesale prices to be made through bilateral contracts negotiated between a generator and retailer. The Ring-Fencing Code requires PWC to provide limited information on generation prices to the Commission, for use in the event the Commission is required to investigate conduct between the PWC Generation and PWC Retail business units. However, there is currently no public information on how wholesale prices are derived, or the underlying generation costs.
- 4.52 This lack of information means customers are unable to make informed decisions about contract terms by assessing if the wholesale price available from PWC is reasonable. Further, there is little opportunity for customers, the Territory Government or the Commission to hold PWC accountable for the cost and price of electricity. The lack of information may also hinder the development of effective competition in the Territory, as market observers would find it difficult to assess the viability of entering the market.
- 4.53 In the NEM, wholesale electricity prices are determined in real time, with generators offering to supply specific amounts of electricity at certain prices. From all offers submitted, the Australian Energy Market Operator (AEMO) determines the spot price for each half hourly trading interval in each of the regions of the NEM. Electricity is dispatched to meet demand according to a

²⁵ Queensland Competition Authority, June 2009, 2009-10 Benchmark Retail Cost Index – Final Decision, page 5.

²⁶ Independent Competition and Regulatory Commission, March 2010, Model of Determining the Energy Purchase Cost Component of the Transitional Franchise Tariff, Report 3 of 2010, Appendix 2, page 42.

²⁷ Power and Water Corporation, April 2010, Review of Retail Price Monitoring for Contestable Electricity Customers – Power and Water's Responses to Issues Paper, page 10.

merit order, from the lowest to highest offer as demand increases. The spot price is the price of wholesale electricity at a point in time. However, the cost passed on to consumers is not necessarily reflective of the spot price as generators, retailers and customers may enter in contracts to manage their exposure to price volatility.

- 4.54 The spot price (and generator offers) is based on a complex range of variables, such as the short run marginal cost (operating costs), individual generator's operating decisions and generation capacity and network constraints (giving generators temporary market power to increase prices).
- 4.55 A wholesale electricity price is published for the Western Australian south west interconnected system. Each day, market participants advise the Independent Market Operator of their bilateral contract position and make bids to buy and offers to sell electricity in each half hourly trading interval on the following day.
- 4.56 The approach recognises that most electricity in Western Australia is traded through bilateral contracts between generators and market customers, but allows market participants to trade around their bilateral position, producing a net contract position.²⁸
- 4.57 In both the NEM and Western Australia, a wholesale reference price is publicly available. This information can be used by customers to inform negotiations with retailers on the terms and conditions of supply contracts.

Draft recommendation

- 4.58 The Commission discussed a proposal for the development of a framework for the disclosure of a wholesale electricity reference price, involving publication of the wholesale reference price (and associated energy sent out), at the generation facility gate, for defined intervals after a reasonable period.
- 4.59 The Commission considered that disclosure of a wholesale reference price in the Territory would provide useful support to the proposed price monitoring regime by increasing transparency and accountability of pricing outcomes and by:
- providing large customers with a point of reference on wholesale prices for comparison with terms and conditions offered by PWC in negotiations;
 - providing customers with consistent, auditable and public information on movements in wholesale prices;
 - signaling potential generation investment opportunities to market entrants and market observers; and
 - supporting monitoring of potential misuse of market power.

²⁸ Independent Market Operator, September 2006, Wholesale Electricity Market Design Summary, page 45.

- 4.60 The final retail price could differ between customers depending on their consumption patterns, peak demand, load factors and load profile. Additionally, discounts could be offered to certain users. Consequently, the wholesale component of a final price could differ from the wholesale reference price. However, the Commission considered that disclosure of a wholesale reference price (and associated energy volumes) would provide sufficient information to customers to assess if the wholesale price component of an offer was reasonable, and to assess the merits of alternative supply options.

Views in submissions

- 4.61 PWC and NTMEU supported the development of a framework to facilitate the publication of a wholesale reference price.

Final recommendation

- 4.62 The Commission recommends that consideration be given to developing a framework for the disclosure of a wholesale electricity reference price, involving publication of the wholesale reference price (and associated energy sent out), at the generation facility gate, for defined intervals after a reasonable period.
- 4.63 The Commission considers that disclosure of the wholesale electricity reference price could provide valuable support to the proposed regular monitoring of PWC's pricing outcomes.
- 4.64 The disclosure of a wholesale electricity price would also be useful when conducting the detailed investigation of PWC's costs and prices using a building block analysis by providing a consistent and transparent data set on wholesale prices over time. The Commission considers that this proposal would be consistent with facilitating eventual alignment with NEM arrangements.

