

Mr Andrew Reeves
Utilities Commissioner
Utilities Commission
GPO Box 915
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Dear Andrew

Re: Review of Full Retail Contestability – Power and Water’s Response to Issues Paper

Thankyou for the opportunity to comment on the Utilities Commission’s Issues Paper regarding options for implementation of full retail contestability (FRC) in the Northern Territory.

Power and Water’s response to the Issues Paper is at Attachment A.

Power and Water supports the review of FRC and looks forward to working with the Northern Territory Government and the Commission to achieve optimal outcomes for Territory customers.

Please contact Ms Djuna Pollard, Manager Regulatory, Pricing and Economic Analysis, on (08) 8985 8431 should you wish to discuss any issues in relation to Power and Water’s response.

Yours sincerely



Andrew Macrides
Managing Director

24 September 2009

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

**SUBMISSION BY POWER AND WATER IN RESPONSE
TO ISSUES PAPER BY THE NT UTILITIES
COMMISSION**

SEPTEMBER 2009

This report contains 27 pages

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1 Introduction

1.1 Background and Purpose

Power and Water Corporation (Power and Water) is currently the sole provider of electricity, water supply and sewerage services in the Northern Territory. Power and Water's electricity services incorporate generation, network, system control and retail operations. These separate business units operate under ring-fencing provisions and other requirements as stipulated in the *Electricity Reform Act*, the *Electricity Networks (Third Party Access) Act* and the *Utilities Commission Act*.

Power and Water supports the Northern Territory Utilities Commission's (the Commission's) review of full retail contestability (FRC) for Northern Territory electricity customers and will co-operate fully with the Northern Territory Government (the Government) and the Commission as they consider the path forward.

Power and Water has reviewed the Commission's Issues Paper regarding the three options for implementation of FRC in the Northern Territory. As the primary provider of electricity services in the Northern Territory, Power and Water is uniquely placed to comment on the nature of the market, the likely impacts on customers and the benefits and costs of introducing FRC.

This document is Power and Water's Submission to the Commission in response to the Commission's *Review of Full Retail Contestability for Northern Territory Customers – Issues Paper (August 2009)*.

This Submission comments on the three options for implementing FRC in the Northern Territory, as detailed in the Commission's Issues Paper. In particular, it responds in Section 2 of this Submission to the Commission's list of issues that are detailed in Appendix A of the Issues Paper.

1.2 Executive Summary

Power and Water supports the review for the introduction of FRC in the Northern Territory and will assist the Commission and Government to achieve their preferred policy objective.

FRC is a major undertaking on which many utilities in other jurisdictions have invested significant amounts of time and money. It has also provided choice to millions of customers which would not otherwise have had a choice of retailers and product options.

Power and Water makes three main points in this submission, being that:

- Power and Water understands that the Commission is drawing a distinction in the design of its Implementation Options between two alternative forms of FRC:

- Full Retail "Competition" where there are multiple retailers actively competing for customers in the NT market; and
- Full Retail "Contestability" where there is the potential for customers to switch retailers. However, because of a lack of new entrants, Power and Water remains the only retailer servicing the NT market and there are no customer transfers.

However, it is important that the Commission has an understanding of and takes into account in its deliberations the costs associated with the introduction of FRC forms. The costs to Power and Water will necessarily reflect the capability that is needed to deliver the regulatory and legislative obligations placed upon it.

The costs to Power and Water will be significant if the Government wants:

- new retailers to have access to the kind of standing data and distribution services that are available in other jurisdictions;
 - to introduce new generation pricing or wholesale market settlement arrangements; or
 - to introduce structural reforms to Power and Water.
- There is a need for the Commission and Government to consider carefully how they intend to deal with a number of core FRC "building blocks" and to reflect these intentions in the final policy position. These "building blocks" are central to the development of FRC and will have implications for the costs of preparing for and implementing FRC. Ultimately, these are the costs the Government will need to balance against the benefits of FRC when deciding whether or not to proceed with FRC. In all cases, the Commission should carefully consider that, based on a preliminary assessment without certainty around the Government's preferred option for FRC introduction, Power and Water has a current capability to support around 100¹ customer transfers per annum; and
 - Power and Water does not yet have any formal views in relation to the various implementation options proposed by the Commission. It has provided some views below, but cannot assess each option in any detail until the "building blocks" have been further developed.

These three main points are covered in more detail below. Comments on the key issues sought by the Commission are set out in section 2.

¹ The preliminary estimate of 100 contestable customer transfers reflects the capability of the current resources available to Power and Water to effect the manual transfer of customers and the subsequent continued requirement to interact with other Retailers for the delivery of service order requests; provision of validated metering data; system management functions and the synthesis of information for the billing of energy, service provision and network use of system charges. Future development in the definition of these processes and the specification of information requirements for the Northern Territory is necessary to provide a more definitive estimate.

Power and Water notes that extending FRC to remote communities in the Northern Territory has not been explicitly ruled out in the Issues Paper. Power and Water considers that including these communities in an FRC environment would be problematic due to low retail headroom or retail margin and the current arrangements for Customer Service Obligations (CSO.) Power and Water requests that, in the Final Report, the Commission clarify that FRC is not currently being considered for application in non-regulated network areas.

1.2.1 Full Retail "Contestability" Versus Full Retail "Competition"

Power and Water understands there to be two forms of FRC being considered, as distinguished below:

- Full Retail "Contestability", where systems and capability investment by Power and Water can be avoided because there are no other retailers operating in the market.

The Issues Paper identifies Option A as the removal of legislative barriers to FRC but no action would be taken by the Government, Commission or Power and Water to develop the systems or capabilities required to support new entrant retailers or to effect customer transfers or settle the wholesale market.

- Full Retail "Competition", where it is assumed that multiple retailers are operating and therefore systems and capability investment by Power and Water are required.

Option B and Option C involve a more measured approach to determining policy first, then identifying the consequent capability requirements and then implementing the preferred approach.

Power and Water's principal concern is in ensuring that it has the necessary capability and systems to support whichever Implementation Option is ultimately chosen by Government. The distinction between "contestability" and "competition" is therefore only pertinent to Power and Water where there are differences of capability required at market's opening.

