
LETTER OF TRANSMITTAL

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

Dear Treasurer

UTILITIES COMMISSION ANNUAL REPORT 2003-04

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 2004.

This report incorporates information regarding the work carried out by the Commission during the 2003-04 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 after receipt.

Yours sincerely



Alan Tregilgas
Utilities Commissioner
for the Utilities Commission
22 September 2004



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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
“GWh”	mean a gigawatt-hour, which is equal to one million kilowatt-hours
“kWh”	means a kilowatt-hour, which is the total amount of energy used in one hour by a device that uses one kilowatt of power for continuous operation
“MW”	means megawatt, which is a measure of the load carrying capacity of generators, transmission and distribution lines
“MWh”	means megawatt-hour, which is equal to one thousand kilowatt-hours
“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:

- reviewing the form of regulation of network access prices and, following a process of public consultation, implementing a price cap methodology for the second regulatory control period, replacing the revenue cap methodology used in the first period;
- advising the Regulatory Minister on the maximum annual increases in electricity retail prices considered appropriate for contestable customers following NT Power's withdrawal from the market and Power and Water's subsequent position as the sole supplier;
- preparing to undertake a detailed examination of certain asset valuation and cost allocation issues that were highlighted by the community service obligation (CSO) valuation exercises undertaken by the Commission during the year; and
- progressing the Commission's compliance review of Power and Water's application of schedule 13 of the *Network Access Code* in establishing network loss factors.

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 complete the review of the appropriate methodologies for valuing regulated assets in the NT context and for allocating costs among lines of business and among customer classes;
- to continue a process of public consultation aimed at developing and publishing a standards-of-service framework in the Territory's electricity industry, including consideration of incentive mechanisms to promote ongoing improvement;
- to codify revised power system control arrangements including associated ancillary service provision and pricing arrangements;
- to advise the Government of the results of the first round of the Commission's monitoring of Power and Water's electricity generation prices; and
- 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.

*Alan Tregilgas
Utilities Commissioner
September 2004*

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 2003, the Power and Water Corporation ("Power and Water") held four licences:

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

At the same time, licences were also held by the following producers whose operations in the electricity supply industry are peripheral to their core business:

- Pine Creek Power Pty Ltd;
- McArthur River Power Pty Ltd;
- Central Energy Power Pty Ltd;
- Energy Resources of Australia Ltd; and
- Groote Eylandt Mining Company Pty Ltd.

In November 2003, Pine Creek Power Pty Ltd surrendered its licence, with the operations previously undertaken by Pine Creek Power Pty Ltd being transferred to McArthur River Power Pty Ltd. Subsequently, McArthur River Power Pty Ltd changed its name to NGD (NT) Pty Ltd. This change was administrative in nature and resulted in no material change in its financial, technical or other capacity to continue operations under its licence.

Water and Sewerage

On 1 July 2003, 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 17 May 2004, the Minister for Essential Services (who is responsible for those sections of the *Water Supply and Sewerage Services Act* dealing with supply and service provision under licence) declared Cox Peninsula - Wagait Beach to be a 'restricted service' water supply licence area, pursuant to section 8 of the Act.

On 21 May 2004, Power and Water advised the Commission of the declaration of Cox Peninsula - Wagait Beach and applied to the Commission for this licence area to be included in its existing water supply licence as a 'restricted service area'.

Power and Water advised that the ‘restricted service area’ in relation to Cox Peninsula - Wagait Beach was to:

“...reflect the differing water supply arrangements for the community. The main difference being that water will be supplied through a single stand-pipe and will not be reticulated to households at this stage.”

On 23 June 2004, the Commission agreed to the variation of Power and Water’s water supply licence to take account of the Minister’s declaration of Cox Peninsula - Wagait Beach as a ‘restricted service area’.

Licence application

In June 2004, the Commission received an application for a retail electricity licence from Paladin Torrix Energy Corporation Pty Ltd, a start-up Alice Springs-based company.

This application is still under consideration by the Commission.

Exemptions and exclusions

Electricity

On 1 July 2003, no exemptions were current under section 87 of the *Electricity Reform Act*.

Prior to 1 July 2003, following consideration of whether localised and own-use activities come within the requirement to be licensed under the *Electricity Reform Act*, the Commission decided that it is appropriate for ‘small’ operations to be outside the scope of the Act. The Regulatory Minister 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.

