

Utilities Commission of the Northern Territory

RING-FENCING GUIDELINES

(version no. 1)

28 January 2009

Background

1. The purpose of these Guidelines is to set out the Commission's views relating to the application or interpretation of, or matters arising under, the Northern Territory Electricity Ring-fencing Code (version 3) ("the Code") which took effect on 1 January 2009.
2. In particular, these Guidelines present the Commission's views in relation to matters that may be relevant when it comes to a Prescribed Business reducing to writing its "related party terms", a copy of which is to be lodged with the Commission by 30 June 2009 pursuant to clause 3.3(a)(iv)(A) of the Code.
3. The Commission expects to extend these Guidelines to cover other aspects of the Code in due course.

Authority for guidelines

4. These Guidelines are issued pursuant to clause 1.6 of the Code, which authorises the Commission to publish guidelines relating to the application or interpretation of, or matters arising under, the Code.
5. Further, section 7 of the *Utilities Commission Act 2000* more generally authorises the Commission to issue guidelines relating to the performance of its functions.

Variation

6. The Commission may vary these Guidelines from time to time where necessary to meet its needs under the Code.
7. The Commission will consult affected parties before adopting a variation to these Guidelines.

Input from Interested Parties

8. The Commission welcomes comments, discussion or suggestions for amendments to these Guidelines from any interested party. Any contribution in

this regard should be should be directed in the first instance to the Executive Officer, Utilities Commission at any of the following:

Postal address:
Utilities Commission
GPO Box 915
DARWIN NT 0801

Telephone:
08 8999 5480

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08 8999 6262

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Version Number and Effective Date

9. An issue or version number and date of issue will identify every version of these Guidelines. These Guidelines become effective as at 28 January 2009.

Interpretation

10. In these Guidelines, unless the contrary intention appears:

the Code	means the Northern Territory Electricity Ring-fencing Code (version 3) ("the Code") which took effect on 1 January 2009
Generator	means a business (or 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
Network Operator	means a business (or component of a business) which holds a licence authorising the operation of an electricity network and the provision of network access services in relation to that electricity network
Power and Water	means all of the businesses conducted by Power and Water Corporation in the NT electricity supply industry
Prescribed Business	means a business (or component of a business) carried on by Power and Water in the nature of: (a) the Network Operator; or (b) a Retailer supplying electricity to non-contestable customers; or (c) the System Operator; or (d) a Generator, until such time as the Commission is satisfied that: (i) Power and Water no longer has a substantial

degree of market power in the market for the generation of electricity for sale in respect of a particular geographical area; or

(ii) the Code should no longer apply to that business; or

(e) any other business which consists of the provision of any other goods or services in the NT electricity supply industry:

(i) to which the Regulations authorising the making of the Code extend to; and

(ii) which the Commission determines in accordance with clause 10.5 of the Code are non-contestable goods or services

Related Contestable Business	means any business (or component of a business), other than a Prescribed Business, carried on by Power and Water in the NT electricity supply industry
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
System Operator	means a business (or component of a business) which holds a licence authorising the provision of power system control and dispatch services in relation to any electricity network (other than in the capacity as an agent of, or service provider to, NEMMCO)
Third Party Competitor	means a Generator or a Retailer (whether identifiable, actual or notional) which either actually or potentially may be in competition with Power and Water

MINIMUM RING-FENCING REQUIREMENTS: RELATED PARTY GOODS AND SERVICES (CLAUSE 3.2)

11. Clause 3.2 of the Code obliges a Prescribed Business – in providing *any* goods or services to, or when receiving *any* goods or services from, a Related Contestable Business (“related party goods and services”) – to do two things:

- to ensure that these goods and services are provided or obtained on terms and conditions that are at **arm’s length**; and
- only if requested by the Commission, to provide the Commission with **reasonable particulars** of these terms and conditions within 30 days of receipt of the Commission’s request.

12. These obligations relate to any and all goods and services provided between a Prescribed Business and a Related Contestable Business. There are no exceptions.

Arm’s length

13. The meaning of “arm’s length” is dealt with in clause 10.3 of the Code.

14. To satisfy the “arm’s length” requirement, a related party transaction must **in fact** meet *each* of the following three requirements (under clause 10.3(b)(ii)):

- the parties must have dealt with each other in relation to negotiation and conclusion of the transaction as if they were unrelated to each other – this would require the parties concerned to each be represented in negotiations by a person or persons who is not also on the staff of the other party or a business unit that supplies goods or services to the other party;
- in these dealings, each party only takes account of the likely impact on the other party to the extent that would be prudent between unrelated parties – this would be evidenced by a written analysis as to why particular terms (proposed or counter-proposed) are in the party’s own interests; and
- the outcome is in fact a matter of real bargaining between the parties – this would require evidence of an offer and counter offer, of a process of negotiations between representatives of each party and of a recorded conclusion to the negotiations.

