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Mr Lyndon Rowe  
Utilities Commissioner  
Utilities Commission of the Northern Territory

by email: [utilities.commission@nt.gov.au](mailto:utilities.commission@nt.gov.au)

Dear Mr Rowe

**POWER AND WATER SUBMISSION TO THE 2019 NORTHERN TERRITORY ELECTRICITY RING-FENCING CODE AND GUIDELINES – ISSUES PAPER**

Thank you for the opportunity to provide input to the Utilities Commission's review of the Northern Territory Electricity Ring-Fencing Code and Guidelines.

Power and Water welcomes the review and trusts that the attached submission will provide useful input to the Utilities Commission's deliberations.

If you wish to discuss any aspect of this submission, please contact Mr Chris Hanlon – Manager, Compliance and Quality in the first instance, on either 8923 4688 or [christopher.hanlon@powerwater.com.au](mailto:christopher.hanlon@powerwater.com.au) and he will coordinate any further assistance or information you may require.

Yours sincerely

Tony Edmondstone  
**Acting Chief Executive**

9 July 2019

# Review of the Northern Territory Electricity Ring Fencing Code and Guideline



Submission to the Utilities Commission of the  
Northern Territory

July 2019

## 1. Introduction

Power and Water welcomes the review of the Northern Territory Electricity Ring Fencing Code (the NT Code) and Guideline and the opportunity to contribute to the review being undertaken by the Utilities Commission.

Power and Water is a diverse business with multiple regulated and unregulated service lines and as such, it supports the continued application of the principles of ring fencing to its regulated lines of business in a fit-for-purpose, efficient and equitable manner that seeks to further the long term interests of its customers.

Power and Water is licensed to provide its services across the Northern Territory to a customer base comprised of just over 95,000 electricity customers and 50,000 water customers. This number of customer connections is spread over five major centres, 15 minor centres, 72 remote communities and 69 outstations, making Power and Water one of the most geographically dispersed utility providers in the country with arguably one of the lowest density customer bases.

These natural characteristics of operating a multi-utility in the Northern Territory mean Power and Water does not enjoy the benefits of scale present in other larger utilities, and so it is commercially and operationally beneficial to aggregate its common functions of technical back-office support and administrative services to keep downward pressure on the costs of its services.

Ring fencing Power and Water's regulated System Control and Market Operator functions can provide benefits to customers and other market participants. It can provide our customers with comfort that they are not unfairly paying for costs that do not relate to the services they are receiving. It can also provide other market participants with the confidence that we are operating in open markets in good faith and are not discriminating against them, including by unfairly benefiting from information that is not available to the market. And it can also provide our stakeholders with the confidence that we are delivering our services in an efficient and appropriate method and are making decisions in an open and transparent manner.

As the Utilities Commission points out in its Issues Paper, the Northern Territory electricity supply industry has undergone substantial structural change since the NT Code and Guideline were last reviewed in 2009. Therefore as Power and Water prepares to enter the national regulatory regime for its distribution network services on 1 July 2019, it is timely to review this local Code to ensure appropriate alignment with the National Electricity Law and the NT National Electricity Rules (NT NER), and remove any overlaps and regulatory driven inconsistencies.

Before addressing each of the 14 questions posed in the Issues Paper, Power and Water makes the following high level observations and recommendations for consideration by the Utilities Commission in its review of the NT Code.

## 2. Long term interests of the consumer

The Northern Territory Government<sup>1</sup> supports best practice principles that aim to deliver effective and efficient regulation that addresses an identified problem; is the minimum level of intervention necessary to achieve stated policy objectives; and that maximises benefits to the community, while taking account of the costs. This review by the Utilities Commission provides an opportunity to put those principles into practice.

Power and Water further proposes through this review that the long term interests of the consumer also be taken into consideration, as a reasonable extension of the Government's intent to "maximise the benefits to the community...", as outlined in the National Electricity Objective:

"to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to: price, quality, safety and reliability and security of supply of electricity; the reliability, safety and security of the national electricity system."

It is recommended this objective also be used as a central guiding principle in the Utilities Commission's review of ring fencing in the Northern Territory.

