
LETTER OF TRANSMITTAL

The Hon Syd Stirling, MLA
The Treasurer
Parliament House
DARWIN NT 0800

Dear Treasurer

UTILITIES COMMISSION ANNUAL REPORT 2004-05

In accordance with the provisions of section 35 of the *Utilities Commission Act 2000*, I am pleased to provide you with the Annual Report of the Utilities Commission of the Northern Territory for the financial year ended 30 June 2005.

This report incorporates information regarding the work carried out by the Commission during the 2004-05 financial year under:

- the *Network Access Code*, in accordance with section 13(2) of the *Electricity Networks (Third Party Access) Act 2000*; and
- other relevant industry regulation Acts, specifically the *Electricity Reform Act 2000* and the *Water Supply and Sewerage Services Act 2000*.

As such, this Report also serves as an annual report on the Commission's activities under each of these other Acts.

I also draw your attention to section 35(2) of the *Utilities Commission Act 2000*, which requires that a copy of this Report be tabled in the Legislative Assembly within six sitting days of receipt.

Yours sincerely



Alan Tregilgas
Utilities Commissioner
for the Utilities Commission
21 September 2005



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Glossary

“Contestable Customer”	means a customer classified by the <i>Electricity Reform (Administration) Regulations</i> as a contestable customer; contestable customers can chose their retail supplier; from 1 April 2002 customers whose annual consumption of electricity is greater than 750MWh are classified as contestable customers
“CSOs”	means community service obligations
“EPO”	means Electricity Pricing Order
“Network Access Code”	means the <i>Electricity Networks (Third Party Access) Code</i> , which is a schedule to the <i>Electricity Networks (Third Party Access) Act 2000</i>
“Non-Contestable Customer”	means any customer other than a contestable customer
“NT Power”	means NT Power Generation Pty Ltd
“Power and Water”	means the Power and Water Corporation
“Regulatory Control Period”	means the period between major electricity network price reviews by the Commission, during which time the methodology used in regulating prices is held constant
“Regulatory Minister”	means the NT Government Minister with responsibility for the <i>Utilities Commission Act</i>
“Ring-fencing Code”	means the NT Electricity <i>Ring-fencing Code</i> made by the Commission
“WSPO”	means Water and Sewerage Pricing Order

COMMISSIONER'S OVERVIEW

Year in Review

The Commission's focus during the year was on:

- completing the Commission's compliance review of Power and Water's application of schedule 13 of the *Network Access Code* in calculating network energy loss factors;
- reviewing the basis for the regulatory asset values assigned to Power and Water's electricity networks;
- advising the Regulatory Minister of the results of the first round of the Commission's monitoring of Power and Water's electricity generation prices;
- continuing the development of a standards-of-service framework for the Territory's electricity supply industry; and
- advising the Regulatory Minister on the effectiveness of aspects of the current regulatory arrangements in light of the absence of a competitor to Power and Water.

These and other activities undertaken by the Commission during the year are canvassed in the body of this Annual Report.

Coming Year's Work Program

The main elements of the Commission's work program over the coming year will be:

- to finalise and implement a standards-of-service framework in the Territory's electricity supply industry;
- to approve revised pricing 'principles and methods' underlying the structure of electricity network access tariffs as a rigorous and transparent basis for any future rebalancing of network access tariffs associated with the move to the price cap form of price control;
- to review the basis of Power and Water's allocation of costs – both operating and capital – between products, regions and customer groupings, and whether the associated policies and methods are consistent with the objectives of economic efficiency, equity and competitive neutrality; and
- to explore the powers that may be available to the Commission under the existing legislative framework to ensure that the interests of contestable electricity customers are protected in the absence of a competitor to Power and Water.

Alan Tregilgas
Utilities Commissioner
September 2005

LICENSING

The Commission issues licences to persons wishing to carry on operations in the Territory's electricity supply, water supply and sewerage services industries, in accordance with the provisions of relevant industry regulation Acts.

Licences on issue

Electricity

On 1 July 2004, the Power and Water Corporation ("Power and Water") held four licences under part 3 of the *Electricity Reform Act*:

- system control (to 30 June 2008);
- retail (to 31 March 2005);
- generation (to 30 June 2010); and
- network (to 30 June 2020).

In March 2005, Power and Water applied for renewal of its electricity retail licence. Following a public consultation period, on 31 March 2005 the Commission issued an electricity retail licence to Power and Water to sell electricity to contestable and non-contestable customers on the same terms and conditions as the previous licence with the exception that the term of the licence was amended to an indefinite period rather than the specified (five year) term of the previous licence.

In June 2004, the Commission received an application for a licence to sell electricity to contestable customers from Paladin Torrix Energy Corporation Pty Ltd ("PTEC"), a start-up Alice Springs-based company. Following a public consultation period and extensive consultations with PTEC, the Commission advised PTEC of the minimum requirements to be met regarding the financial capacity of an electricity retailer, and sought assurances from PTEC by 31 December 2004 that PTEC was able to meet these minimum requirements. The requirements specified were similar to those expected of retailers by licensing authorities in other States and Territories in Australia.

As PTEC was unable to provide the requisite assurances by the 31 December 2004 deadline, the Commission refused to grant the requested licence. PTEC was advised, however, that the Commission would re-open PTEC's application when and if PTEC was able to provide the Commission with the requested information about its financial capacity to operate as an electricity retailer.

On 1 July 2004, independent power producer licences were also held by the following producers whose operations in the electricity supply industry are peripheral to their core business:

- NGD (NT) Pty Ltd;
- Central Energy Power Pty Ltd; and
- Energy Resources of Australia Ltd.

On 1 July 2004, an isolated system licence was also held by:

- Groote Eylandt Mining Company Pty Ltd.

In September 2004, Landfill Management Services Pty Ltd (“LMS”) applied for a licence to generate electricity as an independent power producer at a landfill gas-fuelled renewable energy facility at Shoal Bay. The Commission granted a licence to LMS on 28 July 2005.

In February 2005, Solar Power Stations Australia (“SPSA”) applied for a licence to generate electricity as an independent power producer at solar concentrator plants located at the remote communities of Hermannsburg, Yuendumu and Lajamanu. The Commission granted a licence to SPSA on 26 April 2005.