If Option A was chosen, and Government did not require Power and Water to develop the capability for market start, then there would be few costs involved. It is worth noting, that Power and Water would then be unable to effect customer transfers or provide any different arrangements to that which currently exists. This current capability, based on a preliminary assessment without any certainty around the Government's preferred option for FRC introduction, would only support around 100 transfers of contestable customers per year. If Government or retailers were then to require Power and Water to develop greater capability or undertake contestable customer transfers in excess of 100 then significant delays and costs would be unavoidable.

Of the options cited above, the approach to Options B and C would be Power and Water's preferred approach although it is not in a position to comment on the merits of deferring FRC as this is a decision for Government.

1.2.2 FRC "Building Blocks"

Power and Water will not be in a position to develop cost estimates for its preparations for FRC until it has a firmer idea of what capability it requires for each of the key FRC "building blocks". These are:

- *The mechanisms for purchasing wholesale energy* – there will be a need for Retailers to have a clear basis for purchasing wholesale energy from Power and Water in order to supply its end-use electricity customers. As noted in this response, Power and Water is committed to continuing its current practice of generation pricing and sales however it acknowledges that this may not be in a form that National Electricity Market (NEM) retailers would be familiar with;
- *Settling the wholesale energy market* – as the Issues Paper notes, there will be a need for Power and Water Generation to have a clear basis for settling the wholesale energy market and for charging retailers for the energy consumed by their customers. In the detailed comments provided later in this submission, Power and Water makes clear that it considers this one of the most fundamental "building blocks" to be determined by Government;
- *Identifying each connection point* – as the Issues Paper notes, there will be a need to uniquely identify each connection point as there is information that needs to be known, and periodically updated, by multiple parties for each connection point. In the NEM, there is a National Metering Identifier (NMI) for each connection point. The NT electricity market has not implemented the NMI format as this is not a requirement of the current regulatory framework. The Commission will need to consider if an alternative mechanism should be designed for making connection point information available to retailers, and if so, what form it should take and who should administer it;
- *Populating, maintaining, and providing access to, "standing data" for each connection point* – there is a need to maintain and update data about each connection point in:
 - Power and Water's internal systems – as there is a need for this standing data to be accurate, may require "data cleansing" for this to be achieved. This issue of data cleansing is not considered by the Issues Paper and Power and Water is aware that in other jurisdictions it has been a time-consuming and costly issue; and
 - A centralised database that can be accessed by authorised market participants other than Power and Water Retail. This point is raised in the Issues Paper; however Power and Water will need guidance from Government about the nature and quality of the data that will need to be contained in this database so that data preparations can be undertaken. In the NEM, the data is referred to as "standing data", which is stored in the Metering Settlement and Transfer Solution (MSATS), which is managed by Australian Electricity Market Operator (AEMO). The process for market participants interrogating MSATS for standing data is known as "NMI Discovery" which uses the prime

data key of the NMI to uniquely define the metering installation and associated information, a concept not currently deployed in the Northern Territory.

- *Managing metering data for each connection point* – there needs to be a basis for reading, processing, delivering and using metering data for wholesale generation, network and retail billing purposes. This issue is not raised specifically in the Issues Paper. While interval metering is considered, there is a need for a metrology procedure to determine the technical specification of the metering installation to ensure data integrity used as the basis to financially settle the market. The “chain” of metering information needs careful design and transformation into instruments as part of the regime;
- *Transferring customers between retailers* – there needs to be a basis for effectively transferring customers between retailers as customers churn. This includes establishing certain roles, responsibilities and obligations associated with the customer. Power and Water is aware that in other jurisdictions, designing these transfer arrangements has taken well over 12 months to achieve;
- *Enabling network billing* – there needs to be a basis for Power and Water Networks to bill retailers for the distribution services that they provide. If Government requires billing on a connection point (NMI) basis, then Power and Water needs to ensure that it has the appropriate systems in order to facilitate this;
- *Defining roles of, and relationships between, Market Participants* – the Government needs to make clear the definition of the various roles and responsibilities of parties involved in the market. This will enable parties to prepare themselves for their roles and responsibilities appropriately. In the NEM, each NMI has a relationship with a number of market participants. These relationships (known as ‘Roles’) are coordinated by AEMO in MSATS. The key commercial roles are:
 - Financially Responsible Market Participant (FRMP) - billed by AEMO for wholesale energy (can be any retailer);
 - Local Retailer (LR) – geographically determined retailer who has ongoing responsibilities even once it ceases to be the FRMP; and
 - Retailer of Last Resort (ROLR) - becomes the FRMP for NMIs of a FRMP that is suspended by AEMO or has its retail licence revoked.

In the NEM, the key operational roles are:

- Responsible Person (RP) - accountable for metering installations (not just meters) and the reading, processing and delivery of metering data (usually the FRMP or LNSP);

- Local Network Service Provider (LNSP) - the geographically determined distributor;
- Metering Provider (MP) – responsible for the provision, installation and maintenance of metering installations;
- Metering Data Agent (MDA) – responsible for the collection, processing and transfer of metering data for Types 1 to 4 metering installations; and
- Metering Data Provider (MDP) – responsible for the collection, processing and transfer of metering data for Type 5 to 7 metering installations.

Additionally, in the Northern Territory the role of System Control would need to be examined in the context of FRC. The primary functions currently performed within Power and Water of dispatching generation capacity, load balancing and supply security will need to be augmented to include wholesale market management and financial settlement functions.