## 3. Generator and Retailer services

Power and Water continues to own and operate five generation plants in regional areas and provides full end-to-end electricity services in Indigenous Essential Services (IES) remote towns and communities, under contract to the Northern Territory Government.

However, because none of these generation or retail services are contestable in a practical sense, and the prices for these services are regulated by the Northern Territory Government, there is no potential for cross-subsidisation or discrimination harms, or any other anti-competitive market impacts, arising from Power and Water providing these services in conjunction with either its regulated network distribution services, or its System Control and Market Operation services.

As such, Power and Water recommends that the current "minimum ring-fencing requirements" as it applies to its generator and retailer functions be removed from the NT Code.

## 4. Network (Direct Control) services

On 1 July 2019 Power and Water became subject to the National Ring Fencing Guideline for the ring fencing of its regulated distribution services, with practical modifications to make the guideline suitable for the Northern Territory set out in clause 6.17.1B of the NT NER.

There are also a range of other instruments that work in conjunction with the National Ring Fencing Guideline that give effect to the ring-fencing of direct control services, in particular:

- the Service Classification Guideline;

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<sup>1</sup> Northern Territory Government Regulation-Making Framework, November 2017 Version 2.0'

- the service classification decision in the AER’s Distribution Determination for the regulatory control period;
- the Cost Allocation Guideline;
- Power and Water’s Cost Allocation Method, which is approved by the AER;
- the Shared Asset Guideline; and
- regulatory information instruments, that require Power and Water to provide information to the AER subject to the National Ring Fencing Guideline and cost allocation obligations and to have this information certified and audited, subject to the requirements of the National Electricity Law.

Due to this broad coverage of the National Ring Fencing Guideline and in the interests of regulatory and administrative efficiency, and therefore in the longer term interests of the customer not to add unnecessary costs, Power and Water recommends that the current “minimum ring-fencing requirements” for a Network Operator also be removed from the NT Code.

To this end, Power and Water notes the NT NER limits the application of the National Ring Fencing Guideline in the Northern Territory regarding the obligations for legal separation and office, staff, branding and promotions do not apply to Power and Water because the additional cost of complying with these provisions is not in long term interests of the customer.

Notwithstanding, the NT NER includes a note in clause 6.17.1B under which the operation of the National Ring-fencing Guideline, including the current exemptions on certain provisions applying to Power and Water, will be revisited in the event of the introduction of contestable services (including contestable metering services) in the NT. This means that Power and Water’s ring-fencing obligations will always appropriately reflect the markets in which it operates.

## 5. System Control and Market Operator Services

From its engagement with stakeholders, Power and Water understands that there is concern over the potential for cross-subsidisation or discrimination harms that could arise in relation to system control and market operator services from the types of actions listed in the table below.

The table describes the perceived risk, existing and proposed measures to control the risk, and Power and Water’s views on whether additional ring-fencing measures are required.

Action	Risk or concern	Control	Additional ring-fencing required?
<b>Code Amendment Process</b>	Power Services amending the Network Technical Code (NTC), or System Control amending the System Control Technical Code (SCTC) to advantage Power and Water.	The existing regulatory framework ( <i>Electricity Reform Act 2000</i> and licences) require consultation and Utilities Commission approval of any Code amendments.  The Government’s Utilities Reform Program	<i>No - regulatory oversight, consultation and approval processes already in place, with further reforms underway</i>

Action	Risk or concern	Control	Additional ring-fencing required?
		includes changes to governance arrangements and will result in key rules being separated into a non-Power and Water instruments.	
<b>Cost Allocations</b>	System Control or Market Operator cross-subsidising one or the other as a result of being in the same cost centre within Power and Water.	<p>No existing controls. Power and Water will publish its cost allocation methodology (CAM) principles, providing transparency and certainty.</p> <p>The Utilities Commission could codify the CAM approval and publication obligations if considered necessary, either in a ring-fencing instrument, or in the System Control revenue determination process.</p>	<i>No – Ring-fencing outcomes can be achieved if Power and Water voluntarily publishes its CAM</i>
<b>Generator Dispatch Decisions</b>	System Control prioritising the dispatch of particular generators to advantage Power and Water’s gas contracting arrangements.	<p>Further transparency is required for the dispatch decision process.</p> <p>This is best addressed through the market reform process, rather than ring-fencing provisions.</p> <p>The Government’s I-NTEM 2.0 scope includes significant changes to the dispatch process.</p>	<i>No ring-fencing required, but action is required (and concerns best addressed) through market reform program</i>
<b>Outage Planning Decisions</b>	System Control prioritising network outages over generation outages to enable Power and Water to optimise	Power and Water will publish a guideline on the outage planning process that will provide further transparency on the decision process.	<i>No - Ring-fencing outcomes can be achieved through voluntary guideline</i>

