Review of Prescribed and Excluded Distribution Services

Draft Decision
Review of Prescribed and Excluded Distribution Services

Draft Decision
Request for submissions

Submissions are invited from interested parties. Unless confidentiality is sought, the submissions are generally available for public inspection at the Tribunal’s offices and will be available on-line in PDF format from the time of processing of the submission until 3-4 weeks after the release of the final report of an inquiry. The Tribunal may exercise its discretion not to exhibit any submissions based on their length or content (containing material that is defamatory, offensive, or in breach of any law).

Submissions should have regard to the specific issues that have been raised. There is no standard format for preparation of submissions but reference should be made to relevant issues papers and interim reports. Submissions should be made in writing and, if they exceed 15 pages in length, should also be provided on computer disk in work processor, PDF or spreadsheet format.

Submissions from stakeholders must be received by Thursday, 10 April 2003.

All submissions should be sent to: Review of Prescribed and Excluded Distribution Services
Attn: Lisa Spence
Independent Pricing and Regulatory Tribunal
PO Box Q290
QVB Post Office NSW 1230

The decision making process

The Tribunal will consider the additional information presented in submissions received by interested parties prior to making a final decision. The Tribunal’s final decision on the issues raised in this paper will be made and set out in the 2004 Electricity Network Determination.

Confidentiality

If you want your submission, or any part of it, to be treated as confidential, please indicate this clearly. The Tribunal may include in its publications a list of submissions received during the course of a particular review or inquiry. It may also refer to submissions in the text of its publications. If you do not want your submission or any part of it to be used in any one of these ways, please indicate this clearly.

A request for access to a confidential submission will be determined in accordance with the Freedom of Information Act and section 22A of the Independent Pricing and Regulatory Tribunal Act.

Privacy

All submissions will be treated in accordance with the Privacy and Personal Information Act 1998. Any personal information you give us will not be reused for another purpose.

Public information about the Tribunal’s activities

Information about the role and current activities of the Tribunal, including copies of latest reports and submissions can be found on the Tribunal’s web site at www.ipart.nsw.gov.au.

Inquiries regarding this review should be directed to:
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SUMMARY OF DRAFT DECISION

Excluded distribution services

In exercising the function of determining which distribution services are to be deemed prescribed under clauses 6.10.4 (a) and (b) of the National Electricity Code (the Code), the Tribunal has taken the practical approach of first deciding on which services are to be deemed to be excluded distribution services. The Tribunal has done this by considering:

a) whether effective competition exists in the provision of the service
b) whether there is potential for a competitive market to be established for the service
c) the effectiveness of the form of regulation for prescribed distribution services.

Having regard to these considerations, the Tribunal has determined under clause 6.10.4 (b) of the Code, that the following will be deemed to be excluded distribution services from 1 July 2004:

- Customer funded connections – design and construction of new connection assets; construction of customer-funded network augmentations.
- Customer-specific ancillary services – including inspection and maintenance of customer installations and connection assets (excluding separately defined monopoly services); asset relocation works; conversion to aerial bundled cable; other customer-requested services.
- Metering services – meter supply, installation and maintenance; meter reading and data forwarding; and other metering services which are currently defined as miscellaneous services - provision of metering data, special meter reads, meter tests.
- Public lighting - construction and maintenance of public lighting assets.

Prescribed distribution services

Consistent with the approach taken for deeming excluded distribution services, and having regard to the criteria in clause 6.10.4(a) of the Code, the Tribunal has determined that all distribution services provided by a DNSP will be deemed a prescribed distribution service, except for those distribution services that are deemed an excluded distribution service (as listed above).

The form of regulation for excluded distribution services

The Tribunal has determined under clause 6.10.4(b) of the Code, that where there exists an effectively competitive market for an excluded distribution service, no regulation will be applied. A DNSP must demonstrate to the Tribunal that the particular service satisfies the Tribunal’s test (or criteria) for effective competition.

In the event effective competition does not exist for the excluded distribution service, the Tribunal has determined that the form of ‘light handed’ regulation to apply will include:

- pricing principles
- annual information disclosure
- annual price monitoring and compliance assessment by the Tribunal.

Where non-compliance with the pricing principles or information disclosure is assessed, the Tribunal may disapprove the proposed prices.
1 INTRODUCTION

The Independent Pricing and Regulatory Tribunal of New South Wales (the Tribunal) is currently reviewing the regulatory arrangements to apply to NSW electricity distribution services for the period starting on 1 July 2004. It must identify which distribution services will be prescribed distribution services and subject to the arrangements set out in the Notice under clause 6.10.3 of the National Electricity Code - Economic Regulatory Arrangements (NEC Report 10), and which will be subject to a more light-handed form of regulation (those that will be excluded distribution services).

In June 2002, the Tribunal released a discussion paper on prescribed distribution services, and sought the views of stakeholders. It has now considered the feedback it received and has made a draft decision. This draft decision sets out the Tribunal’s proposed approach to determining prescribed distribution services, provides a list of services that shall be classified as excluded distribution services, and the form of regulation to be applied to these services.

The purpose of this paper is to communicate these draft decisions to stakeholders and seek their feedback. The paper is arranged as follows:

- Chapter 2 provides an overview of the regulatory framework for distribution services in NSW
- Chapter 3 sets out the Tribunal’s draft decision for determining prescribed distribution services and the proposed list of excluded distribution services, and its rationale for these decisions
- Chapter 4 presents the draft decision on the form of regulation for excluded distribution services.

The Tribunal will consider additional information presented in submissions from interested parties prior to making a final decision. Submissions from stakeholders must be received by Thursday, 10 April 2003 and addressed to:

Review of Prescribed and Excluded Distribution Services
Attn: Lisa Spence
Independent Pricing and Regulatory Tribunal
PO Box Q290
QVB Post Office NSW 1230

The Tribunal’s final decision on the issues raised in this paper will be made and set out in the 2004 Electricity Network Determination.

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2 REGULATORY FRAMEWORK FOR SERVICES PROVIDED BY DNSPS

In NSW, the services provided by Distribution Network Service Providers (DNSPs) are subject to different regulatory arrangements, depending on the nature of the service. Figure 2.1 illustrates the levels of classification and the associated regulation.

Figure 2.1 Regulation of services provided by DNSPs

2.1 Distribution services

Distribution services are defined in the National Electricity Code (the Code) as:

The services provided by a distribution system which are associated with the conveyance of electricity through the distribution system. Distribution services include entry services, distribution network use of system services, exit services and network services which are provided by part of a distribution system.

The Tribunal, as the Jurisdictional Regulator for NSW, regulates all DNSP-provided services that fit this definition under the Code. How they are regulated depends on whether they are deemed to be prescribed distribution services or excluded distribution services.
2.1.1 Prescribed distribution services

Services deemed by the Tribunal to be prescribed distribution services are subject to the form and mechanism of economic regulation outlined under clause 6.10.5 of the Code. The Tribunal has established the economic regulatory arrangements that will apply to these services from 1 July 2004. These arrangements are set out in the Notice under clause 6.10.3 of the National Electricity Code - Economic Regulatory Arrangements (NEC Report 10), and include:

- A weighted average price cap for the distribution component of network prices.
- A pass-through of transmission components of network prices.
- Explicit prices for an exhaustive list of miscellaneous prices and monopoly fees.

2.1.2 Excluded distribution services

Services deemed to be excluded distribution services are not subject to the regulatory arrangements outlined above. Under clause 6.10.4 of the Code, the Tribunal may regulate these services by applying forms of regulation that are more ‘light-handed’ than the measures listed in clause 6.10.5. The Tribunal is responsible for determining the specific form of regulation that will apply, which is the subject of Chapter 4 of this paper.

2.2 Non-distribution services

Services classified as non-distribution services are not regulated by the Tribunal under the Code, and are not affected by the Tribunal’s determination on distribution pricing. However, these services may be subject to regulation by the Tribunal using other legislative instruments such as the Electricity Supply Act.