- *Defining service level requirements and obligations of Market Participants* – there is a need to define what each market participant is required to do and how they are required to do it, including in relation to the minimum service performance that they must achieve. This is necessary because other parties are relying on tasks being undertaken in particular timeframes and to particular standards. The Issues Paper queries whether this is necessary in relation to some products. In Power and Water's view, it will be difficult to operate in an FRC environment unless Government makes it clear what the requirements are of each market participant;
- *Managing interactions and requests for actions, between Market Participants* – there is a need to define how market participants will interact with each other and how they will request each other to undertake activities. In the NEM, these are referred to as service order requests. There are no such arrangements currently in place in the Northern Territory and Government will need to make decisions on whether these will be developed and applied;
- *Ensuring Market Participants acquire their required capability* – there is a need to ensure that market participants have in place the necessary systems, processes and procedures in order to enable them to undertake their roles and responsibilities when the market commences. These systems, processes and procedures may vary depending on the nature of the service level requirements and obligations that they have to meet and the volumes of transactions that they need to manage;
- *Providing consumer protection, including contractual arrangements* – there is a need to ensure appropriate protection arrangements are in place as the consumer enters the competitive retail market. In the NEM, this is reflected into various Codes, contracts and agreements. Power and Water has noted in this submission that it supports the introduction of an Ombudsman, however

there is a need to ensure the consumer protection is enshrined into all aspects of the regime; and

- *Promoting customer awareness and education* – there is a need to ensure that customers are aware of the nature of FRC and are educated about their choices, rights and responsibilities. FRC is a new concept in the Northern Territory and there will be a clear policy role for Government to ensure that this occurs.

The nature of these “building blocks” will differ depending on the way in which FRC is introduced in the Northern Territory. The costs to Power and Water (and other participants in the development of FRC, including the Government and the Commission) incur will depend on the nature of the building blocks that are chosen. For example, a minimalist approach of the kind that has been introduced in Queensland, and has been foreshadowed in Tasmania, would:

- Limit the need for Power and Water to populate and maintain NMI Standing Data in MSATS (or equivalent) for the market’s opening. It may only need to:
 - Input large customers into MSATS (or equivalent) in advance of FRC commencing;
 - Upload second tier NMIs when a customer transfer request is initiated;
 - Require Power and Water Networks to collate the NMI standing data (for any NMI not in MSATS) on receiving a NMI Discovery request and return that data to the retailer within a certain number of business days; and
 - Manage a set number of NMI Discovery and NMI Creation requests (or equivalent) each day, with a process to temporarily modify completion times in circumstances where more than the stated number of transactions is received.

If a different decision was taken in relation to the various “building blocks”, requiring for example an automated approach to customer transfer, then the regime implied by those choices would be different and the costs to participants to prepare for it would be different.

Under any approach, however, Power and Water’s costs will be determined by the difference between its current capability in relation to each of the “building blocks” and that which is required at the start of the new market. In this context, it is worth noting that all of the systems that are currently in place within Power and Water are manual, being highly tailored to operate in a vertically integrated business without FRC, subject to metering data and system issues, and operates within an environment of Government ownership. This means that Power and Water has limited capability to transfer currently contestable customers, and no current capability to transfer a franchise customer with an accumulation meter installed.

The following are key issues that would need to be addressed if a new retailer were to approach Power and Water today in relation to switching a contestable customer with interval metering already installed:

- The retailer would not have automatic access to a standing data repository, and therefore would need to contact Power and Water Networks in order to obtain information about the customer, such as details of its premises, load, energy usage data and metering arrangements. There are currently no procedures that define how this should occur, how data should be stored or how it should be provided to retailers.

There would also be a need to update a central database, in the same way that MSATS is updated in the NEM when a customer switches retailer, in order to maintain current information about the customer's premise and the roles that various market participants would have in relation to that premises. This information necessarily changes when a customer switches retailer;

- The retailer would need to contact Power and Water Generation to obtain a quotation to purchase wholesale energy for that customer. This customer by customer approach to generation pricing would be unusual for many retailers, who are used to operating in the NEM whereby they pay a contract price and then seek to pass through "shape margins", "volatility margins" and "sales margins" to customers;
- The retailer would need to be provided with an invoice for generation charges by Power and Water Generation, presumably based on the customer's actual usage. There are no procedures in place at the moment for Power and Water Generation dealing with these sorts of matters for third party retailers. This would require significant system and business process changes within Power and Water Generation, including a capability for resolving any billing disputes;
- The retailer would need to contact Power and Water Networks in order to arrange for "business to business" (B2B) services such as connection to occur. While there are set fees for these services, there are no B2B service order procedures in the Northern Territory which provide retailers with certainty about terms and conditions of supply for these services including timeframes, updates and closing out requests and consequently no automated processes in place;
- The retailer would need to contract with Power and Water Networks to arrange meter data provider services and meter data services. Currently metering provision, ownership and installation is a monopoly service provided by Power and Water under section 6.1.3 of the Network Connection Technical Code. This means that the retailer of a contestable customer does not, as in other jurisdictions, have the choice of whether they or some other party will provide meter provision or meter data services. This may not be acceptable to new retailers; and
- The retailer would need to pay for network charges in accordance with the *Electricity Networks (Third Party Access) Code* (the Code) which would itself require system and business process changes to occur within Power and

Water Networks. Then, if there were any disputes as to the amounts or meter data, the retailer would be limited to the dispute provisions in the Code. These provisions are currently set out in jurisdictional arrangements in other States.

The process for transferring a current franchise customer would be much more difficult because there are currently no processes in place that deal with these customers on an individual basis, and no settlement arrangements set out in legislation. Network charges are calculated and charged to Power and Water Retail on a bulk basis, as are generation charges.

Power and Water's current capability to transfer customers, and to deal with the associated issues after that customer has transferred within the various business units, based on a preliminary assessment, would be limited to no more than 100 customers per annum.

1.2.3 Response on the broad approach to FRC

The three Implementation Options contained in the Issues Paper are:

- Implementation of FRC on 1 April 2010 or as soon as practicable;
- Reschedule FRC and adopt a program of additional reforms to support the development of competition thereafter; and
- Postpone FRC until conditions more favourable to competition develop.

In relation to these Implementation Options, Power and Water would comply with and work to whatever timetable Government adopts in relation to FRC.

