

# **NORTHERN TERRITORY ELECTRICITY RING-FENCING CODE AND GUIDELINES REVIEW**

**DRAFT DECISION**

*March 2020*

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## Glossary

Act	<i>Utilities Commission Act 2000</i>
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
CAM	Cost allocation method
Code	Northern Territory Electricity Ring-fencing Code, which took effect on 1 January 2009
Commission	The Utilities Commission of the Northern Territory, as established by the <i>Utilities Commission Act 2000</i>
DER	Distributed energy resources
DNSP	Distribution Network Service Provider, as defined by the Ring-fencing Guideline Electricity Distribution Version 2, published by the Australian Energy Regulator in October 2017
Electricity supply industry	The industry involved in the generation, supply and sale of electricity or other operations of a kind prescribed by the Electricity Reform Regulations
Gazette	The Northern Territory of Australia Government Gazette
Generator	A business (or a component of a business) which holds a licence authorising the generation of electricity, or whose application for such a licence is currently under consideration by the commission
Guidelines	Northern Territory Electricity Ring-fencing Guidelines, which took effect 28 January 2009
IES	Indigenous Essential Services Pty Ltd, a subsidiary of PWC and a <i>Corporations Act 2001</i> (Cth) company
Issues Paper	Issues Paper for the 2019 Northern Territory Electricity Ring-fencing Code and Guidelines Review, published by the commission on 22 May 2019
Jacana	Jacana Energy, a government owned corporation established in accordance with the <i>Government Owned Corporations Act 2001</i> and the <i>Power Retail Corporation Act 2014</i>
Licence	A licence granted by the commission under the <i>Electricity Reform Act 2000</i>
Market operator	The role fulfilled by the System Controller in accordance with Attachment 6 of the System Control Technical Code, which manages the wholesale exchange of electricity in the Interim Northern Territory Electricity Market in the Darwin-Katherine power system

Minister	The Minister to whom the <i>Utilities Commission Act 2000</i> is committed, currently the Treasurer
National guideline	The Ring-fencing Guideline Electricity Distribution Version 2, published by the Australian Energy Regulator in October 2017
NEM	National Electricity Market
NT	Northern Territory of Australia
NTC	Network Technical Code Version 3.1, approved by the commission and published by Power and Water Corporation in December 2013
Prescribed Business	Has the same meaning as provided by the Northern Territory Electricity Ring-fencing Code and Guidelines
PWC	Power and Water Corporation, a government owned corporation established in accordance with the <i>Government Owned Corporations Act 2001</i> and the <i>Power and Water Corporation Act 1987</i>
Regulations	Utilities Commission Regulations 2000
Regulator	The Utilities Commission of the Northern Territory as established by the <i>Utilities Commission Act 2000</i>
Related Contestable Business	Has the same meaning as provided by the Northern Territory Electricity Ring-fencing Code and Guidelines
Retailer	Means a business (or component of a business) which holds a licence authorising the selling of electricity to end users, or whose application for such a licence is currently under consideration by the commission
SCTC	System Control Technical Code, version 5.0 approved by the commission and published by Power and Water Corporation in May 2015
System Controller	Means a person licenced under the <i>Electricity Reform Act 2000</i> to exercise system control over a power system
T-Gen	Territory Generation, a government owned corporation established in accordance with the <i>Government Owned Corporations Act 2001</i> and the <i>Power Generation Corporation Act 2014</i>

## INTRODUCTION

### Purpose

The purpose of this paper is to communicate the Utilities Commission's (commission) Draft Decision as part of its review of the Northern Territory Electricity Ring-fencing Code (Code) and Guidelines (Guidelines).

### About the Utilities Commission

The commission is an independent statutory body established by the *Utilities Commission Act 2000* (the Act) with defined roles and functions for economic regulation in the electricity, water and sewerage industries and declared ports in the Northern Territory.<sup>1</sup>

The commission seeks to protect the long-term interests of consumers of services provided by regulated industries with respect to price, reliability and quality.

The commission aims to ensure consumer requirements are met by enhancing the economic efficiency of regulated industries through promoting competition, fair and efficient market conduct and effective independent regulation.

The commission has functions under various Acts (and associated regulations) including the *Utilities Commission Act 2000*, *Electricity Reform Act 2000*, *Water Supply and Sewerage Services Act 2000* and the *Ports Management Act 2015*.

### Submissions

This paper provides the commission's associated considerations, reasons and draft recommendations in relation to its Draft Decision. All interested parties are invited to make submissions on the Draft Decision, or any other issue relevant to the review by **30 April 2020**.

In the interest of transparency, the commission strongly encourages all stakeholders to make their submissions publicly available, and to keep any confidential information to a minimum.

Confidential information may include:

- information that could affect the competitive position of an entity or other person, or
- information that is commercially sensitive for some other reason.

Submissions must clearly specify the document (or part of it) that contains confidential information. A version of the submission suitable for publication (that is, with any confidential information removed) should also be submitted.

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<sup>1</sup>Regulated industries for the purpose of the *Utilities Commission Act 2000* are declared by section 13 of the *Electricity Reform Act 2000*, section 7(1) and (2) of the *Water Supply and Sewerage Services Act 2000* and section 119(1) of the *Ports Management Act 2015*.

To facilitate publication, submissions should be provided electronically by email to [utilities.commission@nt.gov.au](mailto:utilities.commission@nt.gov.au) in Adobe Acrobat or Microsoft Word format.

Any questions regarding this Draft Decision or the review should be directed to the Utilities Commission by telephone (08) 8999 5480 or email [utilities.commission@nt.gov.au](mailto:utilities.commission@nt.gov.au).

## Timetable

It is anticipated the review of the Code and Guidelines will be completed in mid-2020. The expected dates for the review are as follows:

Stage	Time
Issues Paper released	17 May 2019
Public consultation	17 May – 20 June 2019
Draft Decision and draft amended NT Electricity Ring-fencing Code released	20 March 2020
Public consultation	20 March 2020 – 30 April 2020
Final Decision and final amended NT Electricity Ring-fencing Code released	June 2020

Following approval by the commission, the amended Code will be available on the commission's website [www.utilicom.nt.gov.au](http://www.utilicom.nt.gov.au). A notice about the amended Code will also be published in the Gazette.