Box 2.1 sets out those services provided by DNSPs that the Tribunal considers to be non-distribution services.

Box 2.1 Non-distribution services

- Wholesale sales of electrical equipment for use on the distribution network
- Advising customers on sustainable energy solutions
- Private lighting design & construction
- Electrical appliance sales
- Electrical product testing and calibration
- Embedded generation
- Services provided outside the DNSPs’ distribution area
- Engineering consultation
- Electricity retail supply
- Transmission services
- Electrical contracting activities

2 'Light-handed' is not defined in the Code.
3 CLASSIFICATION OF PRESCRIBED DISTRIBUTION SERVICES AND EXCLUDED DISTRIBUTION SERVICES

Under the Code, the Tribunal is responsible for determining which distribution services are deemed to be prescribed distribution services. Clause 6.10.4(a) of the Code requires the Tribunal to have regard to the following factors when making this decision:

1. the principles for regulation of distribution service pricing described in clause 6.10.3
2. the extent of effective competition in the provision of that distribution service
3. whether sufficient competition exists to warrant the application of a regulatory approach which is more ‘light-handed’ than the approach described in clause 6.10.5
4. the effectiveness of the form of economic regulation specified under clause 6.10.5 in achieving the efficiency objectives included in clause 6.10.2 and
5. the form, if any, of that regulation.

The Tribunal proposes an approach for determining prescribed distribution services and excluded distribution services that takes these factors into account. The draft decisions are set out below, together with an explanation of the rationale behind the decisions.

3.1 Deeming of prescribed distribution services

The Tribunal proposes to deem all distribution services provided by a DNSP to be a prescribed distribution service, except those that are classified by the Tribunal as an excluded distribution service.

For the regulatory period commencing on 1 July 2004, the Tribunal proposes that all distribution services provided by a DNSP will be deemed to be prescribed distribution services, except those specifically listed by the Tribunal as excluded distribution services.

The Tribunal believes that this approach is clear and unambiguous and it received broad support from stakeholders who responded to the Tribunal’s discussion paper, including DNSPs, the National Electrical Contractors Association (NECA), and AGL. It is also in line with the approaches adopted by the Essential Services Commission of Victoria and the Queensland Competition Authority in their recent determinations (see Appendix 2).

The way in which a DNSP chooses to provide a prescribed distribution service—for example, by providing it itself or by contracting it out—will not affect its classification as a prescribed service. A DNSP may choose to contract out any of its prescribed distribution services, but the service will continue to be subject to regulation through the distribution pricing determination. The DNSP is remunerated for the costs of providing the service through its regulated revenue.

The Tribunal invites comments from stakeholders on its proposed approach for determining prescribed distribution services.

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3 Clauses 6.10.2 through to 6.10.5 are re-produced in Appendix 1 of this paper, which includes Schedule 6.6 of the Code which lists examples of services that could be classified as excluded distribution services.

4 Clause 6.10.5 of the Code is the clause that sets out how the Tribunal is to conduct its distribution pricing determination. It requires that the Tribunal adopt a revenue cap, a weighted average price cap or a hybrid as its form of economic regulation. (See clause 6.10.5(b).)

3.2 List of excluded distribution services

The Tribunal proposes that the following list of services be fixed as excluded distribution services from 1 July 2004:

- **Customer funded connections** - design and construction of new connection assets; construction of customer-funded network augmentations.
- **Customer-specific ancillary services** - including inspection and maintenance of customer installations and connection assets (excluding separately defined monopoly services); asset relocation works; conversion to aerial bundled cable; other customer-requested services.
- **Metering services** - meter supply, installation and maintenance; meter reading and data forwarding; and other metering services which are currently defined as miscellaneous services - provision of metering data, special meter reads, meters tests.
- **Public lighting** - construction and maintenance of public lighting assets.

These services are described in more detail in Appendix 3, and the relationship the services have with existing regulation, such as the Capital Contributions Policy and Ring Fencing Guidelines, is outlined in Appendix 6.

The Tribunal proposes to fix an exhaustive list of excluded services for the regulatory period, and does not intend to re-consider the list until the next regulatory review. Several stakeholders have suggested that there needs to be flexibility in the definition of prescribed distribution services to accommodate changes in the nature of services during the regulatory period. However, the Tribunal does not believe that this would deliver an appropriate level of regulatory certainty and would be difficult to implement.

For example, if a service moves between prescribed and excluded distribution categories during the regulatory period, the revenues, costs and X factor underlying each DNSPs weighted average price cap for prescribed distribution services would require adjustment. Furthermore, since the revenue associated with any excluded service is likely to be small relative to the revenue earned for prescribed services, the costs involved in making the change may well outweigh the benefits.

The Tribunal has however sought to introduce flexibility in the regulatory framework for those services that are excluded. This is discussed in Chapter 4.

The Tribunal invites comments from stakeholders on the draft list of excluded distribution services. Comments in relation to specific services should include detailed reasons why a service should be excluded, or why it should not be deemed excluded.
3.3 **Rationale for deeming a service as an excluded distribution service**

Consistent with the factors outlined in clause 6.10.4(a) of the Code, the key criteria the Tribunal has used to determine whether a distribution service should be deemed an excluded distribution service are:

- whether effective competition exists in the provision of the service
- whether there is potential for a competitive market to be established for the service
- the effectiveness of the form of regulation for prescribed distribution services for regulating the service.

Each of these criteria, and the proposed excluded distribution services to which the Tribunal believes they apply, are discussed below.

3.3.1 **Effective competition exists in the provision of the service**

The Code encourages the development of competitive markets for the provision of distribution services, where this is feasible. If a distribution service is provided within a market with effective competition, price regulation is not necessary as customers have a choice of supplier, and appropriate price signals are being delivered. Thus the existence of effective competition provides strong grounds for deeming a service to be an excluded distribution service, with the aim of removing regulation.

The difficulty lies in determining when effective competition exists. For example, services that are declared contestable by government policy, will not necessarily be provided in a market with effective competition. This can be due to various barriers to entry, such as:

- technical feasibility, and safety and legal obligations
- ambiguity in the contestability policy and current DNSP practice
- existing regulation, which may be restrictive
- economies of scale and scope which, in regions where customer numbers and demand are relatively low, can reduce the financial viability and consequently the sustainability of competing service providers.

For the coming regulatory period, the Tribunal proposes to establish a test (or set of criteria) for determining whether effective competition exists, and for identifying those services that may not need to be regulated. Under this proposal, the onus would be on the DNSPs to demonstrate to the Tribunal that a particular service meets the criteria in the effective competition test. This test is discussed in more detail in section 4.1.1.

At present, the Tribunal does not have evidence that there are any distribution services that are provided with an effectively competitive market. It is believed however, that as the impact of full retail competition policy is felt, competitive markets will develop in related services. The existence of the test will facilitate the timely reduction and removal of regulation as this occurs.

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6 Clause 6.10.3 states that “...concerns over monopoly pricing in respect of the distribution network will, wherever economically efficient and practicable, be addressed through the introduction of competition in the provision of distribution services”.
3.3.2 Potential for a competitive market to be established

For services where there is potential for a competitive market to be established, it is important that the regulation of the service does not entrench or artificially prolong the market power of incumbent service providers. This is consistent with the intent of Chapter 6 of the Code.

As an excluded distribution service, the Tribunal intends to tailor the regulation to the emerging level of competition, allowing both DNSPs and competing service providers to adapt to the changing commercial environment, while preventing the extraction of monopoly rents.

However, the potential for competition does not exist for all distribution services. In NSW, it is the government’s role to determine which distribution services will be contestable and to address significant barriers to entry for other service providers entering the market. Currently, contestable services are defined in the Electricity Supply (General) Regulation 2001 (NSW). In addition, the Ministry for Energy & Utilities (the Ministry) administers a Code of Practice – Contestable Works, and operates as the accrediting agency for service providers (including DNSPs) to provide contestable services.