However, in examining the Commission's three proposed implementation options for FRC and the additional narrative on the conditions for market competition contained in the Issues Paper there exist 5 probable courses of action or scenarios to deploy FRC in the Northern Territory:

These five probable scenarios are:

1. **FRC through removal of the legislative barrier** – assuming the use of either existing systems based on the expectation of low customer transfers, or designing and building Northern Territory specific FRC systems or engaging AEMO to provide the required services using the FRC systems it operates and maintains in the NEM;
2. **FRC through removal of the legislative barrier with improved wholesale price transparency** – implementing requirements that Power and Water Generation deal with retailers on a non-discriminatory basis and publish prices for defined wholesale contracts in advance;
3. **FRC preceded by retail price reform** – fully functional FRC systems and standing data established prior to the commencement of FRC with the start

date for FRC governed by the precondition of achieving an adequate level of cost reflectivity in retail prices;

4. **FRC preceded by wholesale market reform** – potential adoption of NEM wholesale trading arrangements prior to commencement of FRC and potential retail price reform before potentially entering the NEM; and
5. **FRC preceded by structural reform** – structural reform undertaken in preparation of the introduction of new wholesale market arrangements, such as the NEM arrangements.

In relation to the five broad FRC scenarios, Power and Water comments as follows:

Scenario 1 (the removal of the legislative barrier), Power and Water considers that, while appropriate for the relatively low level of churn likely to be achieved under FRC in the Northern Territory, it is not clear what, if any, additional capability it would require in order to support its implementation. If Power and Water is required to establish new capability to enable customer transfers, improve network billing transparency, establish new generation pricing arrangements that are suitable for third parties and maintain a standing data repository, then it will likely incur significant cost.

A transitional approach is not without precedent, for example, when FRC commenced in South Australia on 1 January 2003, it relied on largely manual processes for the first year, supported by a regulatory instrument issued by the South Australian regulator – *Electricity Consumer Transfer and Consent Code – November 2002*. South Australia then moved towards automated processes which took effect from 13 December 2003. It is worth noting however that South Australia was a NEM jurisdiction, and therefore had a much greater range of instruments in its regulatory and legislative regime than are currently in place in the Northern Territory.

In Queensland, a “Minimalist Transitioning Approach” for FRC was adopted by the Queensland Government for Ergon Energy. This was based on the view that, while all of the small customers (those consuming less than 100 MWhs per annum) in its distribution area would become contestable when FRC commenced, from 1 July 2007, it was estimated that only a small proportion would benefit from reduced prices by moving from the uniform retail tariff (i.e. the regulated price payable under the standard retail contract) to a market contract. Under this minimalist transitioning approach, Ergon Energy was allowed to largely retain its pre-FRC manual or semi-automated systems and processes for Day 1 and augment this capability with additional automation as required.

The Queensland Government and Ergon Energy recognised that customer churn was likely to be low in Ergon Energy’s distribution area and therefore a more cost effective solution was tailored to meet the needs of the market compared with what is required in a higher churn environment, such as in Energex’s distribution area, and much of NSW and Victoria. The minimal transitioning approach was designed to apply until it becomes evident that a more automated capability is needed. This was therefore a pragmatic approach that recognised that a fully automated capability would have been a high cost, inefficient response for Ergon Energy given

its expected needs. It should be noted, however, that this approach was limited to those customers using less than 100MWh per annum – there were already established regulatory and legislative provisions in place for customers above 100MWh per annum.

Scenario 2 (the removal of the legislative and improved wholesale price transparency), Power and Water recognises that it may be a desirable for potential new retailers to have greater clarity on the nature and quality of services that they require from the various business units of Power and Water, and that pricing clarity will be a component of this.

Power and Water notes that Scenario 2 may require, amongst other things, the definition of B2B service order procedures, including standard process and transaction data requirements and the publishing of fixed wholesale electricity prices and standard products. Given that many of these requirements are not in effect in the Northern Territory, the time required to design and implement such measures may be significant.

Scenario 3 (FRC preceded by retail price reform), Power and Water considers that the requirement to establish fully functional FRC systems and standing data prior to the commencement of FRC would involve significant cost and considerable resources. The need for adequate cost reflectivity in retail tariffs will need to be examined in the context of the FRC rollout, i.e. the level of cost reflectivity may vary across regions and this may have an impact on both the level of churn that can be expected in each region and the merits of a staged roll-out. A major proportion of the regulated retail tariff is applied to offset the operation of Generation and Power Networks, particularly in covering the energy costs. Consequently, there remains a small fraction available for Retail operation from which to derive sufficient retail headroom. Further, the FRC review will need to take into consideration, under each of the scenarios, the likelihood of future increases in retail prices and changes in cost reflectivity.

Power and Water notes that the assessment of what constitutes an adequate level of cost reflectivity and the framework for future assessments of cost reflectivity may itself require a separate study.

Scenario 4 (FRC preceded by wholesale market reform), Power and Water considers that any decision to adopt NEM wholesale trading arrangements will also involve significant cost and considerable resources to implement. The benefits, if any, of entering the NEM would also need to be carefully assessed.

Power and Water notes that while Tasmania is currently part of the NEM, doubts still remain about the viability of FRC in that state.

In the Northern Territory, the System Control functions of load balancing, dispatching generation capacity, supply security, wholesale market management and financial settlement functions would need to be established and performed either as part of a segregated unit within Power and Water or sourced through AEMO from existing NEM capabilities.

Scenario 5 (FRC preceded by structural reform), Power and Water considers that any structural reform undertaken in preparation of the introduction of new wholesale market arrangements, such as the NEM arrangements, should be carefully assessed and may require a separate detailed examination prior to the FRC review.

In particular, when considering the small market size of the Northern Territory a structural reform of Power and Water may forego the commercial or economic benefits derived from the economies of scale that as an integrated service provider, Power and Water currently attains to the benefit of customers and stakeholders.

As a general comment, Power and Water considers that the Commission and Government should assess the form of FRC that it requires as the first stage in the review process and, in particular, should make a choice about the deployment of the various "building blocks". This would involve, firstly, an assessment of the likely level of customer churn that could be expected in the Northern Territory and the capability it would require of Power and Water, that is:

- Establishing the number of customer transfers that it would like Power and Water to be capable of delivering each day;
- The broad requirements in relation to standing data;
- The roles and responsibilities of network and retail market participants; and
- The wholesale market settlement arrangements.

Power and Water considers that this takes account of the lessons learnt from other jurisdictions who have implemented FRC, where the capability requirements needed to support different expected customer churn volumes are reflected in their respective regulatory frameworks. The experience in other jurisdictions is that the correct choice of capability that is required by incumbents for FRC will in large part be dictated by the expected levels (and timing) of customer churn in the market. The capability choice has a significant impact on the costs that will be incurred in preparing for, and supporting, FRC.