Action	Risk or concern	Control	Additional ring-fencing required?
	the timing of its repair and maintenance works	The Utilities Commission could codify the requirement to publish a guideline, and enable audits against that guideline.	

Power and Water considers that the proposed controls outlined above address the potential harms, within a regulatory framework that meets best practice in that it is appropriately targeted, proportionate, and cost effective. Power and Water would welcome the opportunity to discuss and address any other perceived or potential harms raised by respondents to the Utilities Commission’s Issues Paper.

Further background on the potential ring-fencing concerns for system control and market operator functions, and measures to mitigate them follows:

- Unilaterally amending the NTC or SCTC:** This risk is currently limited as any amendments to these Codes already require the approval of the Utilities Commission. Further, it is understood that the Government’s broader regulatory reform program for the electricity industry includes a review of the governance framework and these codes are expected to be largely transitioned into either the NER or a jurisdictional based instruments that Power and Water does not control. As such there does not appear to be a persuasive cost-benefit argument for the duplication of such matters in a local ring fencing instrument.
- Cross-subsidising the cost of services:** This potential harm is expected to be largely addressed through the recent review and future regulation by the Utilities Commission of the costs of both System Control and the Market Operator. However, consistent with the approach taken in the National Ring Fencing Guideline, this matter could be codified in a local instrument and supported by the application of an appropriate cost allocation methodology, both for the allocation of costs to the System Control business unit from the rest of Power and Water, and also within the business unit, to the separate regulated functions of power system control and market operation.

To this end, Power and Water recommends that that if deemed necessary, that any cost allocation methodology, and the regulatory oversight of such, be applied to its System Control and Market Operator in a manner that is to the greatest extent possible, aligned with that which applies under the NT NER and National Electricity Law. Any substantial deviation or departure from these already established principles of cost allocation that forces duplicate methodologies and regulatory accounts to be maintained, is unlikely to be in the long term interests of the customer.

Power and Water will publish the principles underpinning their cost allocation methodology and provide further detail to the Utilities Commission through the determination process without the introduction of a codified obligation.

- Prioritising outages:** Currently planned outages are approved via the order in which they are received, unless there is a significant system risk or impact from unplanned outages. Power and

Water has been developing procedures that outline both the generation and network outage request processes and plans to finalise and publish these in 2020. The procedures will outline the process and the principles adopted when prioritising planned outage requests and will provide transparency and clarity to participants. These would form the basis of a guideline referred to in the table above.

- **Prioritisation of generation dispatch based on energy source:** Although Power and Water's gas business activities are not considered 'electricity services' and therefore are not within the scope of the NT Code, Power and Water acknowledges a perceived conflict between the System Control and its gas business functions.

However, this risk is currently limited as the Interim Northern Territory Electricity Market (I-NTEM) arrangements specify the approach for dispatch merit order, thereby already restricting this practice. As the NTEM reforms progress, Power and Water expects that further transparency will be provided on the dispatch process in both the formal rules and procedure publication and so it is recommended that this risk be managed in the NTEM rule instrument (currently the System Control Technical Code) rather than as a separate ring-fencing requirement.

In regards to any perception of information gained by the Power System Controller in the performance of its duties, being used to advantage the Gas Unit in its commercial negotiations for example, Power and Water refers the Utilities Commission to Section 40 of the *Electricity Reform Act 2000*. Section 40 "Obligations to preserve confidentiality" explicitly prohibits the sharing of such information through reference to 'preserving the confidentiality of information'. Therefore while a ring fencing instrument could reiterate such prohibitions on the sharing of information held by Power and Water as a result of carrying out its System Control and Market Operator functions, it is likely not necessary for the achievement of such outcomes given the legal requirements already outlined in legislation.