The distribution services currently covered by the Ministry’s Code of Practice are customer-funded connection works and asset relocations. Street lighting, metering services and installation inspection are services which may become contestable in the medium term. The Tribunal considers that all of these services warrant being deemed as excluded distribution services on the grounds that there is potential for them to be provided in a competitive market.

**Metering services**

Under the Code, metering services to customers are due to become contestable in NSW on 1 July 2004. As the Tribunal intends to fix the list of excluded distribution services at the start of the regulatory period (1 July 2004), it believes these services warrant being deemed as excluded distribution services.

The Tribunal’s final decision however will be influenced by any forthcoming decisions from government on the contestability of metering. Over the next six months, the Ministry of Energy and Utilities (the Ministry) will be considering this issue, including arrangements to support contestability where and when this is appropriate. As a first step, the Ministry is issuing a consultation paper early in 2003. The Tribunal will incorporate the government’s policy framework into its final decision as to whether it is a prescribed or excluded service for the July 2004 Determination.

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7 A contestable service is one where the customer has the right to determine which service provider carries out the work.
8 Clause 3 of the Electricity Supply (General) Regulation 2001 (NSW):
   (a) any service provided for the purpose of complying with Division 4 Part 3 of the Act and;
   (b) any service comprising work relating to an extension of a service provider’s distribution system or an increase in the capacity of a service provider’s distribution system.
9 The Ministry will shortly be establishing a working group to review the definition of contestable works and discuss which services should be contestable, as part of a review of the Code of Practice. The review is expected to take approximately 12 months to complete.
10 Clause 9.17A.1(d) of the Code is a derogation which makes the local network provider the responsible person for providing metering services in NSW. This expires on 1 July 2004.
3.3.3 The effectiveness of the form of regulation for prescribed distribution services

For some distribution services, the weighted average price cap form of regulation for prescribed distribution services may not be appropriate, or the most effective, in achieving the principles of the Code. By having these services as excluded distribution services, the regulation can be tailored to provide more efficient outcomes.

This section discusses other circumstances that the Tribunal has taken into account when considering the effectiveness of the form of regulation and whether a service should be a prescribed or excluded distribution service:

- whether a service is a non-standard ancillary service that may be priced on an individual basis
- the ability to separate costs between excluded and prescribed distribution services
- the cost of regulating as a prescribed or excluded service (materiality).

Non-standard ancillary services

In addition to providing core distribution services to broad classes of customers, DNSPs also provide various types of non-standard ancillary services that are requested by individual customers and priced on an individual basis. The Tribunal considers that services of this nature are more effectively regulated as excluded distribution services outside the constraints of the weighted average price cap. The benefits of these services are attributed to individuals and should be charged accordingly. Examples of services that the Tribunal believes fit into this category include asset relocations and maintenance of customer installations.

Separating costs and revenues from prescribed distribution services

An accurate and transparent allocation process is required when identifying revenues and costs associated with excluded distribution services, as they must be excluded from the weighted average price cap. Where the costs and revenues of a particular service are not easily identified, particularly in relation to shared costs components, it may be more efficient to retain the service as a prescribed distribution service, within the weighted average price cap, rather than apply a separate regulatory model.

Materiality

The Tribunal is aware that there are costs involved in administering and complying with pricing regulation. The effectiveness of a form of regulation depends, in part, on the costs associated with that form of regulation, compared to the benefits. Where possible, the Tribunal will adopt a consistent, relatively simple form of regulation for excluded distribution services in order to maximise the benefits and efficiencies which will be achieved by have a service as an excluded distribution service.
4 FORM OF REGULATION FOR EXCLUDED DISTRIBUTION SERVICES

For excluded distribution services, the Tribunal proposes the following regulation:

- For excluded distribution services provided in an effectively competitive market, the Tribunal will not impose any regulation. The DNSP must demonstrate to the Tribunal that there is an effectively competitive market by satisfying the Tribunal’s test (or criteria) for effective competition.

- For all other excluded distribution services, the Tribunal will impose a ‘regulatory package’ which the DNSPs will need to demonstrate compliance with annually. The components of the package will be:
  - Pricing principles
  - Annual information disclosure
  - Annual price monitoring & compliance assessment by the Tribunal.

Where there is non-compliance with the pricing principles or information disclosure, it is proposed that the Tribunal will disapprove the proposed prices.

Under clause 6.10.4 of the Code, the Tribunal may regulate excluded distribution services by applying forms of regulation that are more ‘light-handed’ than the measures listed in clause 6.10.5. How ‘light-handed’ the regulatory approach should be, will depend on a number of factors, including the level of competition in that market and the nature of the service.

The Tribunal anticipates that excluded distribution services in NSW will be subject to varying levels of competition—both over time and over different geographical areas. The form of regulation for the service needs to be flexible in order to accommodate the nature of its market. For example, as more service providers enter the market and the level of competition increases, regulation should be wound back.

The Tribunal is aware that defining the ‘market’ and assessing market conditions can be a complex and time-consuming exercise. In practice, the benefits derived from attempting to fine-tune the regulatory approach to the level of competition may not match the costs involved, given the scale of the services in question. The Tribunal however does also not wish to adopt a form of regulation that hinders the development of competition in those services, or in particular areas.

The DNSPs have stated that where a service has been deemed to be excluded because there is a degree of contestability, the first presumption should be not to regulate but only to monitor. However, there are a number of other largely light-handed approaches that should also be considered, including adopting a combination of measures. These are discussed in detail in Appendix 4.

This chapter presents the Tribunal proposed regulatory framework and its rationale for adopting this approach, and a comparison with the regulation adopted in other States for their current regulatory periods.

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11 'Light handed' is not defined in the Code.
### 4.1 Tribunal’s proposed regulatory framework for excluded distribution services

After reviewing a range of ‘light-handed’ regulation measures (outlined in Appendix 4), the Tribunal proposes the following framework where, in the first instance, all excluded distribution services are subject to a regulatory ‘package’, consisting of pricing principles, information disclosure and price monitoring by the Tribunal.

If the DNSP can provide sufficient evidence to the Tribunal that there is effective competition in the provision of a service within a particular market, then the Tribunal will consider removing the regulatory package for that service in that market. If, on the other hand, there is evidence during the Tribunal’s monitoring process that the adopted approach to regulation is not providing sufficient protection for customers, then the Tribunal will have the power to disapprove the prices proposed by the DNSP and require that alternative prices be submitted.

Figure 4.1 illustrates how this will operate and sections 4.1.1 - 4.1.3 explain the process in detail.

**Figure 4.1 Proposed regulation for excluded distribution services**
4.1.1 No regulation for services with an effectively competitive market

For services where effective competition can be demonstrated, no regulation should be necessary. In section 3.3.1, the Tribunal proposed the use of a test or criteria, for identifying whether effective competition exists in the provision of a service. This test will form the basis by which regulation for that service would be removed. The DNSP or stakeholder will need to apply to the Tribunal to have the regulation removed, by demonstrating that there is effective competition for that service in its particular market.

It is proposed that the criteria for deciding whether a service fits into this category will be:

a) the extent of the market and the conditions of demand for the service
b) consideration of the length of time the service has been contestable, and the number and concentration of other service providers
c) the market power of the DNSP—for example, the DNSP will be assumed to dominate the market where it has more than forty per cent market share\(^3\)
d) if there are any barriers to entry or existing impediments for service providers, or new service providers.

In defining the market, it will be possible for a service to be competitive in one geographical area, such as an urban area, and not in another – for example in a rural area. It is intended that the test will identify these situations with a result that different regulation may apply to services in different geographical locations.

The application of the test will be flexible and transparent, that is, it is proposed that an application to remove regulation can be made at any time during the regulatory period and will be subject to a public consultation process. It should be noted however that only services in the excluded distribution services list would be able to have regulation removed on the grounds of effective competition.

The Queensland Competition Authority and Essential Services Commission Victoria use a similar approach to establish the competitiveness of individual markets. Under these regimes, the DNSPs must demonstrate whether there is effective competition. Examples of the criteria these organisations use, and the test imposed on DNSPs, are set out in Appendix 5.