In this regard, the capability that is developed or acquired should be tailored to the characteristics of the market. If churn volume is expected to be relatively low then a cheaper minimalist approach may be appropriate, whereas a more sophisticated, automated approach may be needed to accommodate high churn levels. Where churn is expected to be low the benefits of FRC are also likely to be low.

Once this process has been completed, the Government, the Commission, the Market Operator (if there is to be one) and Power and Water will need to identify any system or human resource gaps between current capabilities and that required to operate effectively in the new FRC market.

For this reason, Power and Water cannot make any cost estimates about FRC until these arrangements have been agreed and its associated capability gaps have been identified. This is because there is a significant difference in the systems required for a scenario of low numbers of transfers, no central standing data, manual B2B

arrangements and manual wholesale market settlement arrangements, and a scenario requiring automated transfer capabilities, B2B arrangements, central standing data requirements using MSATS (or equivalent), and changes to wholesale market settlement arrangements. These are not "scaling" differences – rather they are quantum differences in the scope of the systems and capabilities required and would necessitate a different strategic approach by Power and Water from day one of planning.

Power and Water notes that, whatever the proposed arrangements, it will take considerable time to put into effect any extensive new or revised internal arrangements and work practices in order to operate effectively in an FRC environment. This may also involve significant cost and resources depending on the option employed.

The extent of retail headroom for small customers, including Tranche 4 customers covered under the Pricing Order in the Northern Territory needs to be investigated. This is important because:

- Retailers will only seek to supply those customers where retail headroom is sufficient; and
- Power and Water Retail expects that there will be a requirement to continue supplying the most unprofitable customers in perpetuity and that it is important to quantify the customer numbers and the associated financial impacts.

This is intractably linked to the issue of the Government's strategy on retail tariff reform, the retention of a maximum uniform tariff and the ongoing levels of the CSO. In this context, it is also relevant that Power and Water will have on-going responsibilities for retailing to water and sewerage customers.

In any case, any decision on the implementation of FRC in the Northern Territory should recognise the unique nature of the Northern Territory electricity supply industry. The legislative and regulatory framework that is introduced to support FRC should accommodate, and build on, these specific circumstances in order to meet the Northern Territory's requirements.

2 Responses to Detailed List of Issues

Power and Water's comments on the Commission's list of issues are set out below.

2.1 Issue 1 – Wholesale Price Transparency

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

Power and Water does not, prima facie, consider the lack of transparency to be an impediment to FRC, although it does recognise that greater transparency may be sought by retailers in relation to the basis on which it sets its prices, and that some oversight of its pricing processes might also be sought by retailers.

Power and Water recognises that that the Northern Territory electricity market is characterised in part by its vertically integrated structure and 100 per cent ownership of electricity generation. However, current policies that resulted from the April 2000 reforms, including:

- Ring-fencing provisions for Power and Water's Generation, Networks, System Control and Retail business units; and
- A Third Party Access Code;

These allow potential new entrant retailers either to negotiate wholesale electricity supply prices with Power and Water Generation or in the case of Power and Water Retail, be supplied electricity at Power and Water Generation's electricity transfer prices. Therefore, new entrants can currently assess the potential attractiveness of the Northern Territory electricity market and have access to supply contracts upon entry. Further, Power and Water's current wholesale market settlement arrangements, between the Generation and Retail businesses, are based on maximum demand for contestable customers, relative to system peak demand, and therefore can be extended to new retailers if and when they choose to operate in the Northern Territory. At present these arrangements are based on customer by customer pricing arrangements. Power and Water notes that it is required to provide the Commission with copies of its third party agreements under the Ring-Fencing Code, including wholesale energy agreements and network access agreements, which can be provided to any requesting party.

Power and Water will work proactively with retailers, the Commission and Government regardless of the model sought.

2.2 Issue 2 – Structure of Power and Water

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

Power and Water considers that its current structure is not an impediment to FRC.

Considering the small market size of the Northern Territory the structural reform of Power and Water may relinquish the commercial or economic benefits derived from the economy of scale accruing from Power and Water's electricity, water, sewerage and retailing businesses remaining integrated.

Previous market reforms resulted from the identification of improvements and arrangements that could be made under continued Government ownership to facilitate increased competition – which have now been implemented.

For example, the following market reforms have been carried out whereby:

- Power and Water's statutory monopoly over electricity supply was abolished;
- Phased introduction of competition occurred;
- The Third Party Access Code was drafted and introduced;
- The Commission was established;
- Network economic and non-economic regulatory arrangements were established; and
- Ring-fencing of Power and Water's business units was implemented, which has resulted in transparent dealings between business units of Power and Water in relation to prescribed services.

However, despite these changes, many of the key structural characteristics of the Northern Territory's electricity industry remain, the market remains small and uncontested by other retailers, there is limited retail headroom, and there are no third party owned generators which are trading under their own name in the market.

Power and Water recognises that there has been significant disaggregation and separation of generation, distribution and retail businesses within other jurisdictions prior to the implementation of FRC. However, the level of disaggregation and separation achieved has differed across jurisdictions in part as a result of differences in the structure and scale of industries. Where multiple generation companies were established, for example in Victoria, there were multiple generators installed at key locations in the network which enabled these companies to trade separately. This was also the experience in NSW.

Power and Water notes that Tasmania, which, in terms of scale, is most comparable to the Northern Territory, has not yet introduced FRC and is at present undergoing a process of determining the likely path to take should FRC be introduced. The issues surrounding the likely success, or lack thereof, of FRC in Tasmania are similar to that faced in the Northern Territory, despite the formal separation of generation, distribution and retail businesses, the connection to the NEM and the transparency of wholesale electricity prices through the Tasmanian regional reference price. In Tasmania, there has been no decision to separate the wholesale business of the

Hydro or to require the separation of Aurora's constituent networks and retail operations.

Power and Water considers that no changes should be made to its structure prior to the introduction of FRC. While Power and Water supports FRC, the small size of the Northern Territory electricity market means that there are significant economies in centralising many of Power and Water's operations. These economies are reflected in retail prices to customers.