The amended Code will commence 30 days after notice is given to the relevant electricity entities and the notice is published in the Gazette, or a later date specified by the commission in its Final Decision.

## DRAFT DECISION

In accordance with section 24(9) of the *Utilities Commission Act 2000* (the Act), the commission is reviewing the Northern Territory Electricity Ring-fencing Code (Code) and Guidelines to ensure their contents and operation are of continued relevance and effectiveness for the electricity supply industry in the Northern Territory.

The commission is cognisant of the Australian Energy Regulator's (AER) Ring-fencing Guideline for Electricity Distribution (national guideline) which imposes a number of obligations on Power and Water Corporation (PWC) as the Northern Territory's electricity distributor, which are similar to those contained in the Territory's ring-fencing Code. Therefore, the Commission plans on taking a pragmatic approach aimed at reducing the regulatory burden for PWC by seeking to fully rely on the national ring-fencing guideline in relation to its regulated lines of business involved in electricity distribution (Power Services business unit to the extent it is regulated by the AER).

However, the national guideline does not extend to non-electricity services and does not adequately cover multi-utility companies like PWC (which has a number of business units that deliver a mix of regulated and non-regulated power services, gas services, water and sewerage services, remote services, metering and System Control, among others).

The national guideline was written for the National Electricity Market (NEM) and in the Territory is specific to electricity distribution in the three AER regulated systems, being Darwin-Katherine, Alice Springs and Tennant Creek. This means some of PWC's regulated and other relevant lines of business will not be covered. Therefore, a Territory ring-fencing Code is still needed to specifically address these gaps and associated potential harms.

While the Commission is seeking to 'wind back' the Territory Code so that it does not apply to the Power Services business unit (to the extent that it is regulated by the AER), it intends to retain the Code, to ensure the other relevant businesses, particularly System Control, are adequately covered.

Subsequently, the commission proposes the following changes to the ring-fencing arrangements in the Territory:

1. To minimise the duplication of obligations and potential for confusion, it is proposed that the Territory's ring-fencing Code be applied only to those parts of PWC that are not covered by the national ring-fencing guideline.
2. To reduce the possibility for PWC to discriminate to its advantage, it is proposed that the Territory's ring-fencing Code:
  - (a) is tailored and maintained to meet the Territory's specific needs
  - (b) is amended to include a general non-discrimination clause to prevent PWC from using its position to give itself an advantage in the competitive sectors of the Territory's electricity supply industry
  - (c) is amended to include a corresponding obligation that applies to each of PWC's prescribed businesses not covered by the national ring-fencing guideline.
3. To minimise the potential for PWC to recover from customers more (or less) than its total costs as a result of two different methodologies for allocating costs, it is proposed that the Territory's ring-fencing Code be amended so that it requires PWC



to apply the same cost allocation methodology that it applies under the national ring-fencing guideline to each of its regulated lines of business.

4. To minimise the potential for System Control to advantage the gas supply business unit in the dispatch of generators, it is proposed that:
  - the Territory's ring-fencing Code be amended to:
    - (a) require System Control to be physically separated from the gas supply business unit
    - (b) place a stronger obligation on System Control to not discriminate (in regards to the dispatch of generators)
  - the Territory Government and PWC develop and publish a clear set of protocols for generator dispatch as part of the implementation of a wholesale electricity market for the Darwin-Katherine system. When these are published, System Control should publish information showing, with due consideration of commercial confidentiality:
    - (i) which generators were dispatched from time to time
    - (ii) how this satisfies the dispatch protocols.
  
5. To minimise the potential for System Control to disadvantage Territory Generation (T-Gen) and/or other generators in the planning and management of network outages, it is proposed that:
  - (a) the Territory's ring-fencing Code be amended to place a stronger obligation on System Control to not discriminate (in regards to the planning and management of network outages)
  - (b) PWC be required to publish a guideline to provide greater transparency on the outage planning process and for this to be codified in the System Control Technical Code (SCTC) (the next time it is amended)
  - (c) The Territory Government consider whether Power Services should be subject to a financial incentive to minimise network constraints arising from network outages.
  
6. If Power Services (to the extent that it is regulated by the AER) becomes active in providing contestable services, including contestable metering or installing distributed energy resources (DER), it is recommended (subject to a cost benefit analysis) that the Territory Government consider the application of further provisions in the national ring-fencing guideline.

The commission has prepared a draft amended Northern Territory Electricity Ring-fencing Code which incorporates and reflects the above draft proposals (at Appendix A). A table summarising the proposed amendments has also been prepared, to assist stakeholders in identifying the proposed amendments (at Appendix B).

The draft decision has been made taking into consideration responses to the Issues Paper, engagement with stakeholders, the objectives of the relevant legislation, Code and associated documents, while remaining cost-effective and proportionate to the potential harms being addressed.

## REVIEW OF THE NT ELECTRICITY RING-FENCING CODE AND GUIDELINES

### Background

This section provides background information relevant to the commission's review of the Code and Guidelines, and subsequent Draft Decision.

#### ***Reasons for ring-fencing***

Natural monopolies exist because in some markets, it is not feasible or efficient to duplicate existing major infrastructure. This creates a market where users have no, or limited options to obtain alternative services. As a result, monopolies have substantial market power which if used incorrectly, has the potential for negative outcomes for industry and consumers.

Regulation aims to protect consumers from the exercise of market power. However, businesses operating within regulated industries are often diverse, providing both regulated and competitive services to the market. This creates potential risk for the relevant business to receive an advantage in the competitive market due to the regulated parts of their business. For example, the relevant business may:

- cross-subsidise services in the competitive market with revenue derived from its regulated services
- provide its contestable business units with access to commercially sensitive information that was acquired through, and for the provision of, regulated services
- discriminate in carrying out its regulated services in favour of its other business units operating within the contestable market.