The Tribunal invites comments from stakeholders on the appropriate test or criteria to establish whether effective competition exists, and whether there are currently any services that are considered to have an effectively competitive market.

\(^3\) Forty per cent is provided as an example only. It is the indicative threshold adopted by Queensland Competition Authority in their approach to deciding whether a service should be treated as an excluded service. It is also the threshold adopted by the Australian Competition and Consumer Commission (ACCC) in their Merger Guidelines to define a situation of ‘unilateral market power’, ACCC, Merger Guidelines, AGPS, Canberra, June 1999, s.5.95.
4.1.2 Regulatory ‘package’ for all other excluded distribution services

Excluded distribution services with no competition in their market, or those that have the potential for competition, or are partially competitive, require some form of price regulation to protect consumers from abuses of monopoly power. For example, services that are provided in a market at the early stages of development, or where the incumbent DNSP is likely to retain substantial market power for a period of time, will need regulation which accounts for the lack of market discipline on the price that can be charged.

The Tribunal believes that in these instances, a ‘package’ approach which has a combination of regulation measures, is sufficient to address the different market situations, whilst not restricting the emergence of competition.

The Tribunal proposes the following framework for the regulation of excluded distribution services which are not provided in an effectively competitive market environment:

a) Establishment of broad pricing principles to achieve objectives of economic efficiency, revenue sufficiency and equity.

b) Annual information disclosure by the DNSPs, to publicly disclose information in relation to any changes in prices and cost structures, and to enable benchmarking and price comparisons by the public.

c) Annual price monitoring by the Tribunal, where the DNSPs submit proposed prices for review and assessment against the pricing principles. If the proposed prices do not meet the pricing principles or information disclosure requirements, the Tribunal has the power to disapprove the prices and the DNSP will be required to re-submit an alternative proposal.

The Tribunal believes that this framework provides a reasonable balance between the interests of customers, DNSPs and other service providers. The pricing principles will enhance the objectives for a competitive market. Price monitoring provides sufficient impetus for DNSPs to behave appropriately in markets where they may be the dominant force, and the price disclosure requirement allows customers to make informed decisions.

The Tribunal recognises that disclosure of costs incurred by DNSPs can provide a competitive edge to other service providers, however, it intends that DNSPs be required to disclose costs at a relatively high-level and not in terms of individual service provision.

The Tribunal proposes that all excluded distribution services listed in section 3.2, will initially be subject to this form of regulation from 1 July 2004, given their current market conditions. However, DNSPs may apply to the Tribunal to have this regulation removed through satisfying the ‘test’ for effective competition.

The Tribunal invites comments from stakeholders on its proposed approach to regulating excluded distribution services. It particularly seeks comments on the content of the principles, the monitoring process, and the information that should be disclosed by the DNSPs in relation to the proposed excluded distribution services.
4.1.3 Review of regulation for excluded distribution services

The Tribunal has proposed a ‘light-handed’ form of regulation to apply to excluded distribution services, with an avenue through which to remove regulation. If however, the proposed framework is demonstrated to be ineffective, the Tribunal may wish to introduce price approval or price setting as part of the regulatory framework for excluded distribution services.

The Tribunal proposes to gauge how effective the framework is through the annual monitoring process. If there is sufficient evidence that the framework is not operating in a fair and reasonable manner for service providers and customers alike, the Tribunal may carry out a formal public review process in order to review the adopted form of regulation and whether additional measures are required.

4.1.4 Regulatory approaches in other states

Victoria, Queensland and South Australia all vary in their approach to the regulation of distribution services. Appendix 2 provides their definitions of prescribed distribution services and Appendix 5 compares their approaches for the regulation of excluded distribution services.

For a service to be eligible for classification as an excluded distribution service in Queensland it must meet the regulator’s criteria for contestability. Once classified, excluded distribution services are not subject to regulation by the Queensland Competition Authority. Queensland has not identified any services that meet this criteria in the current regulatory period.

In Victoria, excluded distribution services are classified by the regulator as either contestable or non-contestable. Contestable services are not subject to regulation. Charges for non-contestable services are subject to a regulatory regime that combines pricing principles, price disclosure and price approval. DNSPs are required to submit an annual pro-forma submission which sets out the proposed charges and other information that will allow the regulator to determine whether the charges comply with the excluded services pricing principles. Currently all excluded services in Victoria are non-contestable and must have a statement of charges submitted.

In South Australia prices for excluded distribution services are required to be “fair and reasonable”, but are not otherwise subject to regulation. However, customers have access to dispute resolution by the regulator if they are dissatisfied with the charges and terms offered. Notification of a dispute allows the regulator to directly set the price for the service in question.
APPENDIX 1    CLAUSES 6.10.2 TO 6.10.5 AND SCHEDULE 6.6 OF THE CODE

6.10.2   Objectives of the distribution service pricing regulatory regime to be administered by the Jurisdictional Regulators

The distribution service pricing regulatory regime to be administered under Part D of the Code must seek to achieve the following outcomes:

(a) an efficient and cost-effective regulatory environment;

(b) an incentive-based regulatory regime which:

(1) provides an equitable allocation between Distribution Network Users and Distribution Network Owners of efficiency gains reasonably expected by the Jurisdictional Regulators to be achievable by the Distribution Network Owners;

(2) provides for, on a prospective basis, a sustainable commercial revenue stream which includes a fair and reasonable rate of return to Distribution Network Owners on efficient investment, given efficient operating and maintenance practices of the Distribution Network Owners;

(3) ensures consistency in the application of regulations applicable to:
   (i) connection to distribution networks;
   (ii) distribution service pricing; and

(4) provides for the recovery by Distribution Network Service Providers of Customer TUOS usage charges from those Distribution Customers that have a metering installation capable of capturing relevant transmission system and distribution system usage data, in a way that preserves the location and time signals of the Customer TUOS usage prices;

(c) prevention of monopoly rent extraction by Network Owners;

(d) an environment which fosters an efficient level of investment within the distribution sector, and upstream and downstream of the distribution sector;

(e) an environment which fosters efficient operating and maintenance practices within the distribution sector;

(f) an environment which fosters efficient use of existing infrastructure;

(g) reasonable recognition of pre-existing policies of governments which are Distribution Network Owners regarding distribution asset values, revenue paths and prices;

(h) promotion of competition in upstream and downstream markets and promotion of competition in the provision of network services where economically feasible;

(i) reasonable regulatory accountability through transparency and public disclosure of regulatory processes and the basis of regulatory decisions;

(j) reasonable certainty and consistency over time of the outcomes of regulatory processes, recognising the adaptive capacities of Code Participants in the provision and use of distribution network assets;

(k) reasonable and well defined regulatory discretion which permits an acceptable balancing
of the interests of Distribution Network Owners, Distribution Network Users and the public interest.

6.10.3 Principles for regulation of distribution service pricing

The regime under which the revenues of Distribution Network Owners and Distribution Network Service Providers (as appropriate) are to be regulated is to be administered by the Jurisdictional Regulators in accordance with the following principles:

(a) Concerns over monopoly pricing in respect of the distribution network will, wherever economically efficient and practicable, be addressed through the introduction of competition in the provision of distribution services.

(b) Where pro-competitive and structural reforms alone are not a practicable or adequate means of addressing the problems of monopoly pricing in respect of distribution services or protecting the interests of Distribution Network Users, the form of economic regulation to be applied is described in clause 6.10.5.

(c) The form of economic regulation applied by the Jurisdictional Regulators must not be changed during a regulatory control period.

(d) Subject to clause 6.10.3(c), if a Jurisdictional Regulator proposes to amend the form of economic regulation specified in clause 6.10.5 applied to a Distribution Network Owner, the Jurisdictional Regulator must:

(1) give two years prior notice to the Distribution Network Owner of the new economic regulation arrangements to apply from the commencement of the next regulatory control period; and

(2) publish a description of the process and timetable for re-setting the form of economic regulation at a time which provides all affected parties with adequate notice to prepare for, participate in, and respond to that process, prior to the commencement of the regulatory control period to which that form of economic regulation is to apply.