In March 2005, Cosmo Power Pty Ltd (“Cosmo”), a subsidiary of Energy Developments Pty Ltd, applied for a licence to generate electricity as an independent power producer at Cosmo Howley Power Station and Pine Creek B Power station following a request from Power and Water to recommence emergency back-up generation at these sites. The Commission granted a licence to Cosmo on 26 April 2005. Cosmo has since advised the Commission that the power purchase agreement with Power and Water for electricity generated from the Cosmo Howley Power Station had expired, but that the agreement for production from the Pine Creek B Power Station has been extended to 30 June 2008. The Commission has amended the licence to reflect these arrangements.

Water and Sewerage

On 1 July 2004, Power and Water held the following licences under Part 2 of the *Water Supply and Sewerage Services Act*:

- water supply (to 31 December 2027); and
- sewerage services (to 31 December 2027).

On 29 September 2004, the Commission agreed to a variation of Power and Water’s water supply licence to make more explicit the basis of the ‘restricted service’ nature of services to be provided in the Cox Peninsula–Wagait Beach licence supply area.

Exemptions and exclusions

Electricity

On 1 July 2004, no exemptions were current under section 87 of the *Electricity Reform Act*.

In line with the Special Lease establishing the mining township of Nhulunbuy, Alcan-Gove Pty Ltd is responsible for, among other things, the provision of electricity supply within the township. Following extensive discussions and in light of investigations being undertaken with respect to normalisation of the township, on 28 April 2005, and with the approval of the Regulatory Minister, the Commission issued an exemption to Alcan-Gove Pty Ltd from the need to hold a licence with respect to electricity supply operations in Nhulunbuy.

The Regulatory Minister has approved the drafting of a Regulation under the Act to exclude certain small operations in the electricity supply industry from the definitions of ‘generation’ and ‘selling’ of electricity, and thus from the requirement to be licensed. A draft

Regulation has been developed, but not yet promulgated, for this purpose.

On 1 July 2004, a general exemption from the need to hold a licence under the *Water Supply and Sewerage Services Act* for persons on-supplying water services within prescribed licence areas was in place.

Monitoring of licence conditions

Both the *Electricity Reform Act* and *Water Supply and Sewerage Services Act* require licensees to lodge with the Commission an annual return containing the information required by the Commission by condition of the licence or by notice in writing.

While Regulation 4(1) of the *Electricity Reform (Administration) Regulations* and Regulation 2 of the *Water Supply and Sewerage Services Regulations* both prescribe 1 August as the date by which the electricity, water and sewerage licence returns must be lodged, the Commission has been aware that some of the requisite information, in particular the regulatory financial statements, may not be available by 1 August. Accordingly, the Commission has dually categorised its information requirements into those required by 1 August and those required by 1 December.

During the year, Power and Water lodged returns with respect to the 2003-04 financial year for each of its licensed areas of operation. These licence returns included an audit of operations authorised by each licence and compliance with licence obligations, undertaken by an independent auditor, Ernst and Young. Ernst and Young's audit found that Power and Water was broadly compliant for each of its licensed operations, although some minor areas of non-compliance were identified, mainly in relation to section 6.10 of the System Control Technical Code which requires generators and the network provider to submit maintenance programs to System Control. Power and Water has undertaken to rectify its non-compliance by the time of the next audit.

For those entities for whom activities in the electricity supply market are not their core business, licence returns are not required to contain the same level of detail as those required from Power and Water.

During the year, the following licensees also lodged returns with respect to the 2003-04 financial year for their licensed areas of operation:

- NGD (NT) Pty Ltd;
- Central Energy Power Pty Ltd;
- Energy Resources of Australia Ltd; and
- Groote Eylandt Mining Company Pty Ltd.

No substantive issues arose as a consequence of these licence returns.

PRICE REGULATION

The Commission regulates certain prices in the monopoly sectors of the Territory's electricity supply industry in accordance with the relevant industry regulation Acts. The Commission does not have an equivalent role in the Territory's water supply and sewerage services industries.

Electricity networks

The *Network Access Code* specifies the price regulation framework to be observed by the Commission and by the network service provider when setting the prices to be paid by network users for the conveyance of electricity through the electricity network.

First Regulatory Control Period – Unders and Overs

While the first regulatory control period involved a cap on network revenue, arrangements were put in place to allow a smoothing of network access tariffs over the period in the event of a breach of the revenue cap in any one year. In particular, the under's and over's arrangements put in place effectively reduced the revenue requirement in the following year if revenue actually recovered in a year exceeded the revenue cap. Likewise, any under-recovery of revenue in a year could be offset against over-recoveries in other years.

During the year, Power and Water reported to the Commission that, at the end of the first regulatory control period (that is, at 30 June 2004), the balance of the under's and over's account was a credit of \$674,819, comprising credits for both the Northern and Alice Springs networks and a debit for the Tennant Creek network.

Given the change in price regulation methodology for the second regulatory control period, i.e., the move from a revenue cap methodology to a price cap methodology, the Commission considered it is impractical to attempt to make an adjustment to future tariffs to take account of previous under- or over-recoveries. Accordingly, for those networks where a credit balance was held in the under's and over's account, such balances were refunded to retailers.

Consequential to the 2004 Regulatory Reset Decision

The 2004 Reset Determination, published in February 2004, included provision for what was termed an asset valuation 'off-ramp'. This allowed for a once-off adjustment to the value of the network price cap were the Commission to find that there had been a material error in the asset values underlying the 2004 Reset price cap formula.

The Commission engaged the Allen Consulting Group ("ACG") to provide advice on asset valuation methodology options, consistent with the Competition Principles Agreement and the objects and provisions of relevant Northern Territory legislation, and to recommend an appropriate and cost-effective asset valuation methodology capable of implementation in the Northern Territory context.

In brief, ACG advised the Commission that:

“In regard to the determination of an initial regulatory asset value for the natural monopoly elements of utility assets (such as electricity transmission and distribution assets), economic principles do not provide unambiguous guidance for the setting of a value, but rather are typically interpreted as providing a feasible range between the scrap value of the assets and the Depreciated Optimised Replacement Cost [“DORC”] value of the assets. Determination of a value within this range is less a matter of applying economic principles in selecting between alternative asset valuation methodologies and more a pragmatic analysis with the most appropriate valuation determined by consideration of the particular circumstances of the regulated business and the outcomes of the valuation.”

The Commission published its draft decision on the asset valuation off-ramp in February 2005.

Submissions were received from both Power and Water and the NT Treasury in response to the Commission’s draft decision.

The Commission published its final decision for the asset valuation off-ramp review on 30 March 2005.