To avoid this, it is necessary to identify and separate the regulated (monopoly) business activities, costs, revenues and decision making processes from those that are associated with providing services in a competitive market.<sup>2</sup> This is achieved through ring-fencing.

Natural monopolies are also usually subject to some form of economic regulation of the prices they can charge for their services due to the risk that they could otherwise use their market power to set prices above a competitive level. These regulated prices are usually set based on an estimate of the efficient costs of operating the regulated business. Where a single business provides a range of services, ring-fencing can assist in ensuring there is clear and appropriate allocation of costs between the various regulated and competitive services that the business offers, so that efficient prices can be set for each regulated service.

There are also some instances where a regulated business has some quasi-regulatory functions, for example in the Northern Territory electricity supply industry PWC's system

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<sup>2</sup> Australian Energy Regulator, *Electricity Distribution Ring-fencing Guideline Explanatory Statement*, November 2016, page 11.

control and market operator functions, and PWC's role in developing changes to the Network Technical Code (NTC) and SCTC.<sup>3</sup> Ring-fencing can help ensure that any such functions are performed in a non-discriminatory manner.

### ***Types of ring-fencing***

There are four main types of ring-fencing which relate to the different ways businesses can be separated. These are: structural, legal, accounting and operational/functional. The table below provides a brief overview of each of the different types.

<b>Type</b>	<b>Description</b>
Structural separation	The regulated business and the contestable business are owned by completely separate entities.
Legal separation	The regulated business and the contestable business are separate legal entities.
Accounting separation	Separate accounts are established and maintained in accordance with an approved cost allocation methodology (CAM), which is used to allocate shared costs accurately between the regulated business and the contestable business.
Operational/functional	The 'working parts' of the regulated business are kept separate from the 'working parts' of the contestable business, for example physical separation of the businesses, restrictions on sharing staff, separate branding, protection of confidential information and obligations to not discriminate.

PWC, Jacana Energy (Jacana) and T-Gen are all government owned corporations owned by the same owner, the Northern Territory Government. Therefore, there is no structural separation between these entities.

Whilst there is legal separation between PWC, Jacana and T-Gen, PWC operates a number of businesses within the legal entity, including the provision of electricity network services, water and sewerage services, gas supply and integrated electricity supply services to remote communities through its subsidiary Indigenous Essential Services Pty Ltd (IES). Further, it has system control and market operator functions.

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<sup>3</sup> Section 66A(4) of the *Electricity Reform Act 2000* requires the commission to be consulted before a network provider can amend the NTC. The commission reviews proposed amendments and can direct the network provider to change them, if necessary. The commission approves the SCTC under section 38 of the *Electricity Reform Act 2000*. Under the SCTC, the commission must approve any proposed amendments.

The Territory's ring-fencing Code and the national guideline set out requirements for accounting separation and operational/functional separation which PWC must comply with.

The commission has taken these requirements, including a detailed breakdown of the classification of services relevant to the ring-fencing arrangements, and the different types of separation into consideration throughout the review and when deliberating, on the appropriate and proportionate response to the harms it is trying to minimise through ring-fencing.

### ***The electricity supply industry in the Northern Territory***

When the Code was first introduced in 2001, PWC (formerly the Power and Water Authority) was the single (vertically integrated) provider of all electricity supply services, including generation, networks/distribution and retail. Since the last review of the Code in 2008, there have been a number of developments in the electricity supply industry that directly impact the Code, including:

- commencement of full retail contestability
- separation of PWC into three separate government-owned corporations
- establishment of an interim wholesale market (I-NTEM) in the Darwin-Katherine regulated network, including a market operator role within PWC System Control
- commencement of the *National Electricity (Northern Territory) (National Uniform Legislation) Act 2015* and transfer of administration of network price regulation to the AER
- progressive adoption of the National Electricity Rules, as modified for the Territory
- recent introduction of a national approach to ring-fencing with the release of the AER's Ring-fencing Guideline for Electricity Distribution (which commenced in the NT 1 July 2019, with derogations)
- the Territory Government's commitment to renewable energy and electricity market reform in the Northern Territory.

Whilst there have been many changes since the Code was first introduced, the current situation is that the majority of electricity supply services are provided by the three government-owned corporations (PWC, Jacana and T-Gen).

Jacana was established as an electricity retailer and T-Gen as an electricity generation business. PWC continues to provide network services to customers in Darwin, Katherine, Alice Springs and Tennant Creek, and continues to be the vertically integrated electricity service provider in numerous off-grid locations in the Territory. It also provides other regulated and non-regulated services, such as gas supply, water and sewerage services, remote services (to its subsidiary IES), metering and System Control, among others.

Some private retailers and generators are licenced to operate in the Territory, however there is still very limited competition. These private businesses are competing against the government-owned corporations that possess a substantial degree of market power.

### ***The Northern Territory Electricity Market***

Commencing in May 2015, the I-NTEM was implemented as a short-term transitional arrangement to facilitate the wholesale exchange of electricity between generators and retailers. It is a virtual market applying only to the Darwin-Katherine system. In accordance with the SCTC, which makes provision for the operation of a wholesale market, a market operator function was established within PWC, to manage the wholesale exchange of electricity in the I-NTEM.

Government has previously signalled its work towards establishing a wholesale electricity market in the Darwin-Katherine system. It is understood future changes, termed I-NTEM 2.0 include:

- reform to the dispatch process to better accommodate the increased number of generators in the system and increased variability from renewable sources, and address System Control limitations related to systems and resourcing
- establishment of an interim generator based reliability standard for the Darwin- Katherine system to ensure retailers contract for their fair share of required capacity
- revising the codified price for ancillary services in the SCTC to adequately recompense the provider of ancillary services and to send accurate price signals to market participants on the cost of their provision.

It is understood that the changes will be tailored to the Territory's circumstances and will seek to ensure that renewable energy can be facilitated in the Darwin-Katherine system in the least cost way whilst still delivering reliable power to consumers. Further, the commission understands its purpose is to provide a transparent and competitive framework for the market to allow for participation by multiple players (government and privately owned) and for it to be technology-neutral.

