

Address all correspondence to:

The Under Treasurer, NT Treasury, GPO Box 1974, Darwin NT 0801

Telephone:

(08) 8999 6033

Location:

38 Cavenagh Street, Darwin NT 0800

Facsimile:

(08) 8999 7150

Our Ref: 2000/672:pe0903

Your Ref:

Mr A Tregilgas
Utilities Commissioner
GPO Box 915
DARWIN NT 0801

Dear Alan

RE: RING-FENCING CODE DISCUSSION PAPER

In response to the Commission's discussion paper, I am writing to provide Treasury's perspective on ring-fencing arrangements in the Territory's electricity supply industry.

One of the Commission's suggestions is that consideration may need to be given to legal separation of some of the Power and Water Authority's (PAWA's) businesses. Legal separation would involve the monopoly and contestable businesses being located in separate legal entities consistent with the Corporations Law (such as a holding company/subsidiary companies structure). The option is raised as a means of addressing concerns regarding the "decision-making independence" of the various businesses within PAWA (that is, the possibility that decisions may be made by a monopoly business that favour a related business over its competitors).

The Government's decision not to split PAWA into separate businesses followed a comprehensive review in 1998. As the Treasurer made clear in his Ministerial Statement in October 1999, the diseconomies associated with structural separation would have been too large given the small size of the Territory market. Retention of PAWA as a vertically integrated, multi-utility business has enabled PAWA's economies of scale and scope to be maintained for the benefit of Territory consumers and taxpayers.

In my view, strict legal separation would not fall far short of structural separation of PAWA's operations and would be of questionable public benefit. The Commission's discussion paper acknowledges that legal separation would add to costs. Apart from the establishment costs of the holding and subsidiary companies, there would be ongoing costs such as those associated with public reporting requirements and the operation of separate Boards. There would appear to be little public benefit in pursuing this option given the additional costs, and particularly given the



Commission's concern that legal separation may, in any case, not eliminate the need for other ring-fencing arrangements.

I note that your draft replacement code would not require formal legal separation, on the basis that this is a matter for the Government as shareholder. Rather, the proposed requirement is for the various businesses to operate **as if** they were subsidiaries as defined under the Corporations Law. However, the precise implications of this requirement are not made clear in the discussion paper.

While effective ring-fencing arrangements are central to the operation of the competitive electricity market, it would be of concern if the arrangements imposed significant costs. To avoid this outcome, it would be preferable to take a conservative approach, starting with arrangements that are not overly intrusive or costly. Subsequently, should the initial ring-fencing not prove effective, an incremental approach could be adopted to further strengthening the arrangements.

If you require further clarification, please contact Paul Emery, Assistant Under Treasurer (Ph. 8999 6700).

Yours sincerely

K B Clarke
Under Treasurer

October 2000