In essence, the Commission found that both Power and Water and the Commission had erred in the approach adopted to regulatory asset values and valuation during the 2004 Reset, in that:

- the asset values (and underlying book values) used in the 2004 Reset involved certain measurement errors; and
- the 2004 Reset’s sole reliance on a Depreciated Optimised Replacement Cost valuation methodology involved a conceptual error in light of relevant requirements of the NT *Network Access Code* and the *Utilities Commission Act*.

The Commission’s final decision involved adoption of a regulatory asset valuation methodology for Power and Water’s electricity network assets that:

- for sunk assets (in practice, assets in place at 1 July 2002), valued assets at an amount that at least ensured cashflows sufficient to meet certain debt and equity return benchmarks; and
- for assets acquired or constructed after 1 July 2002, valued all such assets at depreciated current cost.

Further, the Commission’s final decision provided that a roll-forward methodology would be used in future, where an initial regulatory asset value is thereafter adjusted in full for inflation, asset acquisitions, asset disposals and annual depreciation.

The Commission’s final decision set the depreciated value of Power and Water’s electricity network assets for regulatory purposes (excluding gifted assets) as at 1 July 2002 at \$350 million. The final decision had the effect of reducing average network access tariffs charged at the wholesale level by around 12%. This reduction took effect on 1 July 2005.

**Network
Tariffs**

In May 2005, the Commission approved the reference tariffs and charges for standard network access services to apply during the 2005-06 financial year, in accordance with the final pricing determination of the asset valuation off-ramp review consequential to the 2004 Reset.

As in the previous year, Power and Water chose not to change the tariff structures in the 2005-06 year. In light of this decision, the Commission again approved these tariffs against the existing approved pricing principles statement (approved on 25 August 2000).

The Commission advised Power and Water that it would only approve any changes to the structure of Power and Water's network access tariffs once a revised pricing principles and methods statement were approved. The Commission indicated it would only approve a revised statement if the statement provides a rigorous and transparent basis for any rebalancing consequential to the move to the price cap form of price control in the second regulatory control period.

Retail prices paid by non-contestable electricity customers

**Electricity
Pricing Order**

Electricity prices paid by non-contestable customers, whether residential or commercial, are regulated directly by the Government. This contrasts with electricity prices paid by contestable customers, which are subject to negotiation between these customers and their chosen supplier. The Government exercises its control over prices via an Electricity Pricing Order ("EPO") made under section 44 of the *Electricity Reform Act*.

The Commission is required to enforce compliance with the EPO as if the EPO were a determination of the Commission under the *Utilities Commission Act*.

The EPO which took effect from 1 July 2000 expired on 30 June 2003. A new EPO was made by the Minister with effect from 1 April 2005. While the prices set by the EPO remain unchanged, some redrafting was undertaken to more clearly set out the Minister's intentions.

On 1 July 2004, an EPO was also in effect applying to the fourth tranche of contestable customers (who use between 750MWh and 2GWh of electricity per annum) to phase in cost reflective prices over time. That EPO allowed Power and Water to increase the price charged to these customers by a maximum of CPI+3% in the period 1 April 2004 to 31 March 2005.

Following the expiry of this pricing order on 31 March 2005, the Minister issued a further pricing order, effective from 1 April 2005 to 31 March 2006, with the effect of maintaining at existing levels during this period the prices paid by those fourth tranche contestable customers whose prices remained below cost-reflective levels.

Under section 6(g) of the *Utilities Commission Act*, the Commission also has the function of advising the Regulatory Minister on any matter referred to the Commission by the Minister.

From time to time, at the Minister's request, the Commission has reviewed the amounts of, and methods for setting, the community service obligations ("CSOs") payable to Power and Water for electricity provision principally associated with the Government's policies of uniform (non-contestable) retail tariffs across the Territory and a below-cost (non-contestable) retail price cap in Darwin.

A substantial increase in the value of the CSOs resulted from a review undertaken by the Commission in 2003-04. The Commission undertook no further work in this area in 2004-05.

Wholesale generation prices

Recognising the pricing implications that can arise from contestable markets being supplied by a sole supplier, the Government has previously approved the introduction of prices oversight by the Commission of the Power and Water's electricity generation business. The objective of this prices oversight is to ensure that individual contestable customers pay no more than the reasonable costs of wholesale electricity.

In April 2005, the Commission commenced its first review of the generation component of electricity prices paid by contestable customers, with that review covering the financial years 2002-03 and 2003-04.

The Commission's key findings were that:

- during 2002-03 and 2003-04, Power and Water's wholesale electricity generation prices – which are the subject of the Commission's monitoring – were generally consistent with the Commission's estimates of the reasonable costs of generation in those years; and
- the retail prices actually being paid by contestable customers – which are not subject to the Commission's monitoring – depend upon pricing decisions by Power and Water's retail business that can override any component generation (and network) price that has been subject to price monitoring (or control).

System imbalance charges

Under the *Network Access Code*, the Commission oversees prices paid (or received) by third-party generators when purchasing (or selling) any mismatches between the energy generated by such generators and the load attributable to end-use customers supplied by these generators.

Following revisions to the *Network Access Code* that took effect on 1 July 2001, in May 2002 the Commission accepted Power and Water's proposed economic dispatch arrangements. The Commission continues to defer further development of economic dispatch arrangements predominantly on the basis of the lack of generation competition in the Territory.

System control charges

The *Electricity Reform Act* requires the Commission to approve charges imposed by the power system controller.

The charges approved by the Commission with effect from 1 July 2004 continue until superceded.

Pricing of ancillary services

Regulation 3 of the *Utilities Commission Regulations* grants the Commission authority to determine prices relating to the provision of ancillary services in the electricity supply industry.

Following preliminary work in this area during 2002-03, the Commission decided to proceed by requesting Power and Water, in its capacity as the holder of the system control licence in the regulated power systems, to develop an 'ancillary services arrangement' for the Commission's consideration and approval.

Further development of the pricing for ancillary services has been deferred until generation competition re-emerges in the Territory.

Pricing of water supply and sewerage services

Water and Sewerage

Water and sewerage service prices are regulated directly by the Government. Section 60 of the *Water Supply and Sewerage Services Act* provides for prices to be controlled by the Government via a Water and Sewerage Pricing Order ("WSPO") similarly to the arrangements applying with respect to non-contestable customers in the electricity supply industry.

The Commission is required to enforce compliance with the WSPO as if the WSPO were a determination of the Commission under the *Utilities Commission Act*.

