

**AMENDMENTS TO
THE NT ELECTRICITY
RING-FENCING CODE
DECISION PAPER**

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Foreword

On 27 June 2001, the Commission gave notice in the *Northern Territory Government Gazette* of its making of a ring-fencing code (“the Code”) to apply to certain licensees in the Northern Territory electricity supply industry. The Code came into effect on 1 July 2001.

In January 2002, the Commission became aware of a deficiency in the Code arising on account of the distinctive circumstances of PAWA Generation.

This paper publishes the amendments the Commission has consequently made to definitions in the Code, and provides background to these amendments including with regard to consultations with industry participants and other interested parties.

The Commission will separately re-publish the amended Code.

Any questions regarding the amendments to the Code should be directed in the first instance to the Executive Officer, Utilities Commission, at any of the following:

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CHAPTER**1****BACKGROUND****Legislative authority and requirements**

1.1 When announcing a package of further reforms to the Northern Territory electricity supply industry on 20 October 1999, the then Treasurer stated that:

“PAWA’s network business will also be separated (or ‘ring-fenced’) from its retail and generation functions to ensure that PAWA’s contestable activities gain no advantage – or cross subsidies – from its ongoing monopoly activities.”

1.2 Section 24(1) of the *Utilities Commission Act 2000* (“the Act”) provides that the Commission may make codes or rules relating to the conduct or operations of a regulated industry or a licensed entity. Section 24(2) of the Act provides that the Commission may only make a code or rule under subsection (1) if authorised to do so by the relevant industry regulation Act or by regulations under the Act itself.

1.3 Regulation 2 of the *Utilities Commission Regulations* provides that:

“(1) The Utilities Commission is authorised to make a code relating to ring fencing in a regulated industry.

(2) In subregulation (1) –

“ring fencing” means the separate operation of related or associated businesses of a licensed entity in a regulated industry.”

1.4 On 27 June 2001, the Commission gave notice in the *Northern Territory Government Gazette* of its making of a ring-fencing code (“the Code”) to apply to certain licensees in the Northern Territory electricity supply industry. The Code came into effect on 1 July 2001.

1.5 Section 24(3) of the Act states that the Commission may vary or revoke a code or rule. Section 24(4) of the Act sets out the procedure for addition for amendment of the code or rule, by stating that:

“The Utilities Commission must, before making, varying or revoking a code or rules, consult with the Minister and representative bodies and participants in the regulated industry that the Utilities Commission considers appropriate.”

1.6 Operating in parallel to sections 24(3) and 24(4) of the Act are clauses 6 and 7 of the Code which authorise adding to or amending parts of the Code. Any additions or amendments to the Code are subject to the following of certain procedures, including those set out in clause 7 of the Code.

Identified deficiency in the Code

1.7 Clause 4 of the Code prohibits a ‘prescribed business’ from, among other things:

- allocating any costs that are shared with a ‘related business’ in a manner other than in accordance with Cost Allocation Procedures approved by the Commission;
- disclosing confidential or commercially-sensitive information to a ‘related business’ unless either that information is also disclosed to the competitors of the ‘related business’ or the disclosure of that information is not prohibited under Information Procedures approved by the Commission;
- providing goods or services to, or receiving goods or services from, a ‘related business’ on anything other than a non-discriminatory arm’s length commercial basis; and
- using the marketing staff of its ‘related businesses’ for its own marketing purposes.

1.8 The Code does not prohibit any of the above conduct by one ‘prescribed business’ in relation to another ‘prescribed business’, or by one ‘related business’ in relation to another ‘related business’. The prohibited conduct relates only to conduct by a ‘prescribed business’ on the one hand in relation to a ‘related business’ on the other.

1.9 Therefore, the intent of the Code is only fully effective when a particular line of business is appropriately classified in the circumstances as either a ‘prescribed business’ or a ‘related business’.

1.10 In January 2002, in discussions with PAWA, the Commission became aware of a deficiency in the Code as published on account of the distinctive circumstances of PAWA Generation. Specifically, unlike other prescribed businesses, PAWA Generation is subject to ring-fencing obligations under the Code not because of any monopoly status but because of its market dominance. Market dominant businesses, unlike monopoly businesses, have direct competitors.

1.11 Under clause 11.2 of the published Code, PAWA Generation was classified solely as a ‘prescribed business’. For ring-fencing purposes, this classification is appropriate when it comes to PAWA Generation’s dealings with related businesses (notably, Contestable Retail). However, as a market dominant business, PAWA Generation has actual and potential competitors. Hence, without PAWA Generation being ring-fenced from PAWA’s other prescribed businesses (Networks, System Control and Non-Contestable Retail), these other prescribed businesses could advantage PAWA Generation over Generation’s competitors as much as they could advantage Contestable Retail over Retail’s competitors.