(e) The regulatory regime to be administered by the Jurisdictional Regulator must be consistent with the objectives outlined in clause 6.10.2 and must also have regard to the need to:

(1) provide Distribution Network Owners with incentives and reasonable opportunities to increase efficiency;

(2) create an environment in which generation, energy storage, demand side options and network augmentation options are given due and reasonable consideration;

(3) take account of and be consistent with the allocation of risk between Network Owners and Network Users;

(4) take account of and be consistent with any obligations of Code Participants in relation to distribution networks under Chapter 5;

(5) provide a fair and reasonable risk-adjusted cash flow rate of return to Distribution Network Owners on efficient investment given efficient operating and maintenance practices on the part of the Distribution Network Owners where:

(i) assets created at any time under a take or pay contract are valued in a
manner consistent with the provisions of that contract;

(ii) subject to clause 6.10.3(e)(5)(i), assets (also known as "sunk assets") in existence and generally in service on 1 July 1999 are valued at a value determined by the Jurisdictional Regulator or consistent with the regulatory asset base established in the participating jurisdiction;

(iii) subject to clause 6.10.3(e)(5)(i), valuation of assets brought into service after 1 July 1999 ("new assets"), any subsequent revaluation of any new assets and any subsequent revaluation of assets existing and generally in service on 1 July 1999 is to be undertaken on a basis to be determined by the Jurisdictional Regulator. In determining the basis of asset valuation to be used, the Jurisdictional Regulator must have regard to:

A the agreement of the Council of Australian Governments of 19 August 1994, that deprival value should be the preferred approach to valuing network assets;

B any subsequent relevant decisions of the Council of Australian Governments; and

C such other matters reasonably required to ensure consistency with the objectives specified in clause 6.10.2; and

(iv) benchmark returns to be established by the Jurisdictional Regulator are to be consistent with the method of valuation of new assets and revaluation, if any, of existing assets and consistent with achievement of a commercial economic return on efficient investment;

(6) provide reasonable certainty and consistency over time of the outcomes of regulatory processes having regard for:

(i) the need to balance the interests of Network Users and Network Owners;

(ii) the capital intensive nature of the distribution sector, the relatively long lives of distribution assets, and the variable and frequent augmentation of the distribution network;

(iii) the need to minimise the economic cost of regulatory actions and uncertainty;

(iv) relevant previous regulatory decisions made by authorised persons including:

A the initial revenue setting and asset valuation decisions made by a government at a time at which that government was a Distribution Network Owner in the context of industry reform pursuant to the Competition Principles Agreement;

B decisions made by Jurisdictional Regulators and any regulatory intentions previously expressed; and

C decisions made by ministers under jurisdictional legislation.
6.10.4 Economic regulation of distribution services

(a) The Jurisdictional Regulator is responsible for determining which, if any, distribution services provided by a Distribution Network Owner or Distribution Network Service Provider (as appropriate) in the relevant participating jurisdiction should be deemed to be prescribed distribution services and accordingly subject to economic regulation in accordance with the principles set out in clauses 6.10.3 and 6.10.5. In making this determination the Jurisdictional Regulator is to have regard to:

(1) the principles for regulation of distribution service pricing described in clause 6.10.3;

(2) the extent of effective competition in the provision of that distribution service;

(3) whether sufficient competition exists to warrant the application of a regulatory approach which is more "light-handed" than the approach described in clause 6.10.5;

(4) the effectiveness of the form of economic regulation specified under clause 6.10.5 in achieving the efficiency objectives included in clause 6.10.2; and

(5) the form, if any, of that regulation.

(b) Distribution services which are not prescribed distribution services are deemed to be excluded distribution services and without limiting the discretion of the Jurisdictional regulator under clause 6.10.4(a), excluded distribution services are those to which it is appropriate to apply a regulatory approach which is more "light-handed" than the regulation described in clause 6.10.5 and the Jurisdictional Regulator must determine the form of regulation which is to be applied to excluded distribution services.

6.10.5 Form and mechanism of economic regulation

In respect of distribution services subject to economic regulation pursuant to clause 6.10.4(a):

(a) economic regulation shall be of the prospective CPI minus X form, or some incentive-based variant of the CPI minus X form, and may take into account the performance of the Distribution Network Service Provider and/or Distribution Network Owner (as appropriate) under any prescribed distribution service standards imposed by the Code and any regulatory regime administered by the Jurisdictional Regulator, provided it is consistent with the objectives and principles outlined in clauses 6.10.2 and 6.10.3;

(b) the Jurisdictional Regulator shall specify the form of economic regulation to be applied to the Distribution Network Service Provider to be in the form of either:

(1) a revenue cap; or

(2) a weighted average price cap; or

(3) a combination of the above.

(c) The Jurisdictional Regulator is to apply the form of economic regulation specified in clauses 6.10.5(a), and (b) to each Distribution Network Owner for the regulatory control period which is to be a period of not less than 3 years.

(d) In setting a separate regulatory cap to be applied to each Network Owner in accordance with clause 6.10.5(b), the Jurisdictional Regulator must take into account each Distribution Network Owner’s revenue requirements during the regulatory control period, having regard for:
(1) the demand growth which the Distribution Network Owner is expected to service using any appropriate measure including but not limited to:

(i) energy consumption by categorisation of Distribution Customers or other relevant groups of persons who consume energy;

(ii) demand by categorisation of Distribution Customers or other relevant groups of persons who consume energy;

(iii) numbers of Distribution Customers or other relevant groups of persons who consume energy by categorisation of Distribution Customers; and

(iv) length of the distribution network;

(2) the service standards applicable to the Distribution Network Owner and/or Distribution Network Service Provider (as appropriate) under the Code and any other standards imposed on the Distribution Network Owner and/or Distribution Network Service Provider (as appropriate) by any regulatory regime administered by the Jurisdictional Regulator and by agreement with the relevant Network Users or Distribution Network Users;

(3) price stability;

(4) the Jurisdictional Regulator's reasonable judgment of the potential for efficiency gains to be realised by the Network Owner in expected operating, maintenance and capital costs, taking into account the expected demand growth and service standards referred to in clauses 6.10.5(d)(1) and (2);

(5) the Distribution Network Owner's weighted average cost of capital applicable to the relevant network service, having regard to the risk adjusted cash flow rate of return required by investors in commercial enterprises facing similar business risks to those faced by the Distribution Network Owner in the provision of that network service;

(6) the provision of a fair and reasonable risk-adjusted cash flow rate of return on efficient investment including sunk assets subject to the provisions of clause 6.10.3(e)(5);

(7) the right of the Distribution Network Owner or Distribution Network Service Provider (as appropriate) to recover reasonable costs arising from but not limited to:

(i) any State and Commonwealth taxes which it has paid in connection with the operation of its business as a provider of distribution services;

(ii) charges paid to Transmission Network Service Providers and other Distribution Network Service Providers arising from the provision of distribution services;

(iii) payments made to Embedded Generators for demand side management programs and local energy storage facilities which provide distribution service of a kind set out in or similar to those set out in part 4.5 of schedule 6.6 or in accordance with clause 5.6.2 where the Jurisdictional Regulator determines that this is appropriate;

(8) any correction factors arising from the previous regulatory period;

(9) any reduction or increase in energy losses in the distribution network;
(10) the on-going commercial viability of the distribution industry; and
(11) any other relevant financial indicators.

(e) Notwithstanding clause 6.10.5(c), the Jurisdictional Regulator may revoke a determination during a regulatory control period only where it appears to the Jurisdictional Regulator that:

(1) the determination was set on the basis of false or materially misleading information provided to the Jurisdictional Regulator; or

(2) there was a material error in the setting of the determination and the prior written consent of parties affected by any proposed subsequent re-opening of the determination has been obtained by the Jurisdictional Regulator.