The WSPO which took effect from 1 January 2002 was superceded by the making of a new WSPO by the Minister effective from 1 May 2005. The new WSPO added a new price category of 'stand pipes' and left all other prices unchanged.

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CONDUCT REGULATION

The Commission is assigned a variety of roles when it comes to setting, approving and enforcing codes and rules aimed at ensuring appropriate types of conduct by licensed or regulated entities in the Territory's electricity, water and sewerage services industries.

Network Access Code

Review of Code

Third-party access to the services provided by prescribed electricity networks in the Northern Territory is currently governed by the *Network Access Code* which is a schedule to the *Electricity Networks (Third Party Access) Act*.

The Commission has earlier completed a public inquiry into the Code's effectiveness in facilitating competition and the use of networks by electricity generators and retailers and preventing the exercise of market power by the owners/operators of electricity networks, pursuant to section 8(3) of the Act.

While the Government has previously accepted recommendations dealing with the price regulation provisions of the *Network Access Code* contained in the Commission's final report, it has yet to announce its response to the remaining (non-pricing) recommendations.

Ring-fencing Code

An Electricity Ring-fencing Code developed and published by the Commission took effect on 1 July 2001 (with subsequent amendments in January 2002). The Ring-fencing Code aims at ensuring that monopoly businesses in regulated industries affiliated to contestable businesses do not discriminate against a competitor of that affiliated business, or financially or competitively advantage that affiliated business to the detriment of a competitor of that affiliated business.

The Ring-fencing Code requires that, at reasonable intervals determined by the Commission, Power and Water must report to the Commission on the measures taken to ensure compliance with its obligations under the Code. Such a report, along with the Commission's assessment of compliance, is to be made publicly available by the Commission (subject to the Commission first complying with its obligations under section 26 of the *Utilities Commission Act*).

The Commission did not require such a report from Power and Water during 2004-05.

*Procedures
under the
Ring-fencing
Code*

Under the Ring-fencing Code, Power and Water is required to develop, in conjunction with the Commission, accounting, cost allocation and information procedures designed to ensure compliance with its obligations under the Code.

The Commission has previously approved such procedures for use until 30 June 2005, with Power and Water being required, in consultation with the Commission, to review the effectiveness of the procedures prior to that date.

On 30 June 2005, the Commission extended approval of these procedures to 30 June 2006m, to permit a review to be undertaken of Power and Water's current cost allocation policies and procedures.

National regulatory reporting

In March 2002, a core set of nationally-consistent performance reporting measures developed under the auspices of the Utility Regulators Forum (of which the Commissioner is a member) was published.

In essence, from a Territory perspective, the measures making up the national regulatory reporting standards fall into three categories:

- those measures that Power and Water will report fully;
- those measures that cannot be fully accommodated by Power and Water's existing systems, that will be reported on a reduced basis; and
- those measures for which Power and Water does not currently collect data, which will not be reported pending further consideration.

The Commission has reached in principle agreement with Power and Water on the extent of reporting and the associated timeframes.

During the year, Power and Water continued to compile the data necessary for its participation in the agreed regulatory reporting framework.

Subsequently, Power and Water provided the first set of data with respect to the 2003-04 year, focussing initially on the main Darwin-Katherine inter-connected system. Reporting on other regional centres (Alice Springs and Tennant Creek) is expected to be phased in over time.

STANDARDS OF SERVICE REGULATION

The Commission is assigned a role by the *Electricity Reform Act* in both ensuring that the standards of service enjoyed by non-contestable customers in the electricity supply industry do not fall below minimum levels and, in some circumstances, in reviewing and revising such minimum standards. The Commission does not have an equivalent role in the Territory's water supply and sewerage services industries.

Setting minimum standards of service

Under section 92 of the *Electricity Reform Act*, the standards of service applicable in the year prior to commencement of the Act are the minimum standards to be observed by suppliers to non-contestable customers. The Commission is also empowered to review these minimum standards taking into account, among other things, relevant national benchmarks of service for non-contestable customers.

Issues Paper

The Commission released an *Issues Paper: Developing a Standards-of-Service Framework* in August 2004.

This paper canvassed the general issues associated with the development and implementation of a standards-of-service framework in the Territory's electricity supply industry, and was predominantly concerned with what form such a standards-of-service framework should take and in identifying aspects of monopoly services (to which standards are to apply) that have significant impact on costs and/or consumer value.

In addition to its general call for submissions from interested parties, in response to which three submissions were received, the Commission met with key industry and consumer representatives with a view to canvassing the broad issues relevant from the electricity user perspective.

Draft Code

During the year, the Commission considered the views expressed in submissions received in response to the issues paper, as well as the views expressed in its meetings with key industry and consumer representatives. It also further considered the requirements of relevant legislation.

In August 2005, the Commission released a Draft Standards of Service Code.

It is proposed that the Code apply only to Power and Water for the foreseeable future.

The Draft Code seeks to establish both:

- minimum standards of service benchmarks, by 30 June 2006; and

- reporting of actual standards of service against each of the benchmarks, commencing after the end of each financial year from 2005-06.

The Draft Code does not include any incentive or penalty mechanisms, such as:

- price control adjustments in response to service performance; or
- customer compensation (or guaranteed service level) schemes.

The Commission's view is that the scope for such mechanisms is more appropriately considered in the context of the next network's regulatory reset, due to take effect from July 2009. Decisions on these matters at this later time will also be better informed by the reporting to be required under the Code.

The Commission expects the finalised Code to commence on 1 January 2006.

Compliance with minimum standards of service

Whatever the basis of the minimum standards of service set, the Commission has the responsibility to monitor licensees' compliance with these standards.

Under the proposed Code above, the Commission will publish an annual compliance report, commencing after Power and Water has reported to the Commission on actual standards of service attained during the 2005-06 financial year.

The Commission expects its annual compliance report to facilitate customers, media and other stakeholders in critically assessing and making a judgment on the level of performance by Power and Water compared to the minimum standards of service benchmarks as well as similar service providers elsewhere in Australia. It will also play a role in facilitating informed discussion between consumers and Power and Water on local or generalised standards of service improvements.

TECHNICAL REGULATION

Power system monitoring

Under section 45 of the *Electricity Reform Act*, the Commission is required to undertake an annual review of prospective trends in the capacity and reliability of the Territory's power system, and to submit a report to the Regulatory Minister. The Commission undertakes the function in the absence of a separate technical regulator in the Territory or a government department with similar functions.