## 6. Appropriate arrangements for the Northern Territory

On purely cost-benefit basis there does not appear a strong argument for ring fencing in the Northern Territory given the current reforms underway in the industry and the voluntary measures Power and Water is putting in place.

However, Power and Water recognises the role it plays in the Northern Territory electricity industry and the perceptions that entails, and therefore for the purposes of further transparency and disclosure and to encourage investor and market participant confidence in the industry, Power and Water supports the continuation of pragmatic, light-handed ring fencing to its System Control and Market Operator function.

In the long term interests of customers, Power and Water does caution against the imposition of heavy-handed ring fencing in the Northern Territory that is neither: fit-for-purpose; or cost efficient, for an industry of this size.

For example, a stand-alone government owned corporation to undertake the System Control and Market Operator functions would require: separate premises; financial and billing systems; a Board of Directors; Executive Management and staff; human resource, information technology and other corporate support; preparation of auditable financial accounts and the development of internal governance, processes and procedures necessary to operate under the *Government Owned*



*Corporations Act 2001*. Power and Water estimates this would cost in the order of an additional \$10 million per annum, which would be borne by electricity customers. Such a cost, which would represent an increase in the average customer bill of over \$110 per annum, would represent a disproportionate response to the perceived concerns.

Similarly, Power and Water estimates that the strict application of ring fencing as contemplated by the AER in its National Ring Fencing Guideline (without the existing derogations for Power and Water) would necessitate the creation of, at a minimum, a subsidiary company of Power and Water, to be tasked with the System Control and Market Operator functions. The cost of establishing and running a subsidiary on a marginal cost basis, a method similar to its Indigenous Essential Services Pty Ltd subsidiary is in the order of up to \$5 million per annum, which would equally drive higher prices for electricity customers.

As such, Power and Water advocates for the continuation of light handed, sensible ring fencing in the Northern Territory electricity industry that seeks to complement the measures outlined in Chapter 5 above that are already underway to:

- Establish appropriate cost allocation methodologies for the regulation of System Control and Market Operator charges, consistent with practices adopted by the AER.
- Ensure physical separation of financial accounts of System Control and Market Operator from the rest of Power and Water.
- Remove any perception of inappropriate Power and Water influence over the SCTC and NTC.
- Create greater transparency in dispatch through the continued development of the Northern Territory Electricity Market.

Such an approach should seek to further the long term interests of the consumer by achieving many of the same benefits and protections to consumers of legal and structural separation, without incurring unnecessary costs by duplicating corporate overheads for multiple businesses.

Power and Water is volunteering to implement the measures outlined in Chapter 5. However, if the Utilities Commission considers that additional regulatory support for ring-fencing remains justified, then obligations could be established through:

- i. Amended versions of the current NT Code (and supporting guideline), so that it only imposes obligations on Power and Water's System Control Prescribed Business, which would apply only to Power and Water's System Control and Market Operator functions.
- ii. A new instrument that deals only with ring-fencing for Power and Water's System Control and Market Operator functions.
- iii. The System Control Technical Code.
- iv. The system control revenue determination process

If the Utilities Commission considers that regulatory support is required, Power and Water's recommendation is for a targeted application of ring fencing through either a new instrument dedicated to ring fencing Power and Water's System Control and Market Operator functions (option

ii above) or through System Control Technical Code (option iii above) as an existing, dedicated instrument dealing only with these particular functions.

In terms of implementation timeframes, Power and Water considers that it could have the necessary account separation and cost allocation methodologies in place in time for the Utilities Commission's review and reset of the regulated System Control and Market Operator charges that come into effect on 1 July 2020. This will provide sufficient time to ensure these new processes and procedures can be established, tested and functional, without the need for administratively burdensome manual workarounds.

## **7. Responses to the Issues Paper questions**

The following responses to the 14 questions posed in the Issues Paper should be read in conjunction with the information provided above.