(f) If the Jurisdictional Regulator revokes a determination under clause 6.10.5(e), then the Jurisdictional Regulator may make a new determination in substitution for the revoked determination to apply for the remainder of the regulatory control period for which the revoked determination was to apply.

(g) Prior to the end of a regulatory control period, the Jurisdictional Regulator must publish a description of the process and timetable for re-setting the level of regulatory cap to apply in the next regulatory control period and must provide to all affected parties adequate notice to allow them to prepare for, participate in, and respond to that process.

Clause 6 (Schedule 6.6) of the Code

Schedule 6.6 – Categories of Distribution Network Cost

6 Excluded Distribution Services

Services and activities that the Jurisdictional Regulator may define as excluded distribution services may include but are not limited to the following:

(a) the transportation of electricity not consumed in the Distribution Network Service Provider’s system (i.e. on behalf of another Distribution Network Service Provider).

(b) new connection and augmentation of existing connection to the distribution network.

(c) services (including metering, electric lines or electrical plant) for the specific benefit of any network user requested by that network user and not made available by the distribution network service provider as a normal part of prescribed distribution services to all customers. These services can include:

(1) charges for moving mains, services or meters forming part of the distribution network to accommodate extension, redesign or redevelopment of any premises;

(2) the provision of electric plant (i.e. mobile generators) for the specific purpose of enabling the provision of top-up or standby supplies of electricity; and
(3) the provision of prepayment meters to customers, but only to the extent that the charge for the provision of those meters exceed charges for the provision of standard meters for such customers;

(d) the relocation of electric lines and plant and the carrying out of associated works pursuant to any statutory obligations imposed on the Distribution Network Service Provider;

(e) charges for temporary supplies;

(f) capital contributions or other forms of prudential requirements for new works and augmentations;

(g) charges for reserve and duplicate supply;

(h) charges for supplies with higher quality and reliability standards than required by general practice;

(i) charges for connection points requiring more than the least overall cost, technically acceptable assets;

(j) charges for distribution services and system augmentation required to receive energy from an Embedded Generator;

(k) charges for generator access for Embedded Generators under clause 5.5;

(l) charges for non-compliance with the connection agreement, including but not limited to reactive power, power factor, harmonies, voltage dips and test supply requirements;

(m) charges for multiple connection points to a single property not recovered through prescribed distribution service prices;

(n) charges for public lighting;

(o) charges for provision of metering to a standard in excess of that required for the billing of prescribed distribution network service;

(p) charges for provision of TUOS/ DUOS disclosure statements to Distribution Customers under clause 6.14.8.
### APPENDIX 2  DEFINITION OF PRESCRIBED DISTRIBUTION SERVICES IN OTHER JURISDICTIONS

<table>
<thead>
<tr>
<th>Regulator</th>
<th>Definition of prescribed distribution services</th>
</tr>
</thead>
</table>
- “the services of connection to, and use of, the distribution system (except those that are specifically defined to be excluded services)”  
Clause 5.7.4 specifically states that those services which are NOT excluded distribution services are:  
- the transportation of electricity (except in specific limited circumstances)  
- the carrying out of works or the provision of maintenance of repair for the purpose of carrying out distribution of electricity  
- the provision, installation and maintenance of any meters, switchgear or other electrical plant (except in specific limited circumstances)                                                                                                     |
| **Queensland Competition Authority** | Electricity Distribution: Final Determination of Prescribed Services, September 2000.  
- Initially, all services performed by each DNSP that are associated with, or ancillary to, access to that DNSP’s network for the supply of electricity within that DNSP’s service area to be declared as prescribed distribution services.  
- DNSPs or any other interested party, may apply on a case by case basis to have specific services treated as excluded services where it can be demonstrated that the market for such services is contestable, that is, subject to potential – if not actual - competition. |
| **South Australia**                | South Australian Electricity Pricing Order 1999 – List of prescribed distribution service activities.  
‘Network Services’, where network services are:  
(a) the provision of network capability to support the delivery of electricity to distribution connection points (DCP) up to the agreed maximum demand for the DCP (where applicable) or otherwise at the level of demand at which electricity is generally delivered to or taken from the DCP;  
(b) the management, maintenance and operation of the distribution network to provide the network capability referred to above and  
(c) such additional activities as are necessary to ensure the integrity of the distribution network and maintain the network capability to support the delivery of electricity to and, where applicable, to take electricity from, DCP, using good electricity industry practice and in accordance with the requirements of the Code, the Distribution Code and any other applicable laws as at the Commencement Date.  
‘Connection Services’, where connection services are:  
(a) the provision of capability at each DCP (by means of the connection assets for the DCP) to deliver electricity to or take electricity from the DCP using the connection assets existing as at the relevant Commencement Date; and  
(b) the management, maintenance and operation of those connection assets so as to provide the capability referred to in paragraph A2(a), using good electricity industry practice and in accordance with the requirements of the Code, the Distribution Code, the Metering Code and any other applicable laws as at the Commencement Date”. |
## APPENDIX 3 PROPOSED EXCLUDED DISTRIBUTION SERVICES FOR NEW SOUTH WALES

<table>
<thead>
<tr>
<th>Service</th>
<th>Description</th>
<th>Reasons for classifying as an excluded distribution service</th>
<th>Existing regulatory Instrument</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CUSTOMER FUNDED CONNECTIONS</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New and upgraded customer connections</td>
<td>When a new customer wishes to connect to the distribution network or when a customer wishes to upgrade their electricity connection. It involves the design, estimation, construction and installation services associated with the provision of connection assets, network extensions and (where required) network augmentations (this does not include inspections of new assets to be handed over to the DNSP, or inspection of service work carried out by an Accredited Service Provider (ASP) which are monopoly services).</td>
<td>Contestable service under the Electricity Supply Act s31</td>
<td>Partially regulated by the IPART Capital Contributions Policy. Ministry of Energy &amp; Utilities (MEU) Code of Practice Contestable Works</td>
</tr>
<tr>
<td><strong>CUSTOMER-SPECIFIC ANCILLARY SERVICES</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inspection &amp; maintenance of customer installations and connections</td>
<td>Inspections of work on existing electrical installation that is carried out in relation to a customer’s private electrical assets. It includes work on customer connections and installations downstream from the connection point such as private poles (this does not include inspections of new assets to be handed over to the DNSP, or inspection of service work carried out by an ASP which are monopoly services).</td>
<td>Potential for service providers other than DNSPs to perform the work</td>
<td>Code of Practice Installation Safety Management</td>
</tr>
<tr>
<td>Conversion to aerial bundled cable</td>
<td>Bundling of cables which is carried out at request of another party, such as a telecommunications carrier or local council (ABC works).</td>
<td>Potential for service providers other than DNSPs to perform the work</td>
<td>Charge set by the DNSP</td>
</tr>
<tr>
<td>Asset relocations</td>
<td>Capital works undertaken by DNSPs at the request of a customer (or group of customers), which are not for the purpose of establishing a new connection to the system. Examples include reinstatement of electrical assets following works by other services, for instance road works.</td>
<td>Contestable service under the Electricity Supply Act s31</td>
<td>MEU Code of Practice Contestable Works</td>
</tr>
<tr>
<td>Other customer-requested services</td>
<td>A service that is requested by the customer in addition to the existing prescribed distribution service that it receives. For example, stand-by or temporary supplies, hi-load escorts. The cost of these services depends on the individual case.</td>
<td>Potential for service providers other than DNSPs to perform the work</td>
<td>Charge set by the DNSP</td>
</tr>
<tr>
<td><strong>METERING SERVICES</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Meter provision</td>
<td>Providing, installing and maintaining the customer’s meter.</td>
<td>Services to customers may become a contestable service when the Code’s metering derogation expires.¹ MEU is considering the issue of</td>
<td>Included in the distribution network charge (DUOS)</td>
</tr>
<tr>
<td>Service</td>
<td>Description</td>
<td>Reasons for classifying as an excluded distribution service</td>
<td>Existing regulatory Instrument</td>
</tr>
<tr>
<td>-------------------------------------</td>
<td>-----------------------------------------------------------------------------------------------------------------------------------------------</td>
<td>---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
<td>------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td><strong>Meter data services</strong></td>
<td>Collecting data (ie reading the meter), processing and storing the data, and finally forwarding the data to NEMMCO. Where necessary, meter data services also include meter data substitution, which means estimating energy usage.</td>
<td>competition in metering services to both first tier and second tier customers.</td>
<td>Included in the distribution network charge (DUOS)</td>
</tr>
<tr>
<td><strong>Provision of time-of-use or half hourly metering data</strong></td>
<td>Covers the cost of obtaining and providing historical metering data on a half hourly or time of use basis to non-contestable customers where such data is not available from the customer’s normal meter readings. The charge is intended to cover the cost of installing and removing recording instruments to obtain the half-hourly or time of use metering data.</td>
<td>See above</td>
<td>Miscellaneous service charge</td>
</tr>
<tr>
<td><strong>Special meter reading</strong></td>
<td>Covers the costs of a special meter reading either at the customer’s explicit request or because the meter is inaccessible at the normal reading time and an estimated reading has been offered to the customer and the customer does not accept that offer and insists on an actual meter reading being carried out.</td>
<td>See above</td>
<td>Miscellaneous service charge</td>
</tr>
<tr>
<td><strong>Meter test</strong></td>
<td>Covers the cost of testing a meter for accuracy when requested by the customer. The fee is to be charged to the customers next account if the meter is found to be reading correctly.</td>
<td>See above</td>
<td>Miscellaneous service charge</td>
</tr>
<tr>
<td><strong>STREET LIGHTING</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Construction and maintenance of public lighting</strong></td>
<td>These services include the provision of public lighting assets (streetlighting), and public lighting operations and maintenance which include planned maintenance, repairs and replacements.</td>
<td>Potential to become a contestable service (streetlighting working group currently being established by the Ministry of Energy &amp; Utilities)</td>
<td>Fees charged as a prescribed distribution service</td>
</tr>
</tbody>
</table>