Water and Sewerage

On 1 July 2003, an 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 remained current.

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 2003-04, Power and Water lodged returns with respect to the 2002-03 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, with the only issue arising being that some service level agreements between business units remain in draft form. However, policies and procedures are in place and are being followed, with only the formality of signing being outstanding.

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 2003-04, the following licensees also lodged returns with respect to the 2002-03 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.

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.

2004 Regulatory Reset

In the first regulatory control period (the period from commencement of the Code to 30 June 2004), the Code specified the methodology to be used in some detail. This methodology involved a 'building blocks approach' in which allowed revenue in each year of a regulatory control period is built up from a detailed assessment of projected demand, costs and efficiency levels and then capped at a fixed amount determined at the start of the regulatory control period (the 'revenue cap approach').

In the lead-up to the commencement of the second regulatory control period (the five-year period commencing 1 July 2004), the Code required the Commission as regulator – in consultation with interested parties – to review the price regulation methodology used in the first regulatory control period. The Commission referred to this review as the '2004 Regulatory Reset'.

The 2004 Regulatory Reset essentially involved two broad stages:

- review and revision of the methodology used to regulate prices; and
- the application of the revised methodology.

In July 2003, the Commission initiated the first stage with the release of an *Issues Paper*. Recognising that not all interested parties would wish to review the information in the detail set out in the *Issues Paper*, the Commission also released a shorter *Guide to the Issues*, the aim of which was to provide a less technical description of the main issues identified by the Commission, the context in which they arose and the implications they may hold for network prices and the electricity market more generally.

Disappointingly, only three submissions were received. The Commission was grateful to receive limited submissions from Voice International Limited and the Essential Services Commission of South Australia as well as the detailed submission received from Power and Water.

The Commission released its *Draft Decision* on price regulation methodology issues in September 2003. Price regulation methodology involves the practical and technical detail for the administration of price regulation over which the Commission as regulator has a degree of discretion.

One submission was received from Power and Water in response to the *Draft Decision*.

The Commission's *Final Decision* on price regulation methodology issues was released in November 2003.

The Commission's final methodology decision combined three primary elements – a cost-based adjustment of base year prices, a 'tariff basket' form of price control and an externally-determined annual price cap escalation factor. The principal attractions of this approach were that:

- it is light handed, with no reliance on forecast information and minimal within-period regulatory intervention or compliance activity;
- it greatly increases incentives on the network service provider to structure individual prices in line with costs (thereby managing the associated risks);
- it provides the network service provider with the flexibility necessary to deal with the network implications of offshore gas developments without regulatory adjustments, at the same time as ensuring that existing users are not expected to subsidise new users; and
- it provides a basis for price movements over time that is readily understandable to end users.

***Application of
Chosen
Methodology***

In January 2004, the Commission released its *Draft Determination* of the parameters necessary to give practical effect to its decision to apply a tariff basket form of price cap regulation in the second regulatory control period.

Submissions were received from Power and Water and NT Treasury.

In late February 2004, the Commission issued its *Final Determination* implementing the revised price regulation methodology to apply from 1 July 2004. The effect of the determination was that, on average, network access prices were to escalate annually in line with the consumer price index less an X factor of 2%, subject to no individual network user's tariff escalating by more than 5% annually. In addition, an increase of 4.4% in opening network access tariffs was allowed in 2004-05 only, both on average and at the individual network user level, to ensure such tariffs at least recover the efficient costs of supply.

In view of asset valuation difficulties that were not resolved during the 2004 Regulatory Reset, the *Final Determination* also included an 'asset valuation off-ramp' to be applicable if, prior to 31 March 2005, the Commission was satisfied that the valuation underlying the 2004 Regulatory Reset (either the initial asset base at 30 June 2000 and/or the asset amounts rolled-forward during the first regulatory control period) involved a 'material error'.

During the last quarter of the year, in preparation for consideration of the asset valuation off-ramp, the Commission undertook preliminary work related to a review of the appropriate methodologies both for valuing regulated assets in the NT context and for allocating costs among lines of business and among customer classes.

Network Tariffs

In April 2004, the Commission approved the reference tariffs and charges for standard network access services to apply during the 2004-05 financial year, in accordance with the final pricing determination of the 2004 Regulatory Reset.