Disclosure of non-price information

- 4.65 Price monitoring arrangements often require disclosure of non-price information to enable customers to assess if the price/performance bundle is reasonable.
- 4.66 The type and detail of non-price information provided through information disclosure regimes in other jurisdictions can include:²⁹
- financial statements based on consolidated financial accounts can provide information for assessing market behaviour and pricing outcomes, if accompanied by explanations of the underlying assumptions and methods used to prepare the accounts. The methods for the allocation of costs and revenue should be transparent.

²⁹ Productivity Commission, 2004, Review of the Gas Access Regime, pages 360-72.

- operational statistics for key input and output prices and quantities reported at an aggregate and detailed level, developed using index based techniques, can provide additional information in support of the financial statements. Information produced using index based techniques can make information easier to understand and allow monitoring of the service provider's performance over time. Examples are the percentage growth in input quantities and prices, percentage growth in output quantities and prices, percentage growth in profit, and total factor productivity (percentage growth of outputs less percentage growth of inputs).
- dealings with associates, to monitor if a service provider is treating its associates more favourably than others. This information can be reported as part of the financial and operational statistics information disclosure.
- measures of service quality, such as reliability and customer service.
- third party access negotiations, to monitor if negotiations about access were successful or not. Information reported could include the number of negotiations commenced, the number of agreements made, the number of negotiations in dispute, and the duration of negotiations.

Draft recommendation

4.67 The Commission noted that customers already had access to information on generation and network reliability, and customer service performance through the Electricity Standards of Service Code. Moreover, forward planning information for the system was provided to stakeholders through the annual Power System Review, which the Commission intends making more comprehensive and consistent with NEM practices.

Views in submissions

4.68 Neither PWC nor NTMEU commented on this issue.

Final recommendation

4.69 The Commission is of the view that there is sufficient non-price information at this stage available to customers to assess the service level aspects of electricity supply, including:

- the reporting of generation and network reliability, and customer service performance under the Electricity Standards of Service Code; and
- forward planning information provided through the annual Power System Review.

Customer complaint mechanism

4.70 The Commission is of the view that the information disclosure arrangements under the proposed retail price monitoring regime should give large customers a greater ability to assess and negotiate contract terms. Further, the proposals for monitoring market behaviour and pricing outcomes should give assurance to customers that PWC is operating efficiently, and pricing outcomes are reasonable. On this basis, the Commission considers that contract terms are a matter for negotiation between PWC and each large customer.

4.71 However the Commission considers that, due to PWC's market dominance, there may be a need to provide large customers with an additional safety net.

4.72 Under *the Electricity Reform Act*, a complaint about market conduct may only be made by a customer (or an electricity service provider) if it is adversely affected by the alleged conduct or non-compliance of the firm. The Commission may only investigate a complaint if:³⁰

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

4.73 Currently customers can request the Commission to investigate a specific complaint about PWC's pricing conduct. Contrary conduct is defined as something contrary to the conditions of a licence, or the objects of the *Electricity Reform Act* which are:³¹

- to promote efficiency and competition in the electricity supply industry;
- to promote the safe and efficient generation, transmission, distribution and selling of electricity;
- to establish and enforce proper standards of safety, reliability and quality in the electricity supply industry;
- to establish and enforce proper safety and technical standards for electrical installations;
- to facilitate the maintenance of a financially viable electricity supply industry; and
- to protect the interests of consumers of electricity.

³⁰ *Electricity Reform Act*, Division 8, ss48-51.

³¹ *Electricity Reform Act*, s3.

Experience to date with the customer complaint mechanism

- 4.74 The Commission has only received one formal complaint about PWC's conduct since 2000. The Commission found that PWC did not engage in contrary market conduct. However, the lack of formal complaints may not be evidence of customers' acceptance, as customers have expressed dissatisfaction to the Commission (e.g. through NTMEU) and to the Territory Government about PWC's negotiating process.
- 4.75 The Commission notes that the Territory's market and regulatory framework was designed in expectation of customers having a choice of multiple retailers and bargaining power, equivalent to the experience of the NEM. As such, the complaint mechanism appears to operate as a last resort as it is not designed to address general customer concerns about the conduct of negotiations.

Draft recommendation

- 4.76 The Commission proposed that the customer complaint mechanism be amended to:
- better define what constitutes 'contrary conduct' – this could include the duty to negotiate in good faith;
 - give the Commission greater flexibility and discretion about initiating an investigation of a complaint;
 - widen the scope of matters the Commission could investigate – this could include provisions in relation to:
 - the negotiation process such as failure to comply to a pre-defined timeline for initiating, progressing and finalising negotiations; failure to negotiate in good faith; failure to provide a written response to queries from customers within agreed timeline; or provision of inaccurate information.
 - PWC's inability to demonstrate how offered prices are derived, and whether prices are cost-reflective.
 - reduce the formality of the investigation process;
 - make public the outcome of the investigation, subject to relevant confidentiality restrictions, to provide additional transparency about the operation of the market; and
 - provide the Commission with greater flexibility and discretion to remedy a matter.