Segregation of Power and Water into separate businesses or entities will incur additional costs from the need to introduce multiple systems and the probable requirement to replicate support functions. For example, additional billing systems would need to be implemented for Generation in settlement of power generated for retailers; for Power Networks in charging for network services and work performed on service orders and potentially System Control in financially settling the market, unless this function was derived from AEMO.

2.3 Issue 3 – Retail Margins

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

Power and Water does not have a view on whether the Government should increase the retail tariffs and thus increase retail margins in the Northern Territory. This is a decision for Government.

Power and Water recognises that cost reflectivity of electricity tariffs is an important factor in facilitating the development of a competitive electricity market. However, after accounting for the operation of generation and network operations the residue of regulated retail tariffs available to cover the retail operation and provide retail headroom is limited and may not produce the price reduction sought through the introduction of FRC. A lack of cost reflectivity presents a significant barrier to entry to the market for retailers.

Power and Water notes that in other jurisdictions, such as Western Australia, the lack of cost reflectivity of tariffs has been recognised as a significant issue to be addressed prior to any planned introduction of FRC. In Queensland, the lack of cost reflectivity in standard offer tariffs has also been recognised as a significant contributing factor to the low level of electricity retail competition following the introduction of FRC, and in particular to the low levels of churn in the regions of Queensland serviced by Ergon Energy Queensland.

Power and Water recognises that the nature of its current retail operation is that some customers are not priced at a cost reflective level. This includes some tranche four customers which are supplied under Pricing Order. This means that, on average, Power and Water makes a loss supplying franchise customers and therefore receives a community service obligation payment (CSO) from the Northern Territory Government each year. Retail margins, overall, are therefore negative.

It should also be noted that within customer classes there are varying levels of cost and non-cost reflectivity. Some customer classes in some locations are profitable to serve, while others are not. A decision by the Government to raise the retail tariff to customers will therefore, on average, raise the number of customers that are profitable to serve and therefore open more of the customer base to potential churn in an FRC environment.

The large geographic spread and disparate population bases of the Northern Territory, and the variations in scale and scope that exist across the customer base, ensures that some customers will have a higher cost to serve and therefore that there will likely always be a class of loss making customers regardless of any reasonable increases in the standard offer tariff. In other jurisdictions, equivalent kinds of customers have continued to be funded through a CSO. For example, in rural and regional Queensland, where the uniform retail tariff is significantly below the cost of supplying most customers, the Queensland Government pays Ergon Energy Queensland, the incumbent retailer, a CSO to make up the shortfall.

Power and Water considers that new entrant retailers will only seek to supply customers where they can do so profitably – they will not seek to supply unprofitable customers. This may result in Power and Water retaining a large proportion of higher cost customers, which may need to be addressed through the retention, and increase in the value, of a CSO. While not explicitly mentioned in the Issues Paper, retail tariff reform could also consider a relaxation of uniform tariff policy to recognise the vast differences in the “cost stack” of supply for customers in the different centres in the Northern Territory. Such differences are already reflected into network prices but are not a feature of franchise or “standard offer” prices. Such reforms would remove inherent cross-subsidisation in the structure and level of retail tariffs in the Northern Territory and ensure that retailers were sent appropriate signals about whether to enter markets for particular customer segments.

2.4 Issue 4 – Staged Introduction of FRC

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

As noted above, the nature of Power and Water’s current retail operation is that some customers are not priced at a cost reflective level. The majority of these customers are in areas where the cost of generation and networks are higher, such as in Tennant Creek and Alice Springs. These higher cost areas will therefore have less available retail margin for new retailers to pursue, and thus will be less open to competition than Darwin and Katherine unless the Commission and Government take proactive steps to increase retail tariffs in these areas. It is difficult to see how FRC could be introduced in Tennant Creek and Alice Springs for example, without retail tariff increases. It is also worth noting that while a staged implementation of FRC in the Northern Territory may appear to have its merits, the majority of the costs faced by Power and Water will occur in establishing FRC capabilities in the network billing, NMI standing data and B2B service provision areas in its networks business unit, which will be system driven and will be incurred irrespective of

whether FRC is introduced in (1) Darwin/Katherine markets alone, (2) Darwin/Katherine and Alice Springs markets, or (3) all of Darwin/Katherine, Alice Springs and Tennant Creek. The most important hinge factor for Power and Water's costs is whether FRC is introduced at all, not in the timing of the introduction in the various geographical areas.

Power and Water does not support unmetered loads being made contestable at this stage, for reasons of low retail headroom as well as administrative complexity.

On the first issue, establishing the retail headroom for unmetered loads would be a difficult task and would require significant estimations to be made. Power and Water suspects that these loads are not currently cost reflective, particularly in areas outside of the Darwin/Katherine grids.

Secondly, establishing cost reflectivity, and then establishing ongoing arrangements to ensure that these loads could be contested by new retailers, would require significant work to be undertaken in Power and Water in establishing data repositories and new metering arrangements. It therefore recommends that Government and the Commission consider whether the additional cost involved is justified against the low likelihood of alternative retailers seeking to supply these loads.

Power and Water will cooperate with any policy decision in this regard.

2.5 Issue 5 – Mandatory Interval Metering

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

Power and Water considers that the installation of interval metering for all customers that contract with a second tier retailer should be a pre-condition of retail contestability in the event that the Commission pursues a settlement by differences approach for market settlement. This is because interval metering data will be required by Power and Water Generation in order to settle the purchases of second tier retailers under this approach, with the balance to be paid by Power and Water Retail.

Power and Water considers that the outcome of the National Smart Metering Program is not essential to the decision to proceed or not proceed with FRC. While Power and Water will invest in accordance with any requirement to install smart meters, it does not consider that mandatory installation of smart meters to franchise customers in the Northern Territory will have any material commercial advantage to it or to customers – particularly to residents outside the major regional centres.