In light of Power and Water's decision not to change the tariff structures in the 2004-05 year, the Commission approved these tariffs against the existing approved pricing principles statement (approved on 25 August 2000). The Commission considered that the pre-amble defining, to some extent, the network access services for which the reference tariffs apply, submitted with the tariff schedules for the 2003-04 year, constituted an elaboration of (and therefore part of) these pricing principles.

The Commission considered its use of the approved pricing principles statement appropriate given Power and Water's stated intention to more fully consider changes to the structure of network access tariffs over the coming 12 months, with revised pricing 'principles and methods' to be developed in conjunction with this process.

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 will only approve a revised statement if it provides a rigorous and transparent basis for any rebalancing associated with the move to the price cap form of price control.

Capital Contributions

An access applicant or network user may be required to make a capital contribution towards the extension of the network where such an extension would not be commercially viable without that capital contribution.

The *Network Access Code* specifies the general principles by which such capital contributions are to be established by the network service provider and provides that a draft statement providing details of the principles and methods must be developed and submitted to the regulator for approval.

In May 2004, the Commission approved – for use during the second regulatory control period from 1 July 2004 to 30 June 2009 – the capital contributions principles and methods statement submitted by Power and Water pursuant to clause 81(3) of the *Network Access Code*.

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*.

No additional work was undertaken in this area in 2003-04, and the EPO which took effect from 1 July 2001 continues until it is superseded.

**Community
Service
Obligations**

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.

Under this power, at the Minister’s request, in October 2003 the Commission commenced a review of 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

The Commission reported to the Minister in February 2004. The Commission’s recommendations regarding the value of the CSOs, which implied a substantial increase in the value of the CSOs since the first valuation undertaken in 2001, were accepted by the Government. The Government, however, opted to compensate Power and Water for these CSOs in a manner different to that proposed by the Commission.

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 predominantly on the basis of the lack of generation competition in the Territory, and that any more elaborate arrangements would tip the cost-benefit balance in the current environment.

Since then the Commission has deferred further development of economic dispatch arrangements until ancillary services arrangements (of which energy balancing services form a part) are established and the role of the power system controller is more clearly defined.

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 were unchanged on those approved for the previous year.

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.

Pricing for ancillary services will be addressed after the Commission has reviewed the functions of the power system controller.

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 continues until it is superseded.

The Commission was not involved in any investigation of water and sewerage pricing arrangements in 2003-04.

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 Regulatory Minister was required by the *Electricity Networks (Third Party Access) Act* to review the effectiveness of the *Network Access Code* before 30 June 2003. To assist the Minister's review, at the Minister's request and pursuant to section 8(3) of the Act, during 2002-03 the Commission 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.

Amendments to the Code

Following the Government's acceptance of recommendations dealing with the price regulation provisions of the *Network Access Code* contained in the Commission's final report, amendments to the *Code* were gazetted on 29 October 2003.

As the remaining (non-pricing) recommendations are still under consideration by the Government, progress has not been possible on technical amendments to the *Network Access Code*.

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 2003-04.

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.

During 2003-04, the Commission continued consultations with Power and Water regarding the national reporting requirements and came to an agreement with Power and Water on the extent of reporting and the associated timeframes.

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.

Most of the required information is expected to be available with respect to the 2003-04 year, although the focus initially will be 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.

Standards of Service Framework

During 2003-04, the Commission completed the final stages of its initial research regarding the setting of minimum standards of service for non-contestable customers.

The Commission plans to roll out a standards-of-service framework progressively after a series of public consultations.

In principle, three separate stages can be distinguished in the development and rollout of the standards-of-service framework:

- first, deciding on the particular indicators of standards of service to be used in the framework;
- secondly, setting the benchmarks or targets to apply to certain of the adopted indicators, and against which standards of service will be reported; and
- thirdly, devising reward and/or penalty schemes to provide incentives to service providers to achieve the set benchmarks or targets and perhaps direct compensation to customers.

Issues Paper

The Commission's work during the year resulted in the release of an *Issues Paper* in early August 2004.

This paper canvasses the general issues associated with the development and implementation of a standards-of-service framework in the Territory's electricity supply industry, and is 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.

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.

The Commission anticipates that, once the particular indicators of standards of service to be used in the framework are decided upon, a monitoring regime will be implemented from July 2005, with the possibility of incentive mechanisms commencing from July 2006.

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.