2004 Review

In December 2004, the Commission released its *2004 Annual Power System Review*, reporting on the prospects for system capacity and system load, as well as on the domestic gas supply outlook in the Territory.

The review found that the most pressing supply situation in prospect continues to be in the Alice Springs system, with a breach of the existing 13MW reserve margin continuing until 2005-06. Power and Water is addressing this situation through the installation of temporary capacity later this year and the addition of new capacity in 2005-06.

The situation in the Darwin-Katherine system continues to be adequate over the medium term, with reserve capacity in excess of projected peak demand in most of the scenarios presented over the forecast period. Nevertheless, this conclusion is contingent upon the introduction of an additional 44MW of capacity in 2008-09.

Under the Commission's higher growth scenario for Darwin-Katherine, supply will be tight in 2007-08, making the timing of the additional capacity critical. Under this scenario, further supply pressures are projected to arise in the later years of the review period.

Existing generation capacity in the Tennant Creek regulated system was found to be sufficient for the foreseeable future. However, the small size of the system means that this outlook has the potential to change depending on the commencement of major new mining and industrial developments requiring power from the system.

Gas Outlook

The Commission also noted that the availability of adequate supplies of economically-priced gas currently ranks as the most significant issue for the power system over the review period.

The Commission noted that, since the last review was completed, no firm arrangements that provide Power and Water with access to offshore gas have been disclosed.

While the Commission considered that, in the short term, gas supplies are adequate, until alternative longer-term arrangements are in place, it concluded it was not possible to say with reasonable confidence that sufficient gas supplies will be available at acceptable

cost to maintain power system adequacy in the latter years of this decade.

In the 2004 Power System Review, the Commission also foreshadowed a broadening of the scope of future reviews to include consideration of the role that electricity networks play in the delivery of reliable supply to electricity users.

The Commission noted that the dangers of ignoring this aspect of supply had been demonstrated by the experience of other Australian States, where in recent years there have been a number of cases in which the reliability of supply has been affected by the adequacy of network capacity. Accordingly, the 2004 Power System Review included a section discussing network adequacy issues, with the Commission intending to include an assessment of network adequacy in the Territory in the 2005 Power System Review.

System Control Technical Code

Section 38 of the *Electricity Reform Act* requires the power system controller to prepare a system control technical code and submit it for approval to the Commission. This code sets out the controller's competitively-neutral operating protocols, arrangements for system security and system dispatch, as well as arrangements for the interruption of supply.

The approved code was not amended during the year.

Network Technical Code

Clause 9(2) of the *Network Access Code* requires Power and Water to prepare and make publicly available a network technical code and network planning criteria. Such a code (and associated criteria) was finalised during 2000.

The code was not amended during the year.

Review of function of Power System Controller

In renewing Power and Water's system control licence in 2003, the Commission flagged its intention to undertake a review of the role and functions of the power system controller in the NT context. The licence was extended on the basis that variations may be required to the licence conditions to reflect the outcome of the Commission's review.

Given there are currently no other licensed generators in the NT market, the Commission has deferred the review of the role and functions of the power system controller.

Compliance review of energy loss factors

In June 2003, the Commission issued terms of reference for a review of Power and Water's compliance with Schedule 13 of the *Network Access Code*, following concerns raised regarding the energy loss

factors applied by Power and Water while NT Power operated in the Territory's contestable market.

Under the Code's out-of-balance energy arrangements, the power system controller is required to take account of network energy losses when settling out-of-balance energy supplied or demanded by a generator. The energy loss factors are estimated annually by Power and Water as the network service provider in accordance with Schedule 13 of the *Network Access Code*.

***Final
Findings***

The Commission published its final findings on 31 August 2004. These findings were that:

- Power and Water's initial methodology used in 2000-01 was in technical breach of Schedule 13 of the Code as it did not reflect good electricity industry practice observable at the time;
- there was no evidence that the breach in 2000-01 involved bad faith on Power and Water's part;
- Power and Water's use of a revised methodology in 2001-02 did not involve a breach of Schedule 13 as it did not materially diverge from good electricity industry practice observable at the time;
- the adverse impact on NT Power of the breach in 2000-01 was not significant in magnitude, as evident by the insignificant difference implied if the revised methodology had been applied also in 2000-01; and
- alternative provisions to Schedule 13 were required as a basis for calculation energy losses in the NT context.

COMPETITION OVERSIGHT

While there are natural limits on the capacity of the Commission to foster competition, it has some residual functions and powers that enable it to monitor competition and suggest market improvements. The principal role the Commission can play in this regard is to ensure that it exercises its functions and powers in regulated monopoly sectors in ways that facilitate competition in contestable sectors upstream and downstream of those monopoly sectors.

In addition, under section 6(b) of the *Electricity Reform Act*, section 10(a) of the *Electricity Networks (Third Party Access) Act* and section 6(b) of the *Water Supply and Sewerage Services Act*, the Commission has the function of advising the Regulatory Minister on the operations of the respective Acts.

Competition in the NT electricity market

During 2004-05, Power and Water continued to be the sole supplier in the Territory electricity market.

Review of Electricity Reform Act

Earlier, the Commission had sought legal advice about whether its administration of the *Electricity Reform Act* (or the Act itself) required change to ensure sufficient protections are in place for contestable electricity customers, given the absence of competition.

Subsequently, in June 2005, the Commission provided advice on this matter to the Regulatory Minister. The advice was provided under section 6(b) of the *Electricity Reform Act*, which gives the Commission the role of advising the Minister on the operations of the Act.

The Commission recommended that a review by the Government of arrangements in the NT electricity supply industry is both necessary and timely.

The Commission noted that, in opening up the NT electricity market in April 2000, the Government had adopted a market-based economic model for the electricity supply industry. Following the exit of NT Power from the market and the failure of new entrants to emerge in either the generation or retail sectors, there has been a continuing mismatch between the structure of the industry and the economic model that underpins regulatory policy (and on which the regulatory framework is based). As a result, there are public policy issues to be addressed concerning the protection of contestable customers, the barriers faced by prospective new generators and the efficiency of the single existing supplier (Power and Water).

The Commission also noted that the NT energy sector – encompassing both gas and electricity – is on the threshold of a period of significant change. The Commission advanced the view that this presents a significant opportunity to consider, in an organised and systematic manner, which combination of electricity industry arrangements – structural, institutional and regulatory – may allow

the maximum public benefit to be gained from the changes in prospect.