1.12 For example, it is not appropriate that any of PAWA’s monopoly businesses (Networks, System Control and Non-contestable Retail) share commercially-sensitive information with a market dominant business like PAWA Generation. In particular:

- PAWA Networks should be prohibited from sharing commercially-sensitive information with PAWA Generation about a soon-to-be contestable customer’s load profile; and
- PAWA System Control should be prohibited from sharing commercially-sensitive information with PAWA Generation about a competitor’s generation activities.

1.13 On this basis, the Commission realised that the intention of the Code would be achieved only were the Code amended to classify PAWA Generation as a ‘related business’ *in so far as the conduct of PAWA’s other prescribed businesses (Networks, System Control and Non-contestable Retail) is concerned*. In doing so, it should remain a ‘prescribed business’ in so far as conduct in relation to PAWA’s other related businesses (Contestable Retail) is concerned.

Proposed amendments to the Code

1.14 In accordance with clauses 6.5 and 7.1 of the Code, the Commission subsequently notified all electricity entities, including PAWA and other industry participants and interested parties, of its intention to amend the Code.

1.15 Specifically, the Commission proposed that the definition of 'related business' in clause 11.2 of the Code be broadened to include PAWA Generation solely for the purpose of PAWA's other prescribed businesses (Networks, System Control and Non-contestable Retail).

1.16 The proposed amendments to the definition of 'related business' in clause 11.2 of the Code were as follows (where the underlined words were those words proposed to be inserted into the wording of the Code as published on 1 July 2001 and the struck through words were proposed to be deleted):

"Related Business" means, in relation to a particular **Prescribed Business** of an **Electricity Entity**, any business carried on or activities undertaken in the **Electricity Supply Industry** by that **Electricity Entity** or an **Associate** of that **Electricity Entity** operating in a **Contestable Market** which do not form part of a that **Prescribed Business**.

1.17 This then required an addition in clause 11.2 of the Code to include a definition of 'contestable market', as follows:

"Contestable market" means a market in which more than one supplier is operating in the market or in which there are no statutory impediments to the entry of new suppliers in that market.

1.18 In accordance with clause 7 of the Code, the Commission sought submissions regarding the proposed changes to the Code.

CHAPTER

2

SUBMISSIONS RECEIVED

Electricity entities

2.1 The Commission received submissions from PAWA as the electricity entity concerned and NT Power as a licensed entity.

2.2 NT Power supported the proposed amendments to the Code, stating:

“The amended wording of the definition of “Related Business” should result in each of the Prescribed Business’s that together comprise PAWA (an Electricity Entity) being obliged to treat one another as Related Businesses in respect of issues related to the Contestable Market, and thus subject to the prohibitions set out in clause 4 of the Ring-Fencing Code. We therefore agree that the amendment is appropriate.”

2.3 PAWA broadly supported the amendments to the Code, stating that:

“Power and Water Authority (PAWA) understands that the changes are to formalise the uncertainty regarding the related business status of certain activities within the prescribed businesses as they interact with other prescribed businesses.”

2.4 Specifically, PAWA had no objections to the changes to the Code as it related to the Information Handling requirements under the Code. However, PAWA expressed concern over the potential application of the proposed changes to its Accounting and Cost Allocation Procedures under the Code, stating:

“PAWA does not currently separate Generations’ “Contestable Market Activities” from their “Prescribed Business Activities” in its General Ledger. Therefore, in an example where Networks may bill Generation’s Contestable Market activities, it will be paid from Generation (the whole business unit).”

2.5 In addition to this, PAWA stated that it expected the changes to the Code would require some additional amendment (and therefore considerable additional cost) to PAWA’s soon-to-be-implemented Financial Management System (FMS).

2.6 Rather than contemplate the additional cost, PAWA suggested that the proposed amendments to the Code be redrafted in order to give effect to the Commission’s original representation, being that the changes would have a ‘nil effect’ on PAWA’s Accounting and Cost Allocation Procedures required under the Code. PAWA suggested that, to give effect to the Commission’s representation, two definitions for ‘related business’ should be inserted into clause 11.2 of the Code to distinguish between PAWA Generation’s Information Handling Procedures and its Accounting and Cost Allocation Procedures.

2.7 In addition to these redrafting proposals, PAWA suggested a change to the definition of ‘contestable market’, for the purpose of clarity, to include (where the underlined words are the words proposed to be inserted into the Commission’s proposed changes to the Code):

“Contestable Market” means a market within the Electricity Supply Industry in which more than one supplier is operating in the market or in which there are no statutory impediments to the entry of new suppliers into that market.”