2003 Review

In October 2003, the Commission released its *2003 Annual 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. Although no formal advice has been received, the Commission understands that Power and Water is planning to increase generation capacity in Alice Springs with effect in late 2006.

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, the Commission notes that the Darwin-Katherine supply-demand balance needs to be kept under watch as electricity supply arrangements for prospective major developments firm up and a clearer picture of their impact is evident.

Existing generation capacity in the Tennant Creek regulated system was found to be sufficient for the foreseeable future.

Gas Outlook

The Commission also found that existing supplies of natural gas do not give rise to significant adequacy issues until 2009. This assessment is less pessimistic than in the Commission's 2002 Review mainly because, over the last year, it has been apparent that:

- some gas may be available on a short-term basis from Bayu-Undan producers prior to 2009; and
- several other options have emerged for future uptake of additional recoverable gas reserves.

Together, these short-term fuel purchasing options increase the likelihood that longer-term, lower-cost arrangements can be entered into for electricity generation in the Territory based on the lower price of Timor Sea gas.

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 Commission's approval the system control technical code on 2 August 2002 was valid for the length of Power and Water's system control licence. Following expiry of this licence and subsequent issue of a new licence, this approval lapsed.

Power and Water re-submitted the power system technical code on 5 August 2003, advising the Commission that the technical code had not been altered since previously approved.

The Commission renewed its approval of the system control technical code on 12 August 2003, being satisfied that it provides the necessary protocols and arrangements for the reliable, safe, secure, and efficient operations of the power system.

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 Commission approved a revised code (and associated criteria) submitted by Power and Water in March 2003. The code will continue until superseded or revoked by the Commission.

Review of function of Power System Controller

In renewing Power and Water's system control licence on 27 June 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.

During the year, Power and Water commissioned an examination of the functions of system control. The Commission has delayed public consultation on the codification of revised power system control arrangements to allow Power and Water to consider the outcome of this examination.

Given there are currently no other licensed generators in the NT market, the Commission's revised target completion date for the review of the role and functions of the power system controller in the NT context is now 30 June 2005.

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*.

Draft Findings

Draft findings were provided to the parties involved in October 2003. In light of further analysis by its technical advisers of additional data made available by Power and Water in response to these draft findings, the Commission provided revised draft findings to relevant parties in June 2004.

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
- the Commission needed to develop alternative provisions to Schedule 13 that clearly set out the desired outcomes (or characteristics) to be met by the methodology used by the network service provider in future to calculate energy losses in the NT context.

COMPETITION OVERSIGHT

While the Commission cannot of itself 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 so as to protect competition in contestable sectors upstream and downstream of those monopoly sectors.

Competition in the NT electricity market

During 2003-04, Power and Water continued to be the sole supplier in the Territory electricity market.

Review of Electricity Reform Act

In April 2004, the Commission sought legal advice about whether its administration of the Electricity Reform Act and the Act itself require change to ensure sufficient protections are in place for contestable electricity customers in the absence of competition in the market place.

Subsequently, the Commission has undertaken preparatory work with a view to preparing its own advice on this matter to the Regulatory Minister during 2004-05 (under section 6(b) of the *Electricity Reform Act*, which assigns the Commission a role of advising the Minister on the operations of the Act).

Retail Licence Application

In June 2004, the Commission received an application for a retail electricity licence from Paladin Torrix Energy Corporation Pty Ltd. While the application assessment process has not yet concluded, the Commission notes that the granting of a retail licence does not, of itself, either:

- authorise the licensee to have access to the electricity network (with an access agreement to be negotiated separately); or
- confer a right on the licensee to purchase electricity from a licensed generator on any particular terms and conditions (with a commercially negotiated power purchase agreement being separately required).

While the entrance of an additional retailer may result in some competition in the provision of services tailored to individual customer needs, it is unlikely to result in substantial competitive pressure on prices. As generation and networks charges generally account for around 90% of the electricity price paid by end-use customers, competition among retailers can only affect the retail component of prices of around 10%.

Wholesale generation prices

Following NT Power's withdrawal from the Territory's electricity market effective in September 2002, and recognising the pricing implications that can arise from monopoly service provision, the

2003-04

Government approved in principle a process of prices oversight of Power and Water's generation business by the Commission for as long as that business is not subject to competition or the tangible threat of competition. The purpose of such regulation is to ensure that the wholesale energy prices paid by contestable customers are similar to those that would occur in a competitive environment.