Power and Water notes that there are high costs to the establishment of systems which would underpin interval metering, particularly if the data collected and transferred is required by market participants to settle the market and if NEM like roles and responsibilities are put into effect in the Northern Territory. As the Commission is aware, in the NEM, each NMI has a relationship with a number of

market participants. These relationships (known as 'Roles') are managed by AEMO in MSATS. The key commercial roles are:

- Financially Responsible Market Participant (FRMP) - billed by AEMO for wholesale energy (can be any retailer);
- Local Retailer (LR) – geographically determined retailer who has ongoing responsibilities even once it ceases to be the FRMP; and
- Retailer of Last Resort (ROLR) - becomes the FRMP for NMIs of a FRMP that is suspended by AEMO or has its retail licence revoked.

In the NEM, the key operational roles are:

- Responsible Person (RP) - accountable for metering installations (not just meters) and the reading, processing and delivery of metering data (usually the FRMP or LNSP);
- Local Network Service Provider (LNSP) - the geographically determined distributor;
- Metering Provider (MP) – responsible for the provision, installation and maintenance of metering installations;
- Metering Data Agent (MDA) – responsible for the collection, processing and transfer of metering data for Types 1 to 4 metering installations; and
- Metering Data Provider (MDP) – responsible for the collection, processing and transfer of metering data for Type 5 to 7 metering installations.

Each of these Roles requires various accreditations to be secured, which in turn require certain systems to be installed and capabilities to be obtained.

Once Government has decided upon the metering requirements, and how the data from these meters is to be used to settle the market and to allow transfer of customers, it will be necessary to decide the framework for the various roles and responsibilities to be played by each participant. The NEM Roles, while complex, provide a transparent basis for relationships between parties to be organised and to the extent that these are not adopted, alternatives will be required.

2.6 Issue 6 – Bilateral Contract Market

Is the current bilateral contract market an impediment to FRC and should reform of this market be considered prior to introducing FRC?

Power and Water does not consider that the current bilateral market is an impediment to FRC, although it recognises that it may not have the transparency and dispute resolution arrangements that retailers in NEM jurisdictions are accustomed to.

The current bilateral contract market was designed on the basis that there are a small number of buyers and sellers in the Northern Territory and has been suitable for contestability since the market opened.

The Issues Paper suggested that the bilateral contracting model posed a potential problem to the operation of balancing the market, namely that consumption will be unknown for non-interval metered customers until the meter is read and therefore the generators will not be able to respond dynamically to maintain balance. Power and Water considers this is more of an issue with market settlement than the bilateral contracting model per se – balancing purchases and sales could be accommodated under a settlement by differences approach and the installation of interval meters to second tier retail customers.

Three FRC system implementation options were proposed for market settlement in the Issues Paper for consideration:

1. Development of systems locally which would be responsible for reconciling payments between buyers and sellers;
2. Use of parts of AEMO's systems for these functions; and
3. Use of the entirety of AEMO's systems either on account of NEM entry being a precondition for introduction of FRC, or NEM entry being considered likely to occur at some time after the introduction of FRC.

In Power and Water's view, consideration of these options is premature. The Commission should instead set out the options for wholesale market settlement and its preferred way in which parties should contractually interact with one another. Only once this has been investigated should the Commission proceed to consider the extent to which the preferred arrangements could be implemented locally or using national systems.

Regardless of the precise model chosen, any decision to design a new wholesale market settlement arrangement will involve considerable cost, both in designing the arrangements and in determining whether the system requirements (locally or national) can be integrated with Power and Water's existing systems. In a national sense, the use of MSATS to perform the settlement calculations will require changes to the processes and systems currently in place within Power and Water.

Power and Water supports the investigation of all options for wholesale market settlement, including the status quo, well before the commencement date of FRC.

2.7 Issue 7 – Wholesale Generation Pricing Oversight

Should Power and Water Generation's wholesale pricing be subject to oversight and what form should this oversight take?

Power and Water acknowledges that the current wholesale pricing arrangements may be less transparent than retailers operating in the NEM are accustomed to.

In the event that the Commission elects to pursue a mechanism for wholesale pricing oversight, it should be a light-handed regime in order to minimise the costs to Power and Water Generation, and ultimately consumers, given there are no identifiable problems with the current arrangements.

Generation pricing oversight, if it is designed to resemble network pricing oversight in the Northern Territory, will involve the Commission or Government taking a view on what might constitute efficient generation pricing levels at various intervals. This is a complicated undertaking which will need to consider the costs faced by Power and Water Generation in producing and supplying electricity. This may involve the modelling of the long run marginal costs (LRMC) of electricity generation, in this case of dominant gas generation, while taking into consideration, amongst other things, whether:

- The LRMC is calculated from a 'greenfield' perspective or on an incremental basis;
- To allow for load growth and possible load factor changes; and
- The analysis will be undertaken on a deterministic or probabilistic basis.

Power and Water notes that in April 2005 the Commission undertook a review of the generation component of electricity prices paid by contestable customers, for the period covering financial years 2002-03 and 2003-04. The Commission findings were that Power and Water's wholesale electricity generation prices were generally consistent with the Commission's estimates of the reasonable costs of generation.

This review was updated by the Commission in June 2006, where it was found that during the 2004-05 financial year Power and Water's average wholesale generation revenues had increased to levels close to, or slightly above, the Commission's estimates of the reasonable costs of generation. The increased costs were mainly due to the cost of fuel and a change in asset valuation methodology – from a book value approach to a replacement value.

Power and Water will work proactively with the Commission and Government as necessary as it undertakes this work.

2.8 Issue 8 – Generation Price and Product Clarity

Should Power and Water Generation be required to publish firm prices for specified terms and products?

Power and Water accepts that there will be a need for new retailers to have clarity on the nature and quality of the services that they require from the various businesses of Power and Water, and that pricing clarity will be a component of this. It also acknowledges that retailers will wish to have forward looking clarity of generation pricing arrangements. Currently, NEM retailers have certainty and transparency about wholesale pricing arrangements by virtue of the pool arrangements where generators bid prices against each other with the market settling on the basis of prices which are acceptable to both buyer and seller.

Power and Water Generation provides one primary product – the supply of wholesale energy at different times of the day. Currently, it sells energy to Power and Water Retail for franchise customers – for each of the major regions on the basis of its forecast costs and load – and for contestable customers based on individual customer’s forecast load shape and connection characteristics.