### **Legislative requirements and review process**

In the Territory, the commission is authorised to make codes or rules (including varying or revoking codes) regarding ring-fencing in the electricity supply industry.<sup>4</sup> Regulation 2 of the Utilities Commission Regulations defines ring-fencing as *the separate operation of related or associated businesses of a licensed entity in a regulated industry*. Section 13 of the *Electricity Reform Act 2000* deems the electricity supply industry to be a regulated industry.

Clause 1.6 of the Code authorises the commission to publish guidelines relating to the application or interpretation of, or matters arising under the Code. In addition, section 7 of the Act allows the commission to issue guidelines relating to the performance of its functions. In 2009, the commission released ring-fencing Guidelines, which set out the commission's views relating to the application or interpretation of matters arising under Code.

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<sup>4</sup> Section 24 of the *Utilities Commission Act 2000* and clause 5.1(a) of the Northern Territory Electricity Ring- fencing Code.

In accordance with section 24(4) of the Act, the commission will consult with the responsible Minister, representative bodies and industry participants before varying the current Code. The responsible Minister is the Treasurer.

Through the Issues Paper published in May 2019 (and as required under clause 6 of the Code), the commission advised the required parties, relevant stakeholders and the public that it is considering varying the Code and Guidelines and sought to engage stakeholders by inviting submissions on any issues that should be considered as part of the review. The commission received submissions from the AER, Jacana, PWC and T-Gen. The commission also met with the Department of the Chief Minister and the Department of Treasury and Finance, the AER and PWC to discuss issues raised in the submissions.

With the release of this Draft Decision and draft amended Code, the commission is now seeking feedback from stakeholders, which will inform its final decision and final amended Code.

As required by section 24 of the Act and clause 6 of the Code, the commission will give notice of any variation of the Code to the responsible Minister and each licensed entity to which the Code applies. A notice advising of variations to the Code will be published in the Northern Territory Government Gazette. The commission will also publish a copy of the amended Code on its website.

A review of the Code and Guidelines is an action in the Northern Territory Government's Renewable Energy and Electricity Market Reform Implementation Plan 2018-2020 (initiative 4, action j). Therefore, during the review, commission staff have engaged (and will continue to do so) with the relevant government departments to keep them informed about the progress and milestones of the review.

## **Scope of the review**

The Code aims to promote and safeguard competition and fair and efficient market conduct in the electricity supply industry by promoting the simulation of competitive market conduct and preventing the misuse of market power.<sup>5</sup>

In reviewing the Code, the commission has had regard to the need to:

- promote competitive and fair market conduct
- prevent misuse of monopoly or market power
- facilitate entry into relevant markets
- promote economic efficiency
- ensure consumers benefit from competition and efficiency

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<sup>5</sup> Clause 2.1(a) of the Northern Territory Electricity Ring-fencing Code.

- protect the interests of consumers with respect to reliability and quality of services and supply in regulated industries
- facilitate maintenance of the financial viability of regulated industries
- ensure an appropriate rate of return on regulated infrastructure assets.<sup>6</sup>

The commission has also taken into account the objectives of the Code, which seek to promote and achieve the object of the Act and the *Electricity Reform Act 2000*.

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<sup>6</sup> Section 6(2) of the *Utilities Commission Act 2000*.

## RESPONSE TO THE ISSUES PAPER

### Summary of submissions

Consultation on the Territory's ring-fencing arrangements was undertaken in the form of written submissions to the commission's Issues Paper and telephone interviews, where clarification or further information was required.

Below is a brief overview of each of the submissions received. Copies of the full submissions are available on the commission's website. The key issues raised in submissions are discussed and addressed in more detail below.

#### ***Australian Energy Regulator***

The AER did not respond to the specific questions in the Issues Paper, but provided background on the development of the national ring-fencing guideline for electricity distributors. The AER notes that the guideline exists in a complex landscape of contestable services including issues such as competitive metering and the increasing use of DER in the NEM.

An overview of the different classes of service that exist was also provided, showing the way that the national ring-fencing guideline imposes requirements for legal and functional separation between certain services (though the way in which these are applied in the Territory differs).

Another key point made in the AER's submission relates to the importance of compliance, reporting and independent assessment. The AER emphasises that, in its experience, independent assessment is a very useful tool in identifying the risk of non-compliance.

The AER does not address ring-fencing issues in the Territory in detail, though it does on the face of it, not see any reason that the (national ring-fencing guideline) could not apply to PWC in full sometime in the future. The AER highlights that the mechanisms for waiver and exemption would enable PWC to provide contestable services, if this was beneficial to customers.

#### ***Jacana Energy***

Jacana submitted that the matters raised in the Issues Paper do not directly impact its business activities and services of electricity retailers. However, Jacana supported the adoption of the AER's Ring-fencing Guideline in full (with amendments and supplementary guidelines as required), rather than the Territory having its own ring-fencing Code and Guidelines. Jacana is of the view that this would introduce greater uniformity, avoid the potential for the duplication of requirements and reduce inconsistencies.

#### ***Power Water Corporation***

PWC's submission in summary, is that the commission should reduce the scope of Territory specific ring-fencing requirements substantially and rely primarily on the national ring-fencing guideline. PWC's submission examines a series of issues that it anticipates would be of interest to the commission or other stakeholders and responds to each of the questions set out in the Issues Paper.

PWC's submission is that generation and retail services in remote areas are not contestable in a practical sense. Given this, and that retail prices are regulated by the Northern Territory Government, PWC is of the view that there is no potential for cross-subsidisation,



discrimination harms or any other anti-competitive market impacts in the remote areas that it services and therefore, ring-fencing is unnecessary in these locations.

In regards to services which are defined as distribution services under the AER's national ring-fencing guideline, PWC submits that these are sufficient to avoid potential harms and that the Territory's ring-fencing Code should no longer apply to the services captured by the national requirements.

PWC acknowledges the concerns about potential cross-subsidy and discrimination due to System Control being responsible for both the system control and market operator functions. In particular, PWC identifies amendments to technical codes, cost allocation, generator dispatch decisions and outage planning decisions as the categories of concern and provides suggestions as to how the potential for harm may be addressed. These issues are discussed in further detail, below.