2.8 NT Power also suggested redrafting of the definition of ‘contestable market’ as follows (where the underlined words are the words proposed to be inserted into the Commission’s proposed changes to the Code and the struck out words are those to be deleted):

“**Contestable Market**” means a market in which more than one ~~supplier~~ Electricity Entity is operating in the market or in which there are no statutory impediments to the entry of new Electricity Entities ~~suppliers~~ into that market.”

Interested parties

2.9 The Commission received brief comment from NT Treasury stating that it supported the Commission in its proposal to amend clause 11.2 of the Code to broaden the scope of ‘related business’ and add a definition of ‘contestable market’.

CHAPTER

3

COMMISSION'S ANALYSIS AND DECISION

Proposed redefinition of 'related business'

3.1 The Commission proposed the following amendments to the definition of a 'related business' in clause 11.2 of the Code (where the underlined words were those words proposed to be inserted into the wording of the Code as published on 1 July 2001 and the struck through words were proposed to be deleted):

"Related Businesses" means, in relation to a particular **Prescribed Business** of an **Electricity Entity**, any business carried on or activities undertaken in the **Electricity Supply Industry** by that **Electricity Entity** or an **Associate** of that **Electricity Entity** operating in a **Contestable Market** which do not form part of a that **Prescribed Business**.

3.2 The Commission finds error in PAWA's interpretation of the proposed changes to the definition of 'related business'. PAWA interprets the changes to the Code as requiring PAWA Generation to distinguish between the two sets of activities within the same business. This was neither the intent nor the effect of the proposed amendment.

3.3 The Commission reaffirms that the *intent* of the proposed amendment was not to create a distinction within PAWA Generation – between monopoly and contestable activities – like that made with respect to PAWA Retail. Rather, the intent was to have PAWA Generation *as a whole* treated as:

- a 'related business' when it comes to PAWA Generation's conduct with respect to PAWA's other prescribed businesses (Networks, System Control and Non-contestable Retail); and
- a 'prescribed business' for the purpose of PAWA Generation's conduct with respect to PAWA's other related businesses (Contestable Retail).

3.5 This means that the proposed amendments did not require PAWA Generation to be split into 'contestable' and 'monopoly' businesses and, therefore, the proposed changes to the definition of 'related business' will have no impact on PAWA's Accounting and Cost Allocation Procedures or the design of its new FMS.

3.6 The Commission sought independent legal advice to confirm whether the drafting of the definition of 'related business' gave effect to the Commission's desired outcome for amendment to the Code. This advice confirmed that:

"...the proposed amendments to the Ring Fencing Code are effective to achieve the desired outcome of ensuring that PAWA Generation is considered to be both:

- *a Related Business of PAWA Network, PAWA System Control and PAWA Non-Contestable Retail; and*
- *a Prescribed Business with respect to PAWA Contestable Retail."*

Proposed definition of ‘contestable market’

3.7 The Commission proposed the following definition of ‘contestable market’ to give effect to its proposed definition of ‘related business’:

“**Contestable Market**” means a market in which more than one supplier is operating in the market or in which there are no statutory impediments to the entry of new suppliers into that market.

3.8 As specified in paragraph 2.7 above, PAWA submitted that the definition of ‘contestable market’ be amended for clarity to include the phrase ‘electricity supply industry’. The Commission agrees that the change would further add to the clarity of the definition and therefore accepts PAWA’s submission.

3.9 As specified in paragraph 2.8 above, NT Power submitted that the definition of ‘contestable market’ be amended to substitute the words ‘Electricity Entity’ for ‘suppliers’ in the definition, to be consistent with the wording of the Code. The Commission accepts NT Power’s submission.

Commission’s decision

3.10 The amendments that the Commission has decided to make to the definition in clause 11.2 of the Code, in light of the above analysis, are as follows (where the underlined words are those words being inserted into the wording of the Code as published on 1 July 2002 and the struck through words are being deleted):

“**Related Business**” means, in relation to a particular **Prescribed Business** of an **Electricity Entity**, any business carried on or activities undertaken in the **Electricity Supply Industry** by that **Electricity Entity** or an **Associate** of that **Electricity Entity** operating in a **Contestable Market** which do not form part of a that **Prescribed Business**.

“**Contestable Market**” means a market in the **Electricity Supply Industry** in which more than one **Electricity Entity** is operating in the market or in which there are no statutory impediments to the entry of new **Electricity Entities** into that market.