### **Question 1: Is the current degree of ring-fencing of system control and market operator functions from each other, and the rest of Power and Water, sufficient?**

- Power and Water recognises the role it plays in the Northern Territory electricity industry and the perceptions that entails.
- As such, Power and Water will proactively take steps to provide further transparency to the controls that are currently in place in regulation and internal processes. However, should the Utilities Commission find that further codified regulation is required, Power and Water supports the application of ring fencing to its System Control and Market Operator services through either a new instrument or by amending the current System Control Technical Code.
- Any ring-fencing requirement should provide measured responses to the potential for cross-subsidisation or discrimination, which operate in the long term interests of the customer.

### **Question 2: Which business activities or services require ring-fencing and should be covered by the Northern Territory Electricity Ring-fencing Code (the Code)?**

- Power and Water considers that ring fencing should only apply where the services it provides could potentially result in cross-subsidisation or discrimination in either the markets in which it operates, or other competitive markets.
- An adequate level of legal separation has already been achieved in the electricity industry by virtue of the structural separation of Territory Generation and Jacana Energy.
- System control and market operator functions are the remaining aspects of the Power and Water business that require transparency to build stakeholder confidence that information and decisions are managed appropriately. If codified regulations are required, they should be dealt with either in a new specific instrument or in an amended version of the System Control Technical Code.
- Network Operator, and therefore Distribution Services are now covered by the National Ring Fencing Guideline and a range of other national instruments and therefore do not require duplicate cover under a Northern Territory instrument.

- No ring fencing should apply to Power and Water's generation and retail service line because neither of these services are contestable and so there is considered to be no potential for cross-subsidy or discrimination, or any other anti-competitive market impacts.

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

- System Control and Market Operator – please refer above to question 2.
- Network Operator, and therefore Distribution Services: refer above to question 2. Power and Water considers that there are no other risks to the industry or consumer that a local instrument should be trying to address, than those that are already covered by the National Ring Fencing Guideline.
- Generation and Retail – please refer above to question 2.

**Question 4: Is there adequate separation between Power and Water's business units under the current ring-fencing requirements?**

- Power and Water considers that the structural separation of the generation and retail businesses has achieved an adequate level of legal separation of the electricity supply chain in the Northern Territory.
- For System Control and Market Operator, please refer above to question 1.
- Generation and Retail, please refer above to question 2.
- For Network Operator, and therefore Distribution Services, the Government considered how each kind of separation should apply to Power and Water when it determined how Chapter 6 of the NT NER, and the National Ring-fencing Guidelines, should apply:
  - Legal separation – clause 3.1 of the National Guideline does not apply due to clause 6.17.1B(a) of the NT NER.
  - Accounting separation – clause 3.2 of the National Guideline applies in full, in relation to separate accounts and cost allocation.
  - Office / physical separation – clause 4.2.1 of the National Guideline does not apply due to clause 6.17.1B(a) of the NT NER
  - Staff separation – clause 4.2.2 of the National Guideline does not apply due to clause 6.17.1B(a) of the NT NER
  - Marketing / branding separation – clause 4.2.3 of the National Guideline does not apply due to clause 6.17.1B(a) of the NT NER
- Power and Water understands that the Government made its decisions on these matters having regard to matters such as the impacts on costs and therefore prices, availability of resources and contestability of markets.
- The NT NER, however, includes a note in clause 6.17.1B under which the operation of the National Guideline, including the current exemptions on certain provisions applying to Power and Water, will be revisited in the event of the introduction of contestable services (including

contestable metering services) in the Northern Territory. This means that Power and Water's ring-fencing obligations will always appropriately reflect the markets in which it operates.

**Question 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?**

- Initiative 4j in the NT Government's "Renewable Energy and Electricity Market Reform Implementation Plan 2018-2020" commits it to a "Review of the Ring-fencing Guidelines to ensure greater separation between System Control and Power and Water's other business units".
- The NT Government will achieve this by: promoting national rule and terminology consistency where practical; removing duplicate national and Northern Territory network provider provisions; and leaving a fit-for-purpose instrument that is targeted at remaining entities and desired outcomes.
- Power and Water's proposed approach throughout this submission will achieve this outcome by ensuring there is no real or perceived conflicts of interest in its dealings with other market participants or in the market framework.