### ***Territory Generation***

Overall, T-Gen appears to support the ongoing use of ring-fencing. While it did not directly respond to the questions in the Issues Paper, it provided a series of general statements intended to assist the commission in its review.

T-Gen raised a general concern that PWC's transition to a new operating model appears to be increasing the integration between system control and network operations. Highlighting that in effect, PWC is currently moving in the opposite direction from ring-fencing.

T-Gen expressed concern that some of System Control's actions appear to have favoured PWC over T-Gen, providing two categories of example. The first example relates to the supply of gas while the second relates to the scheduling of network outages. Both of these issues were also discussed in PWC's submission, and are dealt with in more detail in below.

## **Consideration of the key issues raised in the submissions**

### ***Duplication of obligations in Territory Code and national guideline***

PWC made the submission that as the national guidelines and the Territory Code cover broadly the same response to potential harms, albeit in slightly different ways, the current duplication results in the potential for confusion and complexity. PWC's submission was that (in summary) the commission should reduce the scope of the Territory specific ring-fencing requirements and rely predominantly on the national ring-fencing guidelines.

The AER submitted that it could not see any prima facie reason that the national guideline could not apply to PWC in full, at some point in the future.

Jacana expressed the preference for the AER's Guideline to be adopted in full (with amendments and supplementary guidelines as required), rather than the Territory having its own ring-fencing Code and Guidelines.

In the Territory under the current Code, there are three obligations to not discriminate, requiring:

- (a) any goods or services that are provided by a prescribed business to a related contestable business to be provided at arms' length
- (b) the terms and conditions on which a prescribed business supplies nominated goods or services to a related contestable business to be reduced to writing

- (c) the prescribed business must also offer to supply nominated goods and services to other customers on comparable terms to what is offered to the related contestable business.

In accordance with the Territory's ring-fencing Code, PWC must also maintain the confidentiality of information provided to a prescribed business by, or in respect of a customer.

Similarly, under the national guideline, PWC (as the DNSP) must not release confidential information and must only use it for the purpose for which it was acquired or generated.

As Power Services is currently subject to both regimes, the commission agrees there is duplication which could potentially cause confusion or misunderstanding.

However, this and other restrictions only apply to Power Services (to the extent that it is regulated by the AER), and not to any of the other prescribed or other PWC businesses, such as System Control, and are effectively narrower than the Territory's obligations. Further, the national obligation does not work in reverse, meaning it does not place a reciprocal obligation on PWC's other business units that provide gas, remote services and the system control functions, to not, for example, discriminate to the advantage of Power Services or any other business unit.

Accordingly, the commission is of the view that whilst the national guideline can be relied on to provide adequate ring-fencing obligations for Power Services, and thus the Code should be amended to make it clear that it does not apply to Power Services to the extent that it is regulated by the AER, Territory specific ring-fencing arrangements are still necessary to address the potential harms that are not covered by the national guideline.

Specifically, Territory arrangements in the Code should ensure there is an obligation on the prescribed businesses, such as System Control and the other businesses (or components of the business units) carried on by PWC which provide any goods or services in the electricity supply industry, to not discriminate to advantage PWC (including its subsidiary, Indigenous Essential Services Pty Ltd (IES)) or any of its other business units, such as Power Services or its gas services unit.

**Draft recommendation 1: Limit application of ring-fencing Code to the parts of PWC not covered by the national ring-fencing guidelines**

To minimise the duplication of obligations and potential for confusion, it is proposed that the Territory's ring-fencing Code be applied only to those parts of PWC that are not covered by the national ring-fencing guideline.

**Draft recommendation 2: Obligation to not discriminate**

To minimise the potential for PWC to discriminate to its advantage, it is proposed that the Territory's ring-fencing Code:

- (a) is tailored and maintained to meet the Territory's specific needs
- (b) includes a general non-discrimination clause to prevent PWC from using its position to give itself an advantage in competitive sectors of the electricity supply industry
- (c) includes a corresponding obligation that applies to each of PWC's prescribed businesses not covered by the national ring-fencing guideline.

### **Cost allocation**

In its submission, PWC identified the potential for cross-subsidy between System Control and the Market Operator due to being in the same cost centre.

Under the current Code, PWC must establish and maintain separate financial accounts and reports for its electricity business as a whole as well as each prescribed business.

As identified by PWC in its submission, under the national guideline, there are obligations on Power Services to establish and maintain appropriate internal accounting procedures to demonstrate the extent and nature of transactions between the DNSP and its affiliated entities.<sup>7</sup> The purpose of these accounts is to show the difference between the costs, assets and revenues associated with distribution services that are regulated by the AER and those associated with the other services PWC provides. The AER is not interested in the costs, assets and revenues of each of the other specific services that are provided by PWC. However, the commission is concerned about the costs, assets and revenues for the other services PWC provides, which are critical in it performing some of its other regulatory functions, for example system control and market operator charges.

There are similarities between the Territory's and the AER's relevant clauses in regards to the requirement for PWC to allocate or attribute costs between distribution and other services.

PWC made the suggestion that it could publish principles underpinning the System Control and Market Operator cost allocation methodology and provide further detail to the commission through the determination process without the introduction of a codified obligation.

However, the Commission is of the view that this proposal would not adequately address the potential for the two methodologies to be inconsistent in the allocation and reporting of costs. The possibility for PWC to recover more or less than its total costs from its customers remains.

Accordingly, the commission proposes amending the Code to include a requirement for PWC to apply the same cost allocation methodology that applies under the national guideline. This would mean that the accounting and cost allocation procedures currently in force may need to be amended or revoked to ensure there is no duplication, overlap or confusion.

#### **Draft recommendation 3: Cost allocation**

To minimise the potential for PWC to recover from customers more (or less) than its total costs as a result of two different methodologies for allocating costs, it is proposed that the Territory's ring-fencing Code be amended so that it requires PWC to apply the same cost allocation methodology that it applies under the national ring-fencing guideline to each of its regulated lines of business.