During 2003-04, the Commission's work in this area concentrated on developing an appropriate methodology for valuing assets in the NT context and reviewing Power and Water's current approach to allocating costs among lines of business and among customer classes.

Provision of information

Consumer Information

In undertaking its deliberations on the form of network price regulation for the second regulatory control period, the Commission wrote to all contestable customers to encourage them to take full advantage of the opportunity to have a say about the regulation of network access tariffs.

The Commission also wrote to all contestable customers seeking their input to both the draft methodology decision and draft determination.

Market Information

In September 2003, the Commission published market information on the size and composition of the Territory's electricity supply industry, with respect to 2002-03.

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.

Despite some preliminary inquiries from potential complainants, no formal complaints were lodged with the Commission during 2003-04.

Advice to the Government

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.

The Commission exercises this function by providing written and verbal advice to the Minister on matters primarily of an administrative nature. Broad policy advice on economic regulation matters is the primary responsibility of the NT Treasury, although the Commission also puts its view to the Minister where this is necessary or appropriate.

*Retail
Electricity
Price Side
Constraints*

In August 2003, the Commission received terms of reference to advise the Minister on an appropriate maximum annual increase in electricity retail prices to be applied by Power and Water to contestable customers (following NT Power's withdrawal from the NT electricity market and Power and Water's subsequent position as sole supplier). The Commission provided its report to the Minister in September 2003.

The Government subsequently announced its decision to phase-in cost reflective prices for the fourth tranche of contestable customers, while leaving prices for the first to third tranches to negotiation between the customers and Power and Water.

To implement this decision, the Regulatory Minister issued an EPO applying to the fourth tranche of contestable customers (who use between 750MWh and 2GWh of electricity per annum), effective from 1 April 2004 to 31 March 2005.

The Commission expects to initiate compliance monitoring arrangements in relation to the EPO in the second half of 2004.

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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 Industry, Business and Resource 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 5 years. In this role, he is also 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. He also advises both the South Australian Independent Industry Regulator (on gas access matters) and the Queensland Competition Authority (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 since 1996, Mr Tregilgas has worked 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.

