

Mr Philippe Laspeyres  
Senior Regulatory Analyst  
NT Utilities Commission  
Sent by email

Dear Philippe

***Re: Cost Pass-Through Application Draft Determination***

*Introduction*

I refer to the 'Cost Pass-Through Application Draft Decision' recently issued by the Northern Territory Utilities Commission ('the Commission'). This is QEnergy's submission in response to the Draft Decision.

QEnergy submits that:

- the purpose of a cost pass-through mechanism is to compensate network service providers for the costs consequent to exogenous events which are outside the control of the network service provider. QEnergy does not consider that this has been met for the reasons outlined in this submission;
- where a cost pass-through condition has been met, it is incumbent upon the Regulator to examine the true and efficient, incremental, costs associated with the event. QEnergy does not consider that this analysis has been undertaken by the Commission's consultants in relation to labour costs and overheads in particular; and
- an increase in the Maximum Allowable Revenue (MAR) is only the first step in this process, as Power and Water then needs to select which network tariffs to apply the increase. If applied to the Alice Springs, Tennant Creek, or Darwin/Katherine <750MWh market segment, this entire increase will be recovered from Treasury via the Community Service Obligation (CSO). If applied to the Darwin / Katherine >750MWh segments, these customers will pay increased power charges and economic and business productivity will be affected, along with employment levels. QEnergy submits that the Commission should take a more active role in understanding the impacts of this pass-through application on the CSO, customers and on competitive markets in the Northern Territory.

These issues are considered in detail below.

*The 'Exogenous Events' Condition*

QEnergy agrees that pass-through events are a fair part of the regulatory bargain where an event has occurred which is beyond a network service provider's ability to forecast, where the impact on the business can be captured with certainty, and has been significant. Traditionally, pass-through events have been held to have occurred where unexpected changes in Government policy, sudden environmental events or mid-period changes in taxation arrangements have led to step changes in expenditure or obligations.

The crux of the Commission's acceptance that an 'event' has occurred appears in paragraph 3.38 and 3.39 of the Draft Decision. This sets out that "requiring PWC to absorb these costs may affect the ongoing viability of PWC" (3.38) and "the Commission is satisfied that the Davies

Review was an extraordinary development in that it identified general unanticipated degradation of the network condition that PWC as a prudent network service provider had no other rational option but to address”.

QEnergy cannot agree with the Commission’s findings in this respect for two reasons.

Firstly, the findings of the Davies Review were able to be anticipated by Power and Water through prudent and efficient asset management practices and therefore were neither unanticipated nor outside its control. While the findings of the Davies Review were unanticipated, the condition of the assets that led to the Review was within the control of Power and Water to detect. Any defects identified through condition based maintenance practices and procedures were therefore able to be included within the cost forecasts at the time of the 2009 regulatory proposal.

Secondly, it is unprecedented for a regulator to take a decision to allow a pass-through event on the basis of the financial viability of the network service provider. It is doubtful that this decision would be taken if Power and Water were privately owned and unlikely it would be extended to a private sector industry participant in the future. This is therefore an unfortunate and undesirable precedent to establish.

QEnergy submits that Power and Water’s cost pass-through should be disallowed on the basis that the Davies Report findings should not be considered unanticipated. Further, QEnergy submits that the Commission should not have regard for the financial viability of Power and Water in considering whether an “event” has occurred.

#### *The Concept of Prudent, Efficient, Incremental Costs*

It is generally held that pass-through amounts should be limited to those costs incremental to the amounts already allowed in the Determination. QEnergy notes that the overheads and direct labour costs already included in the allowances do not appear to have been considered by the Commission or its consultants.

Power and Water applies an overhead allocation, like all network businesses, to all of its operating and capital amounts which recovers its forecasts of overhead costs including corporate, head office, legal affairs, the CEO and General Counsel, Economics and Finance areas, and asset related charges such as fleet, property, and interest charges. In interstate networks, this can comprise up to 50% of the total opex and capex amounts. These overheads would have been funded in the original Determination and therefore cannot be funded twice. QEnergy submits that these costs must be removed.

Secondly, Power and Water would have included direct labour costs within their regulatory determination for opex and capex, comprising staff and management in the networks business. These staff cannot be re-charged as part of opex and capex as part of the pass-through without duplicating the costs. QEnergy submits that these costs should be removed.

#### *The Impact of This Pass-Through on the CSO and Competition*

QEnergy notes that following the Commission’s approval of the pass-through amount, and after the new MAR has been established, Power and Water will need to make a decision about which network tariffs it intends to increase to recover the increased amounts.

If it elects to increase any of the tariffs in Alice Springs or Tennant Creek, or the <750MWh customer segment in Darwin/Katherine, then the pass-through will simply add to the CSO already paid by Treasury.

If it elects to increase the tariffs for the >750MWh Darwin Katherine customers, then bills for these customers will rise substantially and the Northern Territory economy will be negatively impacted.

It is imperative that the Commission consider the need for a real, cost reflective, basis for network tariff setting immediately and that it take a very active interest in the decisions that are taken by Power and Water Networks in passing through any amounts that are approved under this application. Whether done publicly or not, Power and Water Networks will be taking decisions following the Commission's Final Decision on this application that will result in either large customers paying substantially more for their power, or Treasury paying for the pass-through amounts through the CSO.

I would be pleased to discuss these issues, and this submission, in greater detail should you wish.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Kate Farrar', written in a cursive style.

Kate Farrar  
Managing Director