<sup>7</sup> Note that when applying the national guideline to the Territory, 'affiliated entities' is replaced with 'related electricity service providers'.

### ***Amendments to technical codes***

T-Gen made the submission that a conflict of interest currently exists as PWC is both the rule maker/administrator and the enforcer of the SCTC and the NTC.

Section 38 of the *Electricity Reform Act 2000* requires the System Controller to prepare a SCTC and submit it for approval to the commission. This code sets out the System Controller's competitively neutral operating protocols, arrangements for system security and system dispatch, as well as arrangements for the interruption of supply. The commission must approve any proposed amendments.

Section 66A of the *Electricity Reform Act 2000* requires a network provider to prepare an NTC for the network, setting out the technical requirements to ensure connections to the network are operated and maintained in a secure and reliable manner. The commission must be consulted before a network provider can make or amend the NTC. The commission reviews proposed amendments and can direct the network provider to change them, if necessary.

PWC also recognised this potential conflict of interest, but submits that the concern is appropriately managed as the codes require consultation with relevant stakeholders and the approval of the Commission.

The commission agrees with PWC's submission and is also of the view that this risk is minimal, as amendments to both codes require consultation with stakeholders and the approval of the commission. Nonetheless, the situation where PWC in effect 'owns' and seeks to amend its own rules is not ideal. However, this issue is not within the scope of this review.

### ***Generator dispatch decisions***

T-Gen's submission expressed concern that System Control has an incentive to dispatch T-Gen's power stations to increase PWC's gas sales, at the expense of T-Gen.

With the completion of the Northern Gas Pipeline in late 2018, the Territory is now connected to the eastern gas market. During consultation, PWC advised the commission that whilst the contracts are confidential, the price T-Gen pays for gas is now less than the opportunity cost to PWC of supplying gas to others. PWC asserts that in effect, the gas it sells to T-Gen is more valuable if it were used to underpin gas supply contracts on the east coast of Australia.

Australian gas markets are somewhat opaque in comparison to electricity markets. In the Territory, gas prices are confidential and there is a lack of publically available data. However, it appears the notion that PWC's opportunity cost of gas may be higher than the price T-Gen currently pays, may be valid.

In its submission, T-Gen suggests that this generator dispatch issue could be addressed by removing the system control functions from PWC, which would require the creation of a standalone, independent power system controller and market operator. Whilst this is an option to address the concern, PWC's submission emphasises the high cost of this option. The commission agrees the costs would be disproportionate to the potential harm that is trying to be addressed.

The commission supports alternative, more cost effective ring-fencing measures that may assist in providing greater confidence to stakeholders, which include:

- (a) specifically codifying the requirement for the physical separation between System Control and the gas supply unit to be maintained<sup>8</sup>
- (b) increasing the obligation in the ring-fencing Code to not discriminate, similar to that in the national ring-fencing guideline, but so that it applies to System Control.

The commission intends on amending the Code to implement these specific and stronger obligations.

Unfortunately, stronger ring-fencing requirements alone will not resolve the issue and it is recommended that the issue is addressed through improving the transparency surrounding the generator dispatch process.

It is the commission's understanding that the dispatch mechanism is an integral part of the ongoing development of the wholesale electricity market, currently being undertaken by the Territory Government. The commission recommends that in developing the dispatch mechanism, Government ensures there is adequate and improved transparency around the generator dispatch process.

#### **Draft recommendation 4: Generator dispatch decisions**

To minimise the potential for System Control to advantage the gas supply business unit of PWC in the dispatch of generators, it is proposed that:

- (a) the Territory's ring-fencing Code be amended to:
  - (a) require System Control to be physically separated from the gas supply business unit
  - (b) place a stronger obligation on System Control to not discriminate (in regards to the dispatch of generators)
- (b) the Territory Government and PWC develop and publish a clear set of protocols for generator dispatch as part of the implementation of a wholesale electricity market for the Darwin-Katherine system. When these are published, System Control should publish information showing, with due consideration of commercial confidentiality:
  - (i) which generators were dispatched from time to time
  - (ii) how this satisfies the dispatch protocols.

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<sup>8</sup> The System Control and gas supply units are currently physically separated, however it is not a requirement of the Code. Under the current Code, the gas supply unit does not meet the requirement of a 'prescribed business' or of a 'related contestable business' as it is not involved in the generation, supply or sale of electricity.

### ***Outage planning decisions***

In its submission, T-Gen expressed concern about the decision making process that PWC's Power Services business unit undertakes when deciding when to conduct network maintenance, stating that the impact often forces generators to run uneconomically. PWC acknowledges the issue, noting there may be concern amongst stakeholders that System Control has the potential to prioritise network outages over generation outages.

In general, the SCTC provides the process System Control is to undertake when scheduling network outages. However it is limited, providing no guidance on how to manage the planned outages, and does not contain a requirement to consider the costs associated with the outages.

Through its submission, PWC discusses the possibility of publishing a guideline to improve transparency around its outage planning practices. PWC suggests the guideline could be codified, which would enable monitoring of compliance and enforcement. The commission supports this suggestion and recommends the SCTC is updated to include this obligation, the next time it is amended.

However, it is unlikely this alone would provide greater confidence to stakeholders, in particular generators. Consequently, the commission considers the issue should also be addressed by strengthening the ring-fencing requirements in the Code, specifically in regards to the potential for PWC to discriminate in favour of itself when planning and managing network outages. The commission intends on amending the Code to reflect this position.

Additionally, a financial incentive for Power Services to minimise network constraints arising from network outages could be implemented using a service target performance incentive scheme (STPIS).

At the national level, through guidelines, STPIS is already included in the revenue determinations for distribution and transmission businesses subject to economic regulation by the AER. The current national STPIS applies to PWC's distribution businesses and includes performance measures regarding the reliability of supply and customer service, as well as a guaranteed service level payments scheme.<sup>9</sup>

A similar scheme could be developed for the Territory, with the aim to address concerns about outage planning decisions. The proposed scheme could provide Power Services with an incentive to minimise the impacts of networks outages, based on the time in which more expensive generation is required to be dispatched due to network constraint caused by a network outage. The commission encourages Government to consider this proposal.