15. Arm’s length does not require that prices are fair and reasonable, or only recover efficient costs, and so does not preclude the exercise of some market power (buying or selling) by the Prescribed Business. Such possibilities are the subject instead of other regulatory instruments (including the *Trade Practices Act*), and not the Code.

Meaning of “in fact”

16. The words “in fact” are taken to mean that there must be evidence that the things being referred to actually took place or occurred, such as would be attested by a document trail.

Reasonable particulars

17. It is notable that clause 3.2(b) of the Code requires the Commission to be provided with “reasonable particulars” of the terms and conditions of the supply of related party goods and services. The Commission considers reasonable particulars to include (but not limited to):

- a description of the goods and services being provided or obtained by the Prescribed Business, being a description that sufficiently identifies each good or service and distinguishes it from other goods and services;
- the minimum performance standards to be met by the goods and services being supplied;
- any minimum or indicative annual purchase quantity obligations, by each good or service;
- which goods and services are bundled together for pricing purposes;
- the prices applying, including any within-period indexation or escalation arrangements;
- the length of the period/term of the arrangement, and the terms laid down for renegotiation of terms and conditions at the end of the supply arrangement;
- details of any actions or activities by one or other party prohibited under the terms of the arrangement;
- details of any actions or activities required to be undertaken by one or other party under the arrangement;
- the risks assigned to each party under the supply arrangement; and
- all other *material* non-price terms and conditions.

MINIMUM RING-FENCING REQUIREMENTS: RELATED PARTY TERMS FOR NOMINATED GOODS AND SERVICES (CLAUSE 3.3)

18. Clause 3.3 of the Code deals only with a particular *sub-set* of related party goods and services, namely those relating to **nominated goods and services** provided by a Prescribed Business to a Related Contestable Business.

19. For this sub-set of related party goods and services, the Code not only obliges a Prescribed Business to provide these goods and services to a Related Contestable Business on terms and conditions that are at arm's length (under clause 3.2), but *also* obliges the Prescribed Business (under clause 3.3):

- **to reduce to writing** the terms and conditions (including prices and terms and conditions relating to prices) on which the Prescribed Business provides such a good or service to a Related Contestable Business (“related party terms”);
- to provide the Commission with a copy of the related party terms (initially by 30 June 2009, and thereafter before any revisions take effect); and
- to ensure that these goods and services are only supplied to a Related Contestable Business consistent with the related party terms as lodged with the Commission.

20. It is noteworthy that the Code does not oblige a Prescribed Business to make its related party terms available to any party other than the Commission. The Prescribed Business may however choose to do so of its own volition.

Nominated goods and services

21. Schedule 3 of the Code sets out those goods and services which are to be regarded as nominated goods and services under the Code.

Wholesale generation services

22. Schedule 3 defines wholesale generation services as the generation of electricity by Power and Water for sale or supply to a Retailer.

23. Because nominated goods and services are defined in terms of goods and services supplied by a Prescribed Business to one of its Related Contestable Businesses, goods and services that are not supplied by the Prescribed Business to one of its Related Contestable Businesses are precluded from the definition of nominated goods and services. Thus, for the purposes of the Code, related party goods and services (and so wholesale electricity generation services) do not include ancillary services or standby or backup generation services. The terms and conditions upon which such excluded services are supplied to a Third Party Competitor are the subject instead of other regulatory instruments (including the *Trade Practices Act*), and not the Code.

24. For the purposes of the Code therefore, wholesale generation services only include the sale of wholesale electricity to a Retailer for on-sale to end-use customers.

Network access services

25. Schedule 3 defines network access services as those services defined in clause 3 of the NT Electricity Networks (Third Party Access) Code.

26. The NT Electricity Networks (Third Party Access) Code defines network access services as the services provided to network users by the Network Operator whether in the form of connection services or use of network services.

27. Thus, business to business (B2B) services are not included in the definition of network access services.

28. For the purposes of the Code, network access services are restricted to be those services that Power and Water currently provides:

- in connecting end users or a Generator to the network; and
- in the conveyance of electricity through the network.

To reduce to writing

29. The purpose of reducing the related party terms to writing is two-fold:

- to assist the Prescribed Business to ensure that the related party terms for the supply of key goods and services do, in fact, satisfy the at arm's length requirement – something which might be difficult to ensure or establish if such terms were not reduced to writing; and
- to provide the Commission with a point of reference should a Third Party Competitor lodge a complaint that the terms and conditions (including prices and terms and conditions relating to prices) on which a Prescribed Business is offering to supply the same type of goods and services to the Third Party Competitor are not comparable with the related party terms or are otherwise discriminatory, under clause 3.4 of the Code (see next section).