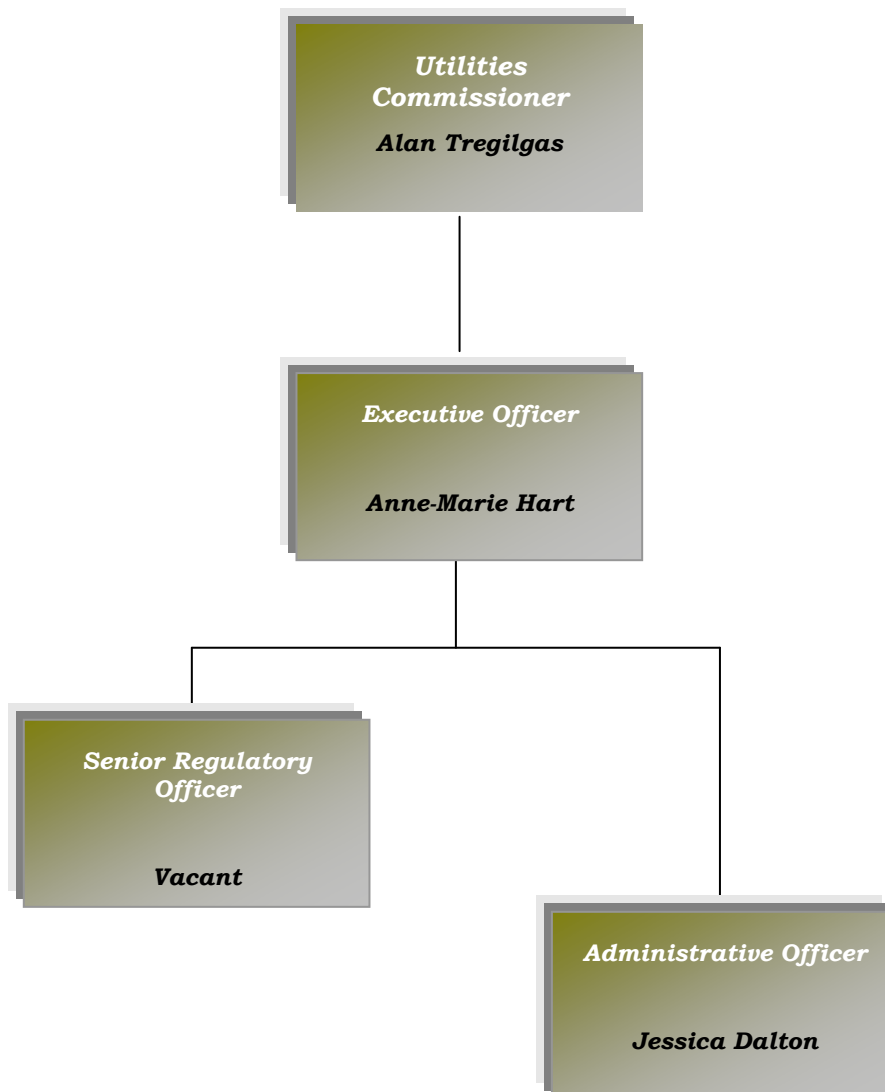
Commission staffing and resources

At 1 July 2003, four staff, employed within the meaning of the *Public Sector Employment and Management Act*, provided support to the Commissioner. Following staff movements within the year, the Commission was restructured by replacing the two vacant Research Officer positions with a single (higher level) Senior Regulatory Officer position. This reflected the Commissioner's assessment of the shift in the Commission's workload following completion of the initial regulatory (and competitive) phases of the reform process.

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 2004



Advisers to the Commission

The Commission also has access to expert technical advice, through the engagement of consultants as detailed in Appendix 6. Section 14 of the *Utilities Commission Act* authorises the Commission to engage consultants when it considers necessary and appropriate.

APPENDIX 2

DETERMINATIONS AND APPROVALS

Nature of decision	Type of decision	Effective period	Date of decision
System Control Charges	Approval	1 July 2003 to 30 June 2004	1 July 2003
Network Technical Code and Network Planning Criteria	Approval	Until 30 June 2020	15 August 2003
System Control Technical Code	Approval	Until 30 June 2008	12 August 2003
Network Access Pricing Methodology and Parameters	Determination	1 July 2004 to 30 June 2009	2 March 2004
Network Access Tariffs	Approval	1 July 2004 to 30 June 2005	2 April 2004
Capital Contributions Principles and Methods	Approval	1 July 2004 to 30 June 2009	26 May 2004
System Control Charges	Approval	From 1 July 2004	30 June 2004

APPENDIX 3

PUBLICATIONS AND REPORTS

During 2003-04, the Commission published the following reports:

July 2003	<i>Networks Pricing: 2004 Regulatory Reset – Issues Paper</i>
July 2003	<i>Networks Pricing: 2004 Regulatory Reset – Guide to the Issues</i>
July 2003	<i>Network Revenue Determinations and Tariff Approvals 2003-04 Decision Paper</i>
September 2003	<i>NT Electricity Market: 2002-03</i>
September 2003	<i>Networks Pricing: 2004 Regulatory Reset – Draft Methodology Decision Paper</i>
September 2003	<i>Annual Report 2002-03</i>
October 2003	<i>Annual Power System Review 2003</i>
November 2003	<i>Networks Pricing: 2004 Regulatory Reset – Final Methodology Decision Paper</i>
January 2004	<i>Networks Pricing: 2004 Regulatory Reset – Draft Determination</i>
February 2004	<i>Networks Pricing: 2004 Regulatory Reset – Final Determination</i>
April 2004	<i>Network Tariffs 2004-05 - 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 2003-04, the Commission provided the following reports in confidence to the Minister:

September 2003	<i>Regulation of Contestable Prices – Side Constraints</i>
March 2004	<i>Valuation of Community Service Obligations (CSOs)</i>

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. Expenditures (and associated receipts) funded by a consultancy arrangement between the Commission and the Essential Services Commission of South Australia associated with regulation of the Tarcoola-Darwin railway, which commenced in the 2001-02 year and finished on 31 March 2004, are published separately in Appendix 5.