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<sup>9</sup> STPIS for distribution businesses also includes a service standards factor adjustment to the price control formula, however, this has not been applied to PWC during the 2019-24 regulatory control period due to a lack of historical data.

**Draft recommendation 5: Outage planning decisions**

To minimise the potential for System Control to disadvantage T-Gen and/or other generators in the planning and management of network outages, it is proposed that:

- (a) the Territory's ring-fencing Code be amended to place a stronger obligation on System Control to not discriminate (in regards to the planning and management of network outages)
- (b) PWC be required to publish a guideline to provide greater transparency on the outage planning process and for this to be codified in the SCTC (the next time it is amended)
- (c) the Territory Government consider whether Power Services should be subject to a financial incentive to minimise network constraints arising from network outages.

## **Addressing the issues raised in the Issues Paper**

In the Issues Paper published in May 2019, the commission posed 14 questions for consideration as part of the review. The questions related to the structure of the electricity supply industry in the Territory, the approach to ring-fencing in the Territory, the national ring-fencing obligations and compliance and enforcement.

Below is the commission's Draft Decision in regards to these issues, following consultation with stakeholders. Where relevant, the questions have been combined where the issues were able to be addressed together.

**(1) *Is the current degree of ring-fencing of system control and market operator functions from each other, and the rest of PWC, sufficient?***

There are substantial economies of scale that can be achieved with the system control and market operator functions undertaken by the System Control. The commission is of the view that there would not be adequate benefits to justify the significant costs of functionally separating these roles, at this time.

It should be noted that while the commission does not require separate financial accounts from System Control in relation to its two main functions (system control and market operator), the commission does regulate the system control charge, which includes a market operator component in relation to Darwin-Katherine customers. This means that PWC must be able to produce appropriate evidence on its efficient costs to meet its regulated obligations to the commission as necessary.

As discussed earlier, the commission supports amendments to the Code to strengthen the obligation on System Control to not discriminate, as well as making it a specific requirement in the Code that System Control (continues to) be physically separate from the gas supply business unit (see recommendation 4).

**(2) *Which business activities or services require ring-fencing and should be covered by the Code?***

**(3) *What are the most suitable ways to ring-fence business activities and services?***

- (4) ***Is there adequate separation between PWC's business units under the current ring-fencing requirements?***
- (6) ***Should cost allocation and financial reporting obligations be included in the Code or be covered by different/separate instruments?***
- (12) ***How should the Code address the potential for duplication of obligations for PWC Networks (now Power Services) to produce and submit separate financial accounts and reports to the Commission and the AER?***

These questions relate to the potential harms that ring-fencing targets and how it applies to PWC.

#### *Cross-subsidisation*

As mentioned above, PWC provides a range of regulated (monopoly) and unregulated (competitive) services. For example, gas supply services are provided in a competitive market, whilst electricity distribution services, system control and market operator functions are regulated by the AER or the commission. Further, PWC supplies remote electricity and other services to its subsidiary IES, which are not regulated. This creates the opportunity for potential harms whereby competitive services are cross-subsidised by those that are regulated, or for services that are regulated by the commission to be cross-subsidised by those regulated by the AER, and vice versa.

Accounting separation and appropriate cost allocation methodology are used to reduce the risk of cross-subsidisation in these circumstances, as reflected in both the Territory's Code and the national guideline.

At the national level, the guideline targets the risk of cross-subsidisation of other distribution services and other electricity services by direct control services. As the NEM is very different to the electricity supply industry in the Territory, the national guideline is not concerned with the cross-subsidisation of gas supply services by System Control or the business unit that provides remote services, or system control functions by the market operator functions or vice versa. Therefore, it is imperative the Territory's Code includes an obligation for separate accounts for those regulated business activities that are not regulated by the AER. Further, the commission needs visibility of the accounts for the business activities regulated by the AER to make sure that the businesses it regulates are not subsidising the business activities regulated by the AER and that reporting by PWC is consistent.

As discussed earlier, PWC is currently required to prepare and comply with two different cost allocation methodologies, one under the Territory's Code and the other in accordance with the national guideline. This creates the potential for confusion and inconsistencies, which may result in PWC recovering too much or too little than its total efficient costs from its customers. Accordingly, the commission recommends the Territory's Code is amended so that it requires PWC to apply the same cost allocation methodology used under the national guideline to each of its regulated lines of business (see recommendation 3).

#### *Discrimination*

As highlighted in the submissions from stakeholders and addressed above, there is potential for the regulated parts of PWC to discriminate in favour of other parts of its business. For example, PWC's System Control division potentially making decisions about generator dispatch and network outages to benefit itself at the expense or disadvantage of T-Gen.



Whilst the national ring-fencing guideline obliges PWC to not discriminate in regards to the provision of direct control services, it does not place a reciprocal obligation in regards to the other business activities PWC undertakes. Therefore, the commission recommends (as discussed above) that the Code be amended to include a similar obligation on PWC to not discriminate, which applies to all of the electricity business activities that are not already covered by the national guideline (recommendation 2).

Whilst System Control and the gas supply unit are already physically separated, the commission believes this requirement should be specified in the Code to prevent problems that may arise in the future (recommendation 4).

#### *Confidential information*

The national guideline compels Power Services to protect the confidentiality of information, however these obligations do not extend to System Control. There is potential for System Control to have access to confidential information that may advantage the gas supply unit, or for decisions made by System Control to be influenced by confidential information obtained by the gas supply unit.

At present, the commission considers this risk is minimal, but if Power Services becomes active in the installation of DER in competition with other providers, then the potential for it to be advantaged by accessing confidential information increases.

In order to mitigate these potential harms, the Code should require System Control and the gas supply unit to protect the confidentiality of information.

Further, the Code should be amended so that it does not apply to Power Services, in order to avoid duplication, as Power Services is already covered by the national guideline (recommendation 1).