The Regulatory Minister has responded, acknowledging the Commission's views and generally endorsing the sentiments expressed. The Minister has also advised the Commission that the issues are to be given due consideration as part of a review to be undertaken within government over the coming year of the existing electricity industry regulatory framework.

Provision of information

Consumer Information

In exploring the issues surrounding the development of a standards-of-service framework in the NT electricity industry, the Commission published a notice in a newspaper circulating generally in Territory, encouraging all consumers to take full advantage of the opportunity to have a say about the standards of service.

The Commissioner also gave interviews to both radio and print media on this issue.

Market Information

In November 2004, the Commission published market information on the size and composition of the Territory's electricity supply industry, with respect to 2003-04.

Electricity supply contract negotiation

The Commission was also approached during the year by a number of individual contestable customers with concerns arising out of the process of negotiating, or renegotiating, electricity supply contracts with Power and Water.

These concerns included the extent to which certain regulatory instruments place constraints on current negotiations taking place regarding a power purchase price. There was some concern that Power and Water may have been adopting a narrow interpretation of some of the relevant regulatory instruments, notably the Ring-fencing Code, the Network Discounting Framework and the Contestable Pricing Guidelines.

In response to specific issues, the Commission endorsed the view that the degrees of freedom available to Power and Water in negotiating network, generation and retail prices with a large new load was greater than perhaps envisaged by Power and Water. The Commission also clarified the tests to be met for any anti-competitive conduct or discriminatory or monopoly pricing to be proven, in part by issuing some *Guidance on Discounting for Large New Loads* in December 2004.

The Commission has been active in using – and intends to continue to use – its 'good offices' with all parties to facilitate supply being arranged on reasonable terms.

Investigating complaints

Under section 48 of the *Electricity Reform Act*, the Commission is obliged to investigate complaints against any electricity entity made on the grounds that the entity is engaging in conduct that is contrary to the objects of that Act or the *Utilities Commission Act*. Such objects

include promoting efficiency and competition in the electricity supply industry.

In July 2004, a tranche 1 contestable customer made a complaint to the Commission pursuant to section 48(1)(b) of the *Electricity Reform Act*. The complaint alleged that Power and Water was engaging in electricity pricing conduct contrary to the objects of the *Electricity Reform Act* and the *Utilities Commission Act*. The pricing conduct involved related to the average price increases for the supply of electricity proposed by Power and Water in the negotiation and finalisation of the complainant's 2004 contract with Power and Water.

Following detailed investigation, the Commission found that the complaint could not be substantiated.

Having examined the data provided by both the complainant and Power and Water, it was the Commission's assessment that:

- the price level payable by the complainant under the 2004 contract with Power and Water was not excessive in terms of its various cost components (networks, system control, generation and retail margin); and
- the complainant was therefore not being unfairly disadvantaged by Power and Water's 2004 contract pricing.

Nevertheless, in light of the pricing outcomes underpinning this complaint, the Commission indicated to Power and Water certain refinements that it might wish to consider to its contestable pricing policies and practices to avoid similar grievance arising in future.

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APPENDIX 1

BACKGROUND INFORMATION ON THE COMMISSION

Establishment of the Commission

The Utilities Commission was established at the commencement of the *Utilities Commission Act* on 21 March 2000, and charged with administering economic regulation in nominated industries in the Northern Territory.

Independence and accountability of the Commission

While established as a separate administrative unit within the NT Treasury, the Commission has specific statutory powers and undertakes its considerations independently of Treasury.

The independence of the Commission from the Government, and from any government-owned business operating in industries regulated by the Commission, is achieved by provisions in the *Utilities Commission Act* requiring that:

- the Commission not be subject to Ministerial direction in the performance of its regulatory functions; and
- members of the Commission be appointed for a fixed term and only subject to dismissal before the end of that term on account of misconduct or incapacity.

This independence does not deem the Commission unaccountable. There are several mechanisms in place in the *Utilities Commission Act* that require consistent, effective and accountable regulation on the part of the Commission.

The *Utilities Commission Act* places certain requirements and obligations on the Commission with regard to the regulatory processes it adopts. These requirements aim to ensure regulatory accountability through transparency and public disclosure of regulatory processes as well as the basis of regulatory decisions and reasonable certainty and consistency over time of the outcomes of regulatory processes.

The *Utilities Commission Act* also provides that an affected party can request a review of a decision of the Commission. An affected person may subsequently appeal the outcome of such a review to the Supreme Court. Such appeals may only be made on the grounds that there has been bias, or that the facts on which the decision is based have been misinterpreted in a material respect.

When deciding on determinations or approvals, or when making codes or rules under the *Utilities Commission Act*, the Commission is required to consult with the Regulatory Minister and representative bodies and participants in the regulated industry that the Commission considers appropriate. All decisions by the Commission are required to include a summary of the information on which the determination is based and a statement of the reasons for making the decision.

Under the *Utilities Commission Act*, any information gained by the Commission that could affect the competitive position of a licensed entity or other person, or is commercially sensitive for some other reason, is to be treated as confidential information. Any person performing a function under the *Utilities Commission Act*, or any relevant industry regulation

Act, would be guilty of an offence were such information disclosed otherwise than as authorised under a relevant Act.

Powers and functions of the Commission

The *Utilities Commission Act* sets out the Commission's main functions as well as the powers that the Commission may exercise in performing those functions. The key regulatory functions of the Commission in regulated industries (provided for in section 6 of the Act) include:

- to regulate prices charged by government monopoly businesses and regulated industries;
- to perform licensing functions;
- to develop, monitor and enforce compliance with, and promote improvement in, standards and conditions of service and supply;
- to make, and to monitor the operation of, codes and rules relating to the conduct or operations of a regulated industry or licensed entities; and
- to investigate and help resolve complaints relating to the conduct or operations of licensed entities.

In exercising its overall powers and carrying out its functions, the *Utilities Commission Act* obliges the Commission to have regard to the need:

- to promote competitive and fair market conduct;
- to prevent the misuse of monopoly or market power;
- to facilitate entry into relevant markets;
- to promote economic efficiency;
- to ensure consumers benefit from competition and efficiency;
- to protect the interests of consumers with respect to reliability, quality and safety of services and supply;
- to facilitate the maintenance of the financial viability of the industry; and
- to ensure an appropriate return on regulated assets.

The *Utilities Commission Act* only defines the Commission's overall functions and powers. Specific responsibilities of the Commission with respect to a particular industry are assigned to the Commission by provisions in relevant industry regulation Acts.