Note 1: Clause 9.17A.1(d) of the National Electricity Code, derogates the local network provider as the responsible person for metering provision (in NSW). This derogation is due to expire on 1 July 2004 which would make metering services contestable.
APPENDIX 4 FORMS OF ‘LIGHT-HANDED’ REGULATION

Excluded distribution services may operate with a range of market conditions – from no competition with no potential for competition, to a fully competitive market. This appendix outlines six light-handed regulatory measures that could apply to excluded distribution services. These are: no regulation, pricing principles, pricing monitoring, price and cost disclosure, price approval and price control. The six measures are presented in order beginning with the least intrusive. A seventh option is then presented which considers a combination of these measures.

No regulation

Where the provision of a service is subject to effective competition between DNSPs and other service providers, regulatory controls are not usually necessary. The application of existing competition and fair trading laws such as the Trade Practices Act should provide sufficient incentive to encourage appropriate price and service behaviour without the need for additional regulatory controls.

Pricing principles and guidelines

In their simplest form, pricing principles for excluded distribution services would be limited to setting broad standards of behaviour for pricing practices by the DNSPs. At the other end of the scale, quite specific pricing guidelines can be set which detail the cost allocation process and pricing methodology.

Currently, each DNSP in NSW is required by the Pricing Principles and Methodologies (PPM)14 to apply a set of pricing principles when setting prices for prescribed distribution services. These principles are directed at ensuring that prices are reasonably based on the costs incurred by the DNSP, that costs are allocated between users on an appropriate basis in a way that avoids the creation of cross subsidies and, that prices take into account forward-looking economic costs and capacity constraints.

When applied in isolation, the use of guidelines and setting pricing principles is a general and non-intrusive form of regulation. Unless supported by periodic pro-forma reporting against specific criteria, as is the case with the PPM, monitoring of this form of regulation is indirect and compliance would be largely voluntary.

Price monitoring

Price monitoring is a frequently used form of regulation when the market power of service providers is initially of concern, but where there is a long-term objective to promote the development of sustainable commercial relationships between the providers and purchasers of the services. Typically it has two main elements:

- a formal monitoring regime, including periodic pro forma reporting on key indicators of behaviour and outcomes over a set monitoring period
- a formal review by the regulator at the end of the monitoring period, with the option to impose stricter regulation based on the conclusions of the review.

The monitoring regime may extend to annual pro forma reporting of costs, revenues, activity levels and pricing policies.

Price monitoring is a light-handed form of regulation that principally relies on the risk of discovery and the threat of stricter controls to limit abuse of market power by the service provider. The focus is on allowing commercial relationships to develop and form the basis of pricing outcomes. Accordingly, a key feature of this form of regulation is that the regulator has no direct role in setting the commercial parameters on which prices are based.

**Price and cost disclosure**

Public disclosure effectively makes the customer the supervisory body, as it allows an informed decision to be made using price comparisons and benchmarking. Information disclosure is a key element of the Tribunal’s approach under the current PPM which regulates the pricing of core network services.

The simplest form of disclosure is where a DNSP is required to publicly list its prices for the services in question and provide prior notice of any changes. It is most effective in active markets, that is, where there is a choice of providers and where price is the most relevant factor in a customer’s decision.

A more intensive approach, and one which is more appropriate where there is limited competition, is to require public disclosure of the costs of service provision and pricing methodologies. It is recognised that disclosure of costs incurred by DNSPs can provide a competitive edge to other service providers. However, this concern could be overcome by the requirement to disclose costs at a relatively high level.

Price disclosure becomes more problematic where the services in question are non-standard, and pricing must be done on a case-by-case basis. To address these circumstances, indicative prices could be published based on a number of typical service configurations and combined with escalation rates for the main sources of service and cost variation.

**Price approval**

The regulator may require price proposals to be formally submitted for review before they come into effect. Review of the price application would take place against specified criteria, which may be qualitative or quantitative.

In addition to review, the regulator may also require that prices are set for a fixed period (annually for example). Such a condition would restrict the flexibility of DNSPs to price according to variations in market conditions. While this may have beneficial effects where the DNSPs have substantial market power, in more competitive situations it may place them at a commercial disadvantage.

Under the existing PPM, a system of price notification and review currently applies to network charges. DNSPs must submit their proposed prices for review 60 days prior to their intended introduction. The proposals are then reviewed against three criteria. Two of these relate to quantitative controls (the revenue cap and side constraints) and the third concerns standards of information disclosure. If the application is assessed as not
complying, the proposed prices cannot come into effect. The service provider then has the option of submitting an alternative proposal.

**Price control**
Quantitative price control may be exercised in two ways—through setting a limit on annual price increases, or by directly setting maximum prices. There are examples of both forms of control in the current determination for prescribed distribution services. Network charges for residential customers are subject to a maximum annual increase of CPI+2% or $30. Maximum charges for each of the services classified as Miscellaneous Services are set directly in money terms and fixed for the duration of the determination.15

A third option is to apply direct price setting as a reserve power for use in dispute resolution. In this case, the regulator would set the price only where the parties have failed to reach agreement through normal commercial processes and subsequent notification of a dispute has been lodged.

**Combination of measures**
The above measures need not be viewed in isolation as in most cases they need to be implemented together for an effective framework. For example, unless pricing principles are supported by some form of monitoring and assessment against the principles, there is little incentive for the DNSP to adhere to the principles. Price disclosure may not be effective if there is a small customer base who have relatively little understanding of the cost content of the prices. This can be overcome if the regulator has some form of price approval or control.

The Pricing Principles and Methodologies for Prescribed Distribution Services (PPM) which currently applies in NSW for prescribed distribution services, is an example of a combination of approaches. The Essential Services Commission Victoria also impose a regime for non-contestable services where DNSPs submit a statement of charges submission for each service. It requires enough information to be submitted in order for the regulator to assess whether the prices are ‘fair and reasonable’.