**Question 6: Should cost allocation and financial reporting obligations be included in the Code or be covered by different/separate instruments?**

- This potential harm is expected to be largely addressed through the recent review and future regulation by the Utilities Commission of the costs of both System Control and the Market Operator.
- However, Power and Water will proactively support increased transparency with the publication of the principles underpinning the System Control and Market Operator cost allocation methodology and provide further detail to the Utilities Commission through the determination process without the introduction of a codified obligation.
- Should further regulatory certainty be required, consistent with the approach taken in the National Guideline, this matter could be codified in a local instrument and supported by the application of an appropriate cost allocation methodology, both for the allocation of costs to the System Control business unit from the rest of Power and Water, and also within the business unit, to the separate regulated functions of power system control and market operation.
- Distribution cost allocation and financial reporting obligations for the Network Operator, and therefore Distribution Services should not be included in NT jurisdictional obligations for Distribution Services because they are already appropriately covered by national arrangements in relation to "separate accounts" and "cost allocation and attribution".

**Question 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)?**

- The current National Guideline and NT Code for ring-fencing arrangements cover broadly the same responses to potential harms, albeit in slightly different ways, namely they both focus on cross-subsidisation and discrimination.
- Minimum ring-fencing requirements – they both cover: separate accounts; cost allocation and attribution; obligation not to discriminate office; staff, branding and promotions; information access and disclosure; and service providers. However, as noted above, not all of these requirements apply to Power and Water.
- The current duplication results in the potential for confusion and complexity, given responsibility for economic regulation of distribution services and services provided by a Network Operator has transferred to the AER; and the terminology used in the NT Code is outdated, which makes it confusing to read in conjunction with the national instruments.

**Question 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?**

- Please refer to question 2 above.

**Question 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?**

- Power and Water considers that the only ring fencing issues that may if required, be addressed through a local instrument are those that are concerned with the System Controller and Market Operator. This is because:
  - Network Operator functions are covered by the National Guideline.
  - Cost allocation to, and between, distribution services and all other services provided by Power and Water is covered by the national cost allocation arrangements, being clauses 6.15 and 6.17 of the NT NER, the Ring-fencing Guideline, the Cost Allocation Guideline, the Cost Allocation Method and the Shared Asset Guideline.
  - Generator functions in the NT Code have been dealt with by the legal separation of Territory Generation from Power and Water.
  - Retailer functions in the NT Code have been dealt with by the legal separation of Jacana Energy from Power and Water.
  - Power and Water's remaining generation or retail services are not feasibly contestable so there is considered to be no potential for cross-subsidy or discrimination harms, or any other anti-competitive market impacts.

**Question 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?**

- Please refer to question 2 above.

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

- Monitoring and reporting of compliance for Distribution Services are appropriately covered by the current National Guideline – Chapter 6 entitled “Compliance and enforcement”.
- The possible new or amended instrument dealing with System Control and Market Operator should deal with monitoring and reporting compliance and should draw on the existing requirements in the NT Code.

**Question 12: How should the Code address the potential for duplication of obligations for Power and Water Networks to produce and submit separate financial accounts and reports to the Commission and the AER?**

- For the reasons detailed above, there is no need for the NT Code to cover Distribution Services, and therefore a “Network Operator” Prescribed Business.

**Question 13: Is the Commission’s current approach to managing breaches of the Code adequate?**

- Monitoring and reporting of compliance for Distribution Services is appropriately covered by the current National Guideline – Chapter 6 entitled “Compliance and enforcement”.
- The new or amended instrument dealing with System Control and Market Operator should deal with breaches by drawing on the existing requirements in the NT Code.

**Question 14: Are the penalties for breaching ring-fencing obligations sufficient?**

- The National Guidelines do not include pecuniary penalty provisions as the AER does not have authority to issue fines in relation to breaches of the Ring-fencing Guideline’s obligations.
- Power and Water’s licences requires it to comply with relevant laws, which includes the NT NER and related guidelines. A breach of any ring-fencing instrument would therefore constitute a breach of its licence.