The relevant industry regulation Acts applying to the electricity supply industry are:

- the *Electricity Reform Act*; and
- the *Electricity Networks (Third Party Access) Act*.

In particular, the Territory's electricity network industry is declared to be a regulated industry (and the Commission assigned the role of regulator) by the *Electricity Networks (Third Party Access) Act*, and the Territory's electricity supply industry more generally is declared to be a regulated industry under the *Electricity Reform Act*.

The relevant industry regulation Act applying to the water supply and sewerage services industries is the *Water Supply and Sewerage Services Act*, which came into effect on 1 January 2001. That Act and its associated regulations require and allow the Commission to undertake certain regulatory functions in the Territory's water supply and sewerage services industries for the provision of those services within a sole provider model.

Related regulatory entities

The Commission undertakes its regulatory functions in the Territory's regulated industries in conjunction with other regulatory entities, notably:

- the 'Regulatory Minister', currently the Treasurer;
- the Safety Regulator – located in the Department of Business, Economic and Regional Development – who has responsibility under the *Electricity Reform Act* for monitoring and enforcing safety standards, and for establishing and enforcing safety-related standards for electrical equipment;
- the Chief Health Officer – located in Territory Health Services – who has responsibility under the *Water Supply and Sewerage Services Act* for monitoring and enforcing certain standards with respect to the water and sewerage industries; and
- the NT Ombudsman, who continues to have responsibility for investigating complaints from non-contestable electricity, water supply and sewerage services customers.

Membership of the Commission

Currently, the Commission is comprised of a single member, Mr Alan Tregilgas. The *Utilities Commission Act* makes provision for the appointment of Associate Commissioners when deemed appropriate by the Regulatory Minister, although none have been appointed to date.

Mr Tregilgas was initially appointed Utilities Commissioner for a four year term commencing on 1 April 2000. On 1 April 2004, he was re-appointed for a further term of five years. In this role, he was during the year an *ex officio* Member of the Australian Competition and Consumer Commission and a member of the Utility Regulators Forum.

Mr Tregilgas performs the role of Utilities Commissioner part time. He remains a senior associate with Access Economics, the Canberra-based economic consultancy group. During the year he also advised both the South Australian regulator (on gas access matters) and the Queensland regulator (on electricity matters).

Mr Tregilgas is a former senior Commonwealth, South Australian and Northern Territory Treasury officer. He also spent four years in the early 1990s as a utilities analyst with the Standard & Poor's Ratings Group in Australia and the Asia/Pacific region. For two years in the mid-1980s while with the Commonwealth Treasury, he represented Australia at the International Monetary Fund in Washington DC. As an economic consultant from 1996, Mr Tregilgas undertook consultancy projects with government agencies in six Australian jurisdictions, including the Northern Territory.

Mr Tregilgas holds a first class honours degree in economics from the University of Adelaide and a masters degree in economics from the Flinders University of South Australia.

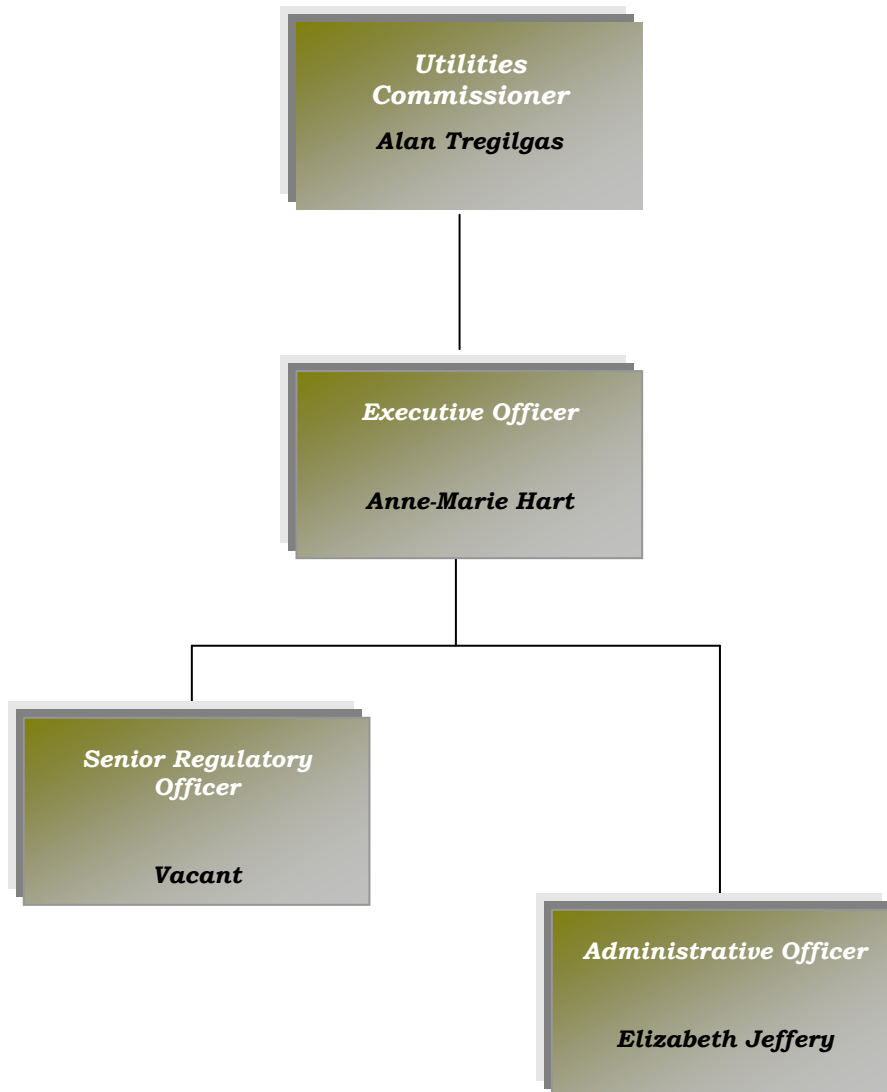
Commission staffing and resources

At 1 July 2004, two staff, employed within the meaning of the *Public Sector Employment and Management Act*, provided support to the Commissioner. A position remains vacant and is expected to be filled in the first half of calendar year 2006.

The Commission's organisation chart at the end of the year is shown on the following page.

Organisational Chart

Utilities Commission of the Northern Territory as at 30 June 2005



Advisers to the Commission

The Commission also has access to expert technical advice, through the engagement of consultants as detailed in Appendix 5. Section 14 of the *Utilities Commission Act* authorises the Commission to engage consultants when it considers necessary and appropriate.