The number and types of elements which are added to the framework will obviously increase the intensity and intrusiveness of the regulation, however, this may be appropriate and necessary, depending on the nature of the service.

15 Miscellaneous Services are prescribed distribution services where the revenue is included in the aggregate revenue cap.
## APPENDIX 5 EXCLUDED DISTRIBUTION SERVICES AND REGULATION IN OTHER JURISDICTIONS

<table>
<thead>
<tr>
<th>Regulator</th>
<th>Excluded distribution services</th>
<th>Basis of excluded distribution services</th>
<th>Form of regulation for excluded distribution services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Essential Services Commission</td>
<td>Listed in the <em>Victorian Electricity Supply Industry Tariff Order</em>, clause 5.7, and supplemented by Essential Services Commission (formerly the Office of the Regulator-General), <em>Electricity Distribution Price Determination 2001-05 Volume II Price Controls</em> as:</td>
<td>The services are classified as either non-contestable or contestable. <strong>Contestable excluded services</strong> Assessed on a case-by-case basis, with consultation. The following are considered as relevant factors: 1. Technical feasibility and safety 2. Effective competition (8 factors to consider) • technical and cost conditions of the provision of the excluded service including the extent of economies of scale and scope and sunk costs • the number and concentration of competing providers of the excluded service in the market • the conditions of demand for the excluded service, including the volume of demand and its sensitivity to variations in price and quality • the degree of countervailing power in the market • the dynamic characteristics of the market, including potential for growth and innovation</td>
<td>Contestable excluded services  - Not subject to approval or assessment against Excluded Service Principles or Reporting Requirements</td>
</tr>
<tr>
<td>Victoria</td>
<td>(a) the transportation of: (i) electricity not consumed in the Distributor’s Distribution System (ie inter-network provider distribution); or (ii) (removed) (b) connection to the Distributor’s Distribution System; (c) services (including metering, electric lines or electrical plant) for the specific benefit of any third party (and requested by the third party) and not made available by the Distributor as a normal part of standard service to all customers. These services include: (i) charges for moving mains, services or meters forming part of the Distributor’s Distribution System to accommodate extension, re-design or re-development of any premises; (ii) the provision of electric plant for the specific purpose of enabling the provision of top-up or standby supplies or sales of electricity; and (iii) the provision of pre-payment meters to customers, but only to the extent that the charges for the provision of those meters exceed charges for the provision of standard meters for such customers; (d) the relocation of electric lines plant and the carrying out of associated works pursuant to any statutory obligation imposed on the Distributor;  (e) (removed by the Price Determination) (f) charges for specific services for identified customers; (g) charges for temporary supplies; (h) capital contributions for new works and augmentation; (i) network services for connection points where customers operate parallel generation requiring a stand-by supply; (j) charges for reserve (duplicate) supply;</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Non-contestable excluded services</strong> - Charges subject to approval - ESC assess the proposed charges against a set of Excluded Service Principles (4) and Methodologies - Information and Reporting Requirements placed on DNSPs, in most cases this information will be reported publicly.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

27
Regulator | Excluded distribution services | Basis of excluded distribution services | Form of regulation for excluded distribution services
--- | --- | --- | ---
(\(k\)) charges for supplies with higher quality and reliability standards than required by the Distribution Code;  
(\(l\)) charges for connection points requiring more than the “least overall cost, technically acceptable” assets;  
(\(m\)) charges for distribution services and system augmentation required to receive energy from an embedded generator, as defined in a licence issued under Part 12 of the EIA to distribute electricity or another Distributor;  
(\(n\)) charges for customer non compliance with the Distribution Code and Supply and Sale Code including but not limited to a reactive power, line losses in excess of deemed distribution losses due to customer’s poor power factor, harmonics, voltage dips and test supplies;  
(\(o\)) charges for multiple connection points to a single property not recovered through the Distribution charges;  
(\(p\)) charges for public lighting operations and maintenance;  
(\(q\)) charges for public lighting assets constructed after 1 July 1994;  
(\(r\)) charges for the provision of metering to a standard in excess of that required for the billing of Network Tariffs; and  
(\(s\)) charges for the provision of reactive power and energy to a connection point or the receipt of reactive power and energy from a connection point.

4. Materiality
  
  **Non-contestable excluded services**
  
  - where the service is not contestable or where it is not safe or technically feasible to open provision of the excluded service  
  - the service cannot be feasibly unbundled from distributors activities or  
  - where the benefits of facilitating competition are immaterial

**Queensland Competition Authority**

Initially, all distribution services have been declared as ‘prescribed’.

DNSPs/stakeholders must make an application to the Authority which provides evidence in line with the Authority’s Contestability Test.

The application must:

- define the market  
- demonstrate that the current level of competition or alternatively the lack of significant barriers to entry means that the DNSP lacks substantial influence in the market.

A contestable market will be determined to exist if:

Initially, all distribution services are declared as ‘prescribed’ and subject to the economic regulation under the Code (non-distribution services are regulated separately).  

Where the service is declared excluded, (subject to the contestability test) the service will not be subject to any regulation.
<table>
<thead>
<tr>
<th>Regulator</th>
<th>Excluded distribution services</th>
<th>Basis of excluded distribution services</th>
<th>Form of regulation for excluded distribution services</th>
</tr>
</thead>
</table>
| South Australia | South Australian Electricity Pricing Order 1999 – List of Excluded Distribution Services by category.  
The South Australian definition of excluded distribution services includes:  
- public lighting      
- new and upgrading connection points,  
- service standards      
- services to a new distributor  
- stand-by and temporary supply      
- distribution system relocations and temporary works  
- metering services  
- embedded generation  
- other miscellaneous services. | - the DNSP does not have substantial market power ie the DNSP does not dominate the market, assumed the case where the DNSP has less than 40% market share  
- or the market lacks significant barriers to entry. | Excluded services must be priced on a ‘fair and reasonable’ basis in accordance with the distribution code where applicable, and the Act. |
APPENDIX 6 RELATED REGULATION

The Tribunal has made a determination relating to the proportion of contributions that customers must make for connection and augmentation to the distribution system (the capital contributions determination). The Tribunal has also proposed ring fencing guidelines that relate to the separation of the DNSP from its contestable works arm. The relationship between these regulations and the deeming of prescribed and excluded distribution services is discussed below.

Capital contributions determination

The capital contributions policy establishes the framework for determining how much customers should be required to contribute towards the capital costs of connecting them to the electricity distribution network. The policy determines what assets are paid for by the DNSP, and what assets are paid for by individual customers. As a general rule, customers are required to pay for assets that are dedicated to providing their connection to the network. In limited circumstances this may be extended to include work on augmenting the existing network. Rules are included for cost allocation and reimbursement in cases where customer funded assets are later shared with other network users. For the majority of cases, customer funded work will be limited to the customer’s side of the network connection.

Customer funded connection work, both on the network side of the connection point and the customer side, is contestable. The Electricity Supply Act provides customers with the right to choose the means by which the required work is carried out, whether this is by the local DNSP or an authorised contractor. Prima facie, connection services of this nature are therefore at least potentially competitive and as such suitable for classification as an excluded service. As noted previously however, the availability of authorised contractors and hence the level of competition may vary considerably, particularly between urban and rural areas.

By making the services excluded, it will not affect the operation of the capital contributions policy.

Ring fencing guidelines

The Tribunal’s proposed ring fencing guidelines are currently under review by the Minister for Energy and Utilities. Inter alia, the guidelines require DNSPs to separate the functions, costs and revenues of distribution services that are declared by government to be contestable. Services that are contestable are potentially competitive and therefore eligible for consideration as excluded services. The ring fencing guidelines will therefore assist in maintaining appropriate levels of separation between prescribed and excluded distribution services.

16 The Tribunal made the determination under the IPART Act in April 2002.
17 s.31, Electricity Supply Act 1995 (NSW).