30. Reducing related party terms to writing is not intended to provide a Third Party Competitor with information about the nature of services they might expect to be offered by the Prescribed Business.

31. Written related party terms may fall short of executable contracts provided that the terms and conditions and the obligations on each party set out in an agreement would be capable of unambiguous interpretation and application by other industry participants were they to act as one or other party to the agreement. They must at least embody the “reasonable particulars” of the terms and conditions of the supply of related party goods and services as defined in paragraph 17 above.

MINIMUM RING-FENCING REQUIREMENTS: THIRD PARTY TERMS (CLAUSE 3.4)

32. The Code puts direct obligations on a Prescribed Business in relation to “third party terms” – that is the terms and conditions (including prices and terms and conditions relating to prices) on which the Prescribed Business provides goods and services to a Third Party Competitor – in relation only to a particular *sub-set* of goods and services, namely nominated goods and services.

33. For all goods and services provided by a Prescribed Business to a Third Party Competitor other than nominated goods and services, the Prescribed Business is only obligated (under clause 3.2):

- to ensure that such goods and services are provided to its Related Contestable Business on terms and conditions that are at *arm’s length*; and
- only if requested by the Commission, to provide the Commission with *reasonable particulars* of these terms and conditions within 30 days of receipt of the Commission’s request.

34. For nominated party goods and services only, the Code not only obliges that these goods and services be provided to a Related Contestable Business on terms and conditions that are at arm’s length (under clause 3.2) *and* consistent with written terms and conditions lodged with the Commission (under clause 3.3), but *also* obliges the Prescribed Business (under clause 3.4) both:

- to offer to supply **the same type** of goods and services to a Third Party Competitor; and
- to ensure that any offer to supply these goods and services to the Third Party Competitor is on **comparable terms**.

Meaning of “the same type”

35. The Code does not obligate a Prescribed Business to offer the same (i.e., identical) nominated goods and services to both its Related Contestable Business and a Third Party Competitor. Clause 3.4(a)(iii) of the Code merely obliges a Prescribed Business to offer to supply “the same type” of goods and services to any Third Party Competitor.

36. This means that:

- the Third Party Competitor is provided with some flexibility to seek the supply of a nominated good or service in the precise form which suits the method of its operations; and
- the Related Contestable Business can obtain a nominated good or service in the form which best suits the method of its operations.

37. Hence, the Code does not oblige the Prescribed Business to offer to supply a standardised set of nominated goods and services. It is the “type” of goods and

services which must be the same. Hence, it is the effect or purpose of the good or service, not its precise nature that is important.

38. This interpretation is reinforced by the distinction between clauses 3.4(b)(i)(A) and (B), which only makes sense if there are differences in the structure or content in the terms between the related party terms and the third party terms. The “comparable terms” requirement in clause 3.4(b)(i)(A) applies where there is direct comparison because of the similarity in the type of nominated good or service involved. The “non-discriminatory” requirement in clause 3.4(b)(i)(B) applies where there is no direct comparison on account of differences in the nominated good or service involved.

Comparable terms

39. The meaning of “comparable terms” is dealt with in Clause 3.4(b) of the Code.

40. The Code does not require that third party terms be identical in all respects to the related party terms, rather:

- that they be “no less favourable” and non-discriminatory; or
- that the Commission authorises differences on the grounds that they result from another applicable law or are “fair and reasonable” in the circumstances.

41. It is noteworthy that the Code does not oblige the Prescribed Business to develop a standard offer/terms/contract for nominated goods and services, including in advance of a request from a Third Party Competitor for the supply a nominated good or service. The Prescribed Business may however do so if it considers that it makes commercial sense or otherwise is good business practice.

42. If a Third Party Competitor is concerned that:

- the particulars of the related party terms appear more favourable than the third party terms it is being offered; or
- the Prescribed Business is not prepared to provide particulars of the related party terms to the Third Party Competitor as a point of comparison,

the Commission invites inquiries from the Third Party Competitor so that the Commission can undertake its own compliance investigation. The Commission will then develop and communicate its own assessment (in a manner consistent with the confidentiality requirements of the Code) regarding whether nominated goods or services are being supplied consistent with the related party terms and/or whether the third party terms being offered to the Third Party Competitor are no less favourable than the relevant related party terms. The Commission will provide its written assessment to both the Third Party Competitor and the Prescribed Business. The Commission will conduct such investigations in a timely manner, and will investigate and report in phases where necessary.