4.77 The proposed amendments were a response to the concerns of a number of large customers about the existing customer complaint mechanism. The reasons for large customers not using the complaint mechanism included:³²

- a lack of clarity as to what constitutes contrary conduct;
- relatively stringent criteria to meet before the Commission would become involved in a complaint;
- the formality of the investigation process the Commission must follow; and
- large customers being exposed to significant legal and other transaction costs.

4.78 The Commission did not consider that there was a need to introduce a negotiate/arbitrate process. The Commission considered that this approach would unnecessarily draw the Commission into commercial negotiations.

Views in submissions

4.79 PWC asked the Commission for clarifications about the specifics of the proposed changes to the customer complaint mechanism. In particular, PWC queried whether the Commission intended to become involved in setting contract terms and conditions in cases where there is a deadlock in the negotiation process.

4.80 PWC also requested that all parties should be treated in fairness and that the contestable customer pricing guidelines be consistent with the *Trade Practices Act 1974*.

4.81 NTMEU supported the Commission's proposed changes to the Customer Complaint Mechanism framework. It also supported the re-introduction of a contestable customer pricing guidelines.

4.82 Finally, NTMEU re-iterated the view that a negotiate/arbitrate process be implemented by the Commission.

Response to views in submissions and further analysis

4.83 The Commission does not consider the involvement of the regulator in the negotiation process between retailers and customers a desirable feature of the regulatory framework. The determination of terms and conditions of supply is a matter best left to the negotiating parties.

4.84 The Commission is of the view that the negotiation process is a concern for large customers but is not a necessary aspect of a retail price monitoring

³² Northern Territory Major Energy Users, March 2010, Utilities Commission's Review of Options for the Development of a Retail Price Monitoring Regime for Contestable Electricity Customers – Comments on the Issues Paper, page 19.

regime. The Commission considers that further investigation of the operation of the complaint mechanism and regulatory options may be warranted.

- 4.85 The Commission considers that large customers will, under the information disclosure arrangements as part of the proposed price monitoring regime, be provided with greater level of information to better negotiate the terms of their contract with PWC.

Final recommendation

- 4.86 The Commission does not recommend any changes to the existing customer complaint mechanism at this stage.
- 4.87 The Commission considers that any changes to the customer complaint mechanism require further investigation of operation of the complaint mechanism and regulatory options. The Commission may consider reviewing the customer complaint mechanism and the introduction of customer pricing guidelines independently of this review.

CHAPTER 5

Implementation considerations

Implementation of proposals

5.1 The terms of reference ask the Commission to provide detailed plans for the implementation of any recommendations.

Legislative head of power

5.2 The Commission considers the following options are available for implementing the Commission's proposals for a retail price monitoring framework:

- a reference from the Treasurer under the *Utilities Commission Act*, s.6(1)(g) to advise the Minister on any matter referred by the Minister;
- a new Regulation under the *Electricity Reform Act* establishing a retail price monitoring framework, and placing associated obligations on the Commission and electricity industry participants;
- amendment of the *Electricity Reform Act* to establish a retail price monitoring framework, and placing associated obligations on the Commission and electricity industry participants; and
- by a Direction from the Treasurer (as shareholding Minister) to the PWC Board under the *Government Owned Corporations Act*, s.8(4) for PWC to participate in a retail price monitoring framework.

5.3 The Commission considers that a reference from the Treasurer is the fastest way of implementing the framework. However, the Commission considers that legislation is appropriate in the longer term, whether a new Regulation or amendment to the *Electricity Reform Act*, as this would provide regulatory certainty, and a clear signal to customers and PWC of the purpose and scope of the retail price monitoring arrangements. Further, the Commission considers that a clear statutory framework would facilitate consistent, accountable and transparent operation of the regime.

5.4 The Commission considers that the proposed wholesale price disclosure arrangements probably require legislation for implementation, as the proposal affects market design and operation, and would influence generator business practices.

5.5 The Commission notes that the *Government Owned Corporation Act* [s.8(4)] allows the shareholding Minister to:

- issue directions to the board of a government owned corporation;
- require the board to provide them with information relating to the government owner corporation; and

- direct the board to use or establish policies under which the government owned corporation is to operate.