During the year, with the Senior Regulatory Officer position remaining vacant, Mr Philip Theaker (of East Cape Pty Ltd) was engaged to provide some high-level assistance on a number of key projects. This assistance was facilitated by his temporary location in Darwin.

APPENDIX 2

DETERMINATIONS AND APPROVALS

Nature of decision	Type of decision	Effective period	Date of decision
Accounting and Cost Allocation Procedures – Extension of Approval	Approval	1 July 2004 to 30 June 2005	1 July 2004
Network Access Pricing – 2004 Regulatory Reset Asset Valuation Off-ramp	Determination	1 July 2006 to 30 June 2009	30 March 2005
Network Access Tariffs	Approval	1 July 2005 to 30 June 2006	23 May 2005
Information Procedures – Extension of Approval	Approval	1 July 2005 to 30 June 2006	30 June 2005
Accounting and Cost Allocation Procedures – Extension of Approval	Approval	1 July 2005 to 30 June 2006	30 June 2005

APPENDIX 3

PUBLICATIONS AND REPORTS

During 2004-05, the Commission published the following reports:

August 2004	<i>Developing a Standards-of-Service Framework - Issues Paper</i>
August 2004	<i>Energy Loss Factors Compliance Review – Summary of Findings</i>
September 2004	<i>Annual Report 2003-04</i>
November 2004	<i>NT Electricity Market: 2003-04</i>
December 2004	<i>Annual Power System Review 2004</i>
December 2004	<i>Guidance on Discounting for Large New Loads</i>
February 2005	<i>2004 Regulatory Reset Asset Valuation Off-ramp – Draft Decision</i>
March 2005	<i>Complaint Investigation – Summary of Findings</i>
April 2005	<i>2004 Regulatory Reset Asset Valuation Off-ramp – Final Decision</i>
May 2005	<i>Network Tariffs 2005-06 – Commission Analysis</i>

These publications can be viewed on the Commission's website: www.utilicom.nt.gov.au

In response to referrals from the Regulatory Minister in accordance with section 6(1)(g) of the *Utilities Commission Act*, the Commission also undertakes reviews for and provides advice to the Minister. Where required by the terms of reference issued by the Minister, the reports setting out the Commission's findings and recommendations remain confidential to government.

During 2004-05, no referrals were received from the Minister.

Section 6(b) of the *Electricity Reform Act* provides that the Commission also has the function of providing advice to the Regulatory Minister on the operation of the Act. During 2004-05, the Commission provided advice, in confidence, to the Minister on the need to review the *Electricity Reform Act*.

APPENDIX 4

EXPENDITURES AND RECEIPTS

This Appendix publishes the expenditures of the Commission that are funded directly from Consolidated Revenue, as well as the associated receipts.

NORTHERN TERRITORY UTILITIES COMMISSION EXPENDITURE BY CATEGORY OF COST

Category of Cost	2003-04 \$000	2004-05 \$000
PERSONNEL COSTS	288.2	198.3
Salaries and related costs	233.5	183.0
Superannuation	54.7	15.3
OPERATIONAL EXPENDITURE	172.1	181.8
Consultants Fees	152.0	134.6
Official Duty Fares	1.7	28.8 ^b
Travelling Allowance and Accommodation	1.7	5.5 ^b
Training & Study Expenses	1.5	5.2
Document Production	4.9	2.3
Motor Vehicle Expenses	5.4	1.6
Other Plant & Equipment	1.4	1.2
Recruitment & Relocation Expenses	0.1	1.0
Advertising	0.4	0.8
Memberships & Subscriptions; Freight; Library Services	0.0	0.8
Entertainment	1.9 ^a	0.0
Communications & IT Services	1.0	0.0
Office Req & Stationery	0.1	0.0
OVERHEADS ALLOCATIONS	144.8	70.0
TRANSFERS	100.0	-
TOTAL EXPENDITURE	705.1	450.1

^a Costs involved in hosting the Utility Regulators Forum in Darwin in August 2003.

^b The Commissioner's travel expenses have increased as part of changed arrangements for his second term of office.

The reduction in personnel costs between the two years reflects the decision to leave unfilled all vacancies that arose during the year, and the reduced hours involved in the Commissioner's second term (which commenced on 1 April 2004).

The amount shown as a transfer in 2003-04 represents savings achieved by the Commission that were re-allocated to other related areas in NT Treasury in that year.

RECEIPTS BY ACCOUNT^a

Account	2003-04 \$000	2004-05 \$000
Fees and Charges	181.4	182.9
Licence Application Fees	0.0	1.0
Electricity Licence Fees	136.4	136.9
Water and Sewerage Licence Fees	45.0	45.0
TOTAL REVENUE	181.4	181.9

^a Section 19 of the *Utilities Commission Act 2000* provides that, unless otherwise directed by the Treasurer, fees and other monies received by the Commission are paid into the Consolidated Revenue Account.

APPENDIX 5

ADVISERS TO THE COMMISSION

In 2004-05, the Commission used the services of the following consultants. The costs for the year totalled \$134,625.

Greater than \$50,000

East Cape Pty Ltd

During 2004-05, the Commission received advice from East Cape Pty Ltd in relation to the following matters:

- pricing issues associated with the Commission's investigation of a complaint lodged by a contestable customer with respect to electricity pricing practices by Power and Water;
- preparation of the annual power system review; and
- general contract support involving Mr Philip Theaker's temporary location in Darwin, with a focus on the oversight of Power and Water's wholesale electricity generation pricing, the provision of advice regarding the current (and prospective) effectiveness of the *Electricity Reform Act* and broad-based assistance to the Commission in carrying out its regulatory responsibilities.

The Allen Consulting Group Pty Ltd

During 2004-05, the Commission received advice from the Allen Consulting Group Pty Ltd in relation to asset valuation methodology options, consistent with the Competition Principles Agreement and the objects and provisions of relevant Northern Territory legislation.

Greater than \$10,000 and less than \$50,000

NIL

Less than \$10,0000

Electric Power Consulting Pty Ltd

During 2004-05, the Commission received advice from Electric Power Consulting Pty Ltd in relation to the compliance review of the energy loss factors calculated by Power and Water under Schedule 13 of the *Network Access Code*.

Minter Ellison

During 2004-05, the Commission received advice from Minter Ellison in relation to legal issues associated with the Commission's investigation of a complaint lodged by a contestable customer with respect to electricity pricing practices by Power and Water.