#### **(5) *How can the Code assist the Northern Territory Government to deliver its initiative to establish a regulatory framework which supports its Renewable Energy and Electricity Market Reform Implementation Plan for 2018-2020?***

Among other things, the proposed amendments to the Code will place a stronger obligation on System Control to not discriminate in regards to the dispatch of generators and the planning and management of network outages (see recommendations 4 and 5 above). Increased ring-fencing in the Code allows for greater clarity around System Control's operations which will provide more confidence for investors in the Territory's electricity supply industry.

Under the Government's Renewable Energy and Electricity Market Reform Implementation Plan, there may be an opportunity for Power Services to become active in providing contestable services to customers, such as contestable metering services or installing DER. If this does eventuate, this Code review recommends that Government further consider the separation of staff, noting at present, the relevant provisions of the national ring-fencing guideline regarding the separation of staff does not apply in the Territory. Accordingly, the commission would also review and update the Code (if necessary) to ensure appropriate separation within its other relevant business units if PWC were to provide any new contestable services.

**Draft recommendation 6: Application of the national ring-fencing guideline in the Territory**

If Power Services (to the extent that it is regulated by the AER) becomes active in providing contestable services, including contestable metering services or installing distributed energy resources, it is recommended (subject to a cost benefit analysis) that the Territory Government consider the application of further provisions in the national ring-fencing guideline.

**(7) *What is the impact of, and potential for duplication of ring-fencing requirements due to the introduction of the national Ring-fencing Guideline for electricity distribution by the Australian Energy Regulator (AER)?***

As part of the review, the commission considered whether the newly adopted national ring-fencing guideline provides adequate ring-fencing for the Territory electricity supply industry. In particular, it was considered whether it replicates the Territory's ring-fencing Code entirely and if not, whether differences between the two give rise to a need for ongoing use of the Code or other Territory specific instruments.

In broad terms, the national guideline imposes similar obligations on the Power Services business unit of PWC as the Territory's ring-fencing Code. The commission agrees that with the introduction of the national ring-fencing guidelines, there is duplication between the AER's guideline and the Territory's ring-fencing Code. The commission is of the view that the Code be amended so it does not apply to Power Services (to the extent that is regulated by the AER), as it is sufficiently covered by the national guideline, reducing the regulatory burden on PWC and minimising the potential for confusion.

The specific areas where there is duplication or inconsistencies were discussed in more detail in earlier sections of this Draft Decision (recommendations 1, 3 and 6).

**(8) *Taking into consideration the national obligations, does the NT still need its own Code? Would it be better to use a different approach, for example supplementary guidelines that build on the national obligations?***

**(9) *Is a code still the most appropriate way to manage ring-fencing in the NT? If not, what are the preferred alternatives and why?***

**(10) *Are the matters covered by the current Code and associated documents relevant and sufficient to meet the needs of the NT electricity supply industry?***

The current Code, with modernisation (as set out in the draft recommendations and draft revised Code) is relevant and sufficient to meet the needs of the Territory's electricity supply industry.

The commission supports the submissions from stakeholders that the current Code should be modernised to align with the national ring-fencing guidelines as much as possible. This will help reduce the cost of compliance for PWC, and ultimately consumers. However, due to differences that exist between the NEM and the Northern Territory electricity supply industry, and the different ring-fencing needs of these markets, the commission has formed the view that a separate ring-fencing Code continues to be required for the Territory.

It is not intended that the Territory Code apply to the business activities already regulated by the AER (within PWC's Power Services business unit), but it will include obligations to address the unique and specific needs of the Territory electricity industry. These needs are discussed in more detail above (recommendations 2, 3, 4 and 5).

**(11) *Is the current method for monitoring and reporting compliance (or non-compliance) with the Code adequate? Are there any preferred alternative options?***

**(13) *Is the Commission's current approach to managing breaches of the Code adequate?***

In regards to matters not covered by the national ring-fencing guideline, PWC makes the submission that the revised Code (or instrument) regarding the system control and market operator functions should draw from the existing requirements of the Code. The commission currently relies on its *Compliance Framework and Reporting Guidelines*,<sup>10</sup> which sets out its approach and expectations regarding compliance. The licences that PWC is required to hold in order to carry out operations in the Territory electricity market also contain compliance process and reporting obligations, including the provision for external audits.

In its submission and as a result of its recent experiences with the national ring-fencing arrangements, the AER emphasised the importance of effective monitoring and enforcement for the success of any ring-fencing regime. The commission agrees with this statement and acknowledges that a variety of tools are required.

In the Territory, the current compliance regime is based on PWC reporting to the commission. As there can be potential risks when relying purely upon self-reporting by regulated entities, the commission supports the AER's submission that independent assessments by third parties are essential to the success of ring-fencing regimes.

The commission intends on undertaking independent assessments by a third party, which will be carried out using a risk-based approach. The frequency and scope of any independent assessments will be based on the potential for harm and in accordance with the commission's *Compliance Framework and Reporting Guidelines*.

**(14) *Are the penalties for breaching ring-fencing obligations sufficient?***

The commission is responsible for administering the licensing of the electricity supply industry in the NT. In regards to electricity, PWC holds licences for standard generation, retail, network and system control operations. As outlined by PWC in its submission, it is a condition of its licences to comply with all relevant codes and rules made under the Act. Therefore, a breach of the Territory's ring-fencing Code would constitute a breach of its licence, and in turn a breach of the section 31(1) of the *Electricity Reform Act 2000*.

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<sup>10</sup> Published in February 2016.

The current penalty for a breach of the ring-fencing obligations is a financial sanction of up to \$387,500.<sup>11</sup> Following a finding of guilt and through an application to the court, the commission also has the option to recover the amount benefited by the electricity entity when contravening its licence condition.

Accordingly, the commission is of the view that the current penalties for breaching the ring-fencing Code are sufficient and no changes are recommended.

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<sup>11</sup> The penalty is 2,500 penalty units. For 2018-19, a penalty unit is \$155.

## **APPENDICES**

**Appendix A: Draft Amended Northern Territory Electricity Ring-fencing Code (marked-up)**

**Appendix B: Table of Proposed Amendments to the Code**