5.6 The Commission does not consider that a direction to the PWC Board represents an appropriate way of establishing a regulatory obligation.

Timing

- 5.7 The Commission considers that the timing of implementation, and the start of retail price monitoring activities, would be determined by the method of establishing the retail price monitoring framework.
- 5.8 If the framework were implemented by a reference to the Commission from the Treasurer, the Commission's considers that the earliest the retail price monitoring activities could start is July 2011, with the first reports available about four to six months later.
- 5.9 A retail price monitoring framework implemented by legislation would take longer to be established and operating. Similarly, the Commission is not certain that a wholesale price disclosure framework could be implemented quickly.
- 5.10 A detailed building block assessment of PWC's unbundled retail costs and prices could be conducted in parallel with an assessment for the Treasurer of the level of retail tariffs for small customers prior to the expiry of the current Pricing Order on 30 June 2013. This exercise would probably take up to 12 months.

Confidential information

- 5.11 The Commission considers that an effective retail price monitoring regime for the Territory should ensure that electricity industry participants and customers have access to key information necessary to make informed investment and consumption decisions. This requires increased disclosure of information on prices and costs than is currently available.
- 5.12 PWC has raised concerns that disclosure of prices and pricing methodologies could, in an open market, damage its competitive position by providing commercially sensitive information to market entrants.³³
- 5.13 The NTMEU has provided a customer perspective, suggesting that that firms with monopoly characteristics tend to avoid information disclosure by claiming that it is commercially sensitive. The NTMEU considers that this argument is invalid due to the absence of any competition currently and for the foreseeable future. The NTMEU suggested that, when considering disclosing certain information, the Commission should assess the firm's commercial interests against those of the public. The NTMEU added that the lack of information was an impediment to effective competition.³⁴

³³ Power and Water Corporation, April 2010, Review of Retail Price Monitoring for Contestable Electricity Customers – Power and Water's Response to Issues Paper, page 2.

³⁴ Northern Territory Major Energy Users, March 2010, Utilities Commission's Review of Options for the Development of a Retail Price Monitoring Regime for Contestable Electricity Customers – Comments on the Issues Paper, page 37.

- 5.14 The Commission is of the view that the dominant market power of PWC establishes a case for more information disclosure, rather than less, particularly while there are concerns that PWC has the potential to misuse market power.
- 5.15 The Commission recognises that the treatment of information, and the public disclosure of information, requires consideration of the effect on the market, such as the potential for providing customers with more information (and bargaining power) or providing new entrants with a competitive advantage through insight into the incumbent's business practices.
- 5.16 The *Utilities Commission Act* stipulates that information is considered confidential if it can be demonstrated that the competitive position of a firm could be affected or if the information is deemed commercially sensitive for some other reason.³⁵ The following requirements apply to the disclosure of information that may be deemed confidential or commercially sensitive:³⁶
- the disclosure is made to another person who is also performing a function under the *Utilities Commission Act* or a relevant industry regulation Act;
 - the disclosure is made with the consent of the person who gave the information or to whom the information relates;
 - the disclosure is authorised or required under Act or law;
 - the disclosure is authorised or required by a court or tribunal; or
 - the disclosure is authorised by regulations.
- 5.17 The Commission considers that clear rules would confirm the treatment of information that might be deemed confidential or commercially sensitive, but should be available for public release to support the effective operation of the proposed retail price monitoring arrangements.
- 5.18 The most effective way to provide certainty about the treatment of information is to specify in the legislative framework established to implement the retail price monitoring arrangements the information that might be released, and the process for dealing with situations where the need to release information is contested.

Data quality provided to the Commission

- 5.19 The Commission is of the view that consistency and accuracy of the data are essential underpinning principles in the development of an effective retail price monitoring regime as information will be most of use to stakeholders if it allows comparisons over time and against benchmarks.
- 5.20 NTMEU considers that the effectiveness of the retail price monitoring regime depended on, among other things, the accuracy of the information, and proposed that the information disclosed should be prescribed and subject to audit. NTMEU added that, a

³⁵ *Utilities Commission Act*, s26(1).

³⁶ *Utilities Commission Act*, s26(2).

provision should be included to discourage inaccurate, and delays in, information disclosure.

- 5.21 The Commission is of the view that accurate information is necessary for the quality of regulation and monitor pricing outcomes on a meaningful and consistent basis over time. The Commission requested PWC in July 2010 to undertake an audit of service performance data. The Commission is also encouraging PWC to develop compliance processes that will provide PWC with the systems and practices to obtain and report accurate and reliable data. The Commission expects that these efforts by PWC will assist in developing confidence in data collected and reporting through any future retail price monitoring framework.