NORTHERN TERRITORY UTILITIES COMMISSION EXPENDITURE BY CATEGORY OF COST

Category of Cost	2002-03 \$000	2003-04 \$000
PERSONNEL COSTS	388.2	288.2
Salaries and related costs	314.5 ^a	233.5
Superannuation	73.7	54.7
OPERATIONAL EXPENDITURE	163.5	172.1
Consultants Fees	123.4	152.0
Motor Vehicle Expenses	8.0	5.4
Document Production	2.2	4.9
Entertainment	0.2	1.9 ^b
Official Duty Fares	7.6	1.7
Travelling Allowance and Accommodation	1.1	1.7
Training & Study Expenses	14.0	1.5
Other Plant & Equipment	3.7	1.4
Communications & IT Services	0.2	1.0
Advertising	1.4	0.4
Office Req & Stationery	0.4	0.1
Recruitment & Relocation Expenses	0.4	0.1
Memberships & Subscriptions; Freight; Library Services	0.9	0.0
OVERHEADS ALLOCATIONS	135.5	144.8
TRANSFERS	-	100.0
TOTAL EXPENDITURE	685.2	705.1

^a Salary sacrifice superannuation costs included last year in the 2002-03 figures in the salary and related costs item have been reclassified to the superannuation item, with no change to the total personnel costs in 2002-03.

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

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 have been re-allocated to other related areas in NT Treasury.

RECEIPTS BY ACCOUNT^a

Account	2002-03 \$000	2003-04 \$000
Fees and Charges	177.2	181.4
Licence Application Fees	0.0	0.0
Electricity Licence Fees	132.2	136.4
Water and Sewerage Licence Fees	45.0	45.0
TOTAL REVENUE	177.2	181.4

^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

PROVISION OF CONSULTANCY SERVICES TO ESCOSA

On 16 July 2001, the Regulatory Minister authorised the Commission to undertake the function of assisting the Essential Services Commission of South Australia (ESCOSA) with its role as regulator of the Tarcoola-Darwin railway. This was an exercise of the Minister's power under section 6(1)(h) of the *Utilities Commission Act*.

Through a consultancy contract entered into between the Commission and ESCOSA, the Utilities Commissioner was engaged to work on a part-time basis as Railway Adviser to ESCOSA. In this capacity, the Commissioner was assigned responsibility for drafting pricing and service guidelines for use by the track operator and any appointed arbitrator and recommending any pricing-related determinations

This arrangement concluded on 31 March 2004, following publication of all relevant guidelines.

The expenditures funded by these arrangements during the 2003-04 financial year, and associated receipts, are set out below:

ESCOSA-RELATED EXPENDITURE AND RECEIPTS

<i>Pre-GST amounts</i>	2002-03 \$000	2003-04 \$000
Consultancy fees	48.0	36.0
Total Revenue	48.0	36.0
Salaries and Related Costs	24.0	18.0
Official Duty Fares	15.5	11.4
Travelling Allowance & Accommodation	7.2	5.5
Total Expenditure	46.7	34.9

Expenditure and receipts differ between the two years in the Table mainly because the 2003-04 arrangements only applied for 9 months of the year.

APPENDIX 6

ADVISERS TO THE COMMISSION

In 2003-04, the Commission used the services of the following consultants. The costs for the year totalled \$151,961.

Greater than \$50,000

Electric Power Consulting Pty Ltd

During 2003-04, 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*.

Greater than \$10,000 and less than \$50,0000

East Cape Pty Ltd

During 2003-04, the Commission received advice from East Cape Pty Ltd in relation to the review of the network price regulation methodology used in the first regulatory control period and the canvassing of modifications to the methodology for application during the second regulatory control period.

Morgan Buckley/Minter Ellison

During 2003-04, the Commission received advice from Morgan Buckley and Minter Ellison in relation to the following matters:

- legal issues associated with the Commission's review of the energy loss factors calculated by Power and Water under Schedule 13 of the *Network Access Code*; and
- the protections necessary for contestable electricity customers (as opposed to non-contestable customers) in the absence of competition in the market place.

Network Economic Consulting Group Pty Ltd

During 2003-04, the Commission received advice from Network Economic Consulting Group Pty Ltd in relation to the review of the amounts of, and methods for valuing, community service obligations.

Marsden Jacob Associates Pty Ltd

During 2003-04, the Commission received advice from Marsden Jacob Associates Pty Ltd in relation to completion of the review of Power and Water's price structures for the provision of water supply and sewerage services.

Less than \$10,0000

Infrastructure and Regulation Services Pty Ltd

During 2003-04, the Commission received advice from Infrastructure and Regulation Services Pty Ltd in relation to the development and implementation of a standards-of-service framework in the Territory's electricity supply industry.