Publishing firm, forward looking prices for the supply of wholesale energy is fraught with difficulty and is only possible in circumstances where all of the energy is being sold to one retailer (as is the case currently). Where energy is being sold to multiple retailers for multiple customers, it can be difficult to achieve this without extensive cross subsidisation. For example, if one retailer was to purchase an amount of energy for one large contestable customer with a peaky load shape, and for no other customers, then the sale of this energy may be on a different basis than it would be if that retailer sought supply for two customers where the sum of the two load shapes provides an overall flat load. This is because generators will reward retailers which contract with them for flat loads rather than peaky loads.

The issue of wholesale market pricing and wholesale market settlement is a complex one which Power and Water strongly suggests should be a primary focus of the Commission prior to detailed consideration of FRC. Designing a system whereby Power and Water Generation can price and charge wholesale energy to multiple retailers on a basis that does not cross-subsidise retailers, allows the commercial arrangements to balance and which does not require significant additional metering expenses is a first order issue in planning for FRC.

2.9 Issue 9 – Load Profiling

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

Power and Water accepts that profiling is an accepted mechanism to convert meter readings from accumulation meters (that are usually read monthly or quarterly) to half hours (or some longer period). This is required if the wholesale market is settled in half hourly (or some longer) trading intervals and the wholesale price therefore differs half hourly (or by some longer period).

That said, the calculation of net system load profiling is a complex exercise which may not be justifiable in the context of few churning customers. Further, the implementation of net system load profiling will leave Power and Water Retail, as host retailer, funding the differences between the total load and that supplied by second tier retailers, which may in turn impose risks on Power and Water Retail, which it will need to identify and make clear to the Commission.

While there are many issues that the Commission will need to consider in the development of load profiles – particularly relating to the source of the profiles – Power and Water will address these with the Commission as the process continues. Of particular significance is the way in which the Commission intends to approach the various NEM Roles in metering and settlement, and what role it requires Power and Water to play in this regime.

Power and Water will work proactively with the Commission as it works through the proposals for wholesale market settlement, including the development of, and use of, net system load profiling.

2.10 Issue 10 – Standard Contract Terms

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

Power and Water considers that the development of a standard form contract is an essential component of the introduction of FRC and should be pursued by the Commission and Government.

It notes, however, that:

- The development of standard contracts in other jurisdictions has been a time consuming and intensive process to complete and involved the participation of third party retailers, the Commission, Government and network companies; and
- Development of these contracts in Queensland was conducted alongside the development of a Queensland Electricity Industry Code, which contained the standard contract as an Attachment. Such an Industry Code may well be required in the Northern Territory.

Power and Water considers that while the development of standard contracts is an important issue in the preparation for FRC, it is not one of the most important building blocks when placed alongside the wholesale market settlement system and the form of generation pricing. It is essential however that when it comes time for this work to commence, that the Commission have regard for the significant work that has been undertaken in states such as South Australia and Queensland in the development of standard offer contracts. These States have established, through extensive stakeholder involvement including the largest national retailing companies, workable contracts which now form the basis of supply to millions of customers in FRC environments. It is suggested however, that work on this aspect of FRC be deferred until the more fundamental issues have been resolved.

2.11 Issue 11 – Electricity Ombudsman

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

Customer protection is an integral component of the introduction of FRC. If the best outcome in a competitive market is to be achieved, there is a need for customers to be offered protection from industry participants and be provided a clear framework from which they can raise complaints and voice their concerns.

Given that Northern Territory consumers have purchased electricity solely from Power and Water since its formation, a strong framework for customer protection

needs to be in place to provide customers with confidence to switch retailers, should competition develop. In this sense, the foundation for customer comfort must lie in the fact that there is a legislative regime in place that offers adequate protection for the Northern Territory's retail customers.

Adequate customer protection also needs to be in place to ensure that marketing tactics are fair and that customers are not unfairly pushed into new contracts without information. In Australian jurisdictions where FRC has been implemented door-to-door selling techniques are widespread and recognised as the most effective way of communicating with customers about new gas and electricity market offerings and gaining new customers. This potentially creates an environment for misrepresentation, or misinformation, whereby customers may feel pressured into making decisions without the appropriate level of consideration.

Power and Water notes that there has been a tendency in other jurisdictions where FRC has been introduced for retailers to enter markets aggressively. Customer protection frameworks have been important in working through billing and conduct issues in these jurisdictions. For example, 2008/09, the Queensland Energy Ombudsman received 13,526 complaints of which 198 complaints related to conduct by energy marketers including provision of misleading information and other factors including pressure tactics.²

Power and Water suggests that any amendment of the existing *Ombudsman (Northern Territory) Act* or any decision to set up an independent electricity industry ombudsman's office should have strong regard to the best practice elements of similar models undertaken in other jurisdictions where FRC has been implemented. Schemes such as the Energy and Water Ombudsman (NSW) (EWON), Energy and Water Ombudsman (Victoria) (EWOV) and the Energy Industry Ombudsman (SA) (EIOSA) have been operating successfully in their respective jurisdictions for a number of years.

Key issues to be considered with regard to the functions and powers of an electricity ombudsman's office include:

- The degree of independence required;

The scope of coverage under the legislation, primarily whether customers supplied by unregulated networks, or customers excluded from FRC (in the case of a limited or phased roll out of FRC) should have access to the electricity ombudsman.

The NSW and Victorian schemes, while originally not including excluded customers have since extended the jurisdiction in this area;

- The extent to which the electricity ombudsman can require the provision of information from energy businesses;
- The scope of orders available to the electricity ombudsman;

² <http://www.eoq.com.au>

- The scope of the disputes the electricity ombudsman can consider. For example, whether to provide coverage in relation to land disputes, which can potentially involve, amongst other things:
 - Land damage;
 - Granting of easements;
 - Damage to gas and water pipes, channels, drains and dams; and
 - Damage, maintenance, placement and safety of pole cabling;
- Whether the functions conferred on the electricity ombudsman should allow for the promotion of customer access to the scheme;
- Whether the powers of the electricity ombudsman should extend to consider disputes between energy entities; and
- The capacity for the electricity ombudsman to require reconnection of a customer whilst a dispute is under consideration.

