

**NT ELECTRICITY
RING-FENCING CODE
DECISION PAPER**

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GLOSSARY

Commission Act	<i>Utilities Commission Act</i>
Code	Northern Territory Electricity Ring-fencing Code
Commission	Utilities Commission
Consultation Paper	<i>Review of NT Electricity Ring-fencing Code: Proposed Variations</i> , Consultation Paper, February 2008
February Draft	Draft Third Version of the Northern Territory Electricity Ring-fencing Code issued for comment in February 2008
Issues Paper	<i>Possible Review of Certain Regulatory Instruments</i> , Issues Paper, August 2007
May Draft	Draft Third Version of the Northern Territory Electricity Ring-fencing Code issued for comment in May 2008
NT Treasury	Northern Territory Treasury
NTMEU	Northern Territory Major Energy Users Group
October Draft	Draft Third Version of the Northern Territory Electricity Ring-fencing Code issued for comment in October 2008
Power and Water	Power and Water Corporation
PWC Generation	Power and Water’s generation business unit
PWC Networks	Power and Water’s networks business unit
PWC Retail	Power and Water’s retail business unit
Reform Act	<i>Electricity Reform Act</i>
Response Paper	<i>Possible Review of Certain Regulatory Instruments</i> , Response Paper, January 2008

CHAPTER**1****BACKGROUND****Introduction**

1.1 The NT Electricity Ring-fencing Code was made in 2001 and came into force on 1 July 2001. The Code replaced an interim ring-fencing code. Minor definitional amendments were made to the Code in April 2002. Accordingly, the Code has been in operation for over six and a half years without detailed review. During this time, there have been considerable regulatory developments in relation to ring-fencing and other forms of regulatory structuring in the electricity supply industry (and other industries) elsewhere in Australia.

1.2 Accordingly, in January 2008, the Commission decided to undertake a major review of the NT electricity ring-fencing code.

Consultation paper February 2008

1.3 In February 2008, the Commission published a consultation paper “Review of the NT Electricity Ring-fencing Code: Proposed Variations” (the Consultation Paper) proposing a comprehensive revamping of the Northern Territory Electricity Ring-fencing Code. This possibility was first foreshadowed in the “Possible Review of Certain Regulatory Instruments” Issues Paper published by the Commission in August 2007 and confirmed in the Commission’s Response Paper published in January 2008.

1.4 In the Consultation Paper, the Commission proposed that it revoke the existing Code in its entirety, and promulgate a new version of the Code. A draft Code (hereafter referred to as the “February Draft”), showing how a final Code may look with the proposed variations incorporated, was also provided.

1.5 The Commission proposed to reissue a new code, rather than simply amend the existing Code, for two main reasons. The first is that, while based on the existing Code, the revised Code contains extensive amendments from the existing text, changes to nomenclature, and numbering and formatting changes. Secondly, it now common regulatory practice for new versions of regulatory documents to be reissued when extensive changes are made to them.

1.6 The February Draft proposed two main sets of changes to the Code.

1.7 First, the Commission proposed to expand the minimum ring-fencing obligations contained in the Code in a number of respects including in relation to the requirement relating to the basis which on a Prescribed Business carried on by Power and Water deals with a Contestable Business carried on by Power and Water (related-party contracts). It was also proposed that goods and services subject to a related-party contract must be provided to third parties who seek the same type of goods or services (third-party contracts) on terms which are fair and reasonable and non-discriminatory.

1.8 Secondly, the Commission proposed to introduce requirements relating to default terms and conditions for certain types of goods or services currently provided under related-party contracts. The purpose of this was to provide transparency as to the terms and conditions on which these goods or services are provided, and to enable third parties to have the option of acquiring the same goods or services from Power and Water on these default terms and conditions.

1.9 Submissions on the February Draft were received from:

- NT Major Energy Users Group (NTMEU); and
- Power and Water Corporation (Power and Water).

1.10 NT Treasury advised that they would defer its submission until a revised Draft Code was circulated.

May 2008 Draft Code

1.11 Following consideration of submissions received in response to the February Draft and its own further deliberations in consultation with its legal advisers, the Commission decided to proceed with the proposed variations to the Code, although with some further amendments to the proposed draft Code.

1.12 In May 2008, the Commission published a further paper “Review of the NT Electricity Ring-fencing Code: Proposed Draft Code”. This paper was the Commission’s formal notice in accordance with clause 7.4 of the Code that it has made a draft decision to proceed with the proposed variation. Again, a draft Code (hereafter referred to as the “May Draft”), showing how a final Code may look, was also provided.

1.13 The major revisions to the draft Code related to clarifying transitional issues and timelines and the adoption a less prescriptive approach to default terms and conditions.

1.14 While not accepting Power and Water’s argument that the Commission’s role in approving default terms and conditions and arms’ length contracts would go beyond the usual type of involvement by a regulator in commercial negotiations, and could expose Power and Water to action by the ACCC under the Trade Practices Act, the Commission noted that its involvement in approving default terms and conditions (and all variances between terms and conditions in the arm’s length (related-party) contracts and the approved default terms and conditions) was in contrast with the approved Procedures approach taken with regard to accounting separation, cost allocation and information sharing under the existing Code.

1.15 Accordingly, the May Draft removed the requirement for the Commission to approve in advance default terms and conditions and added the requirement for the development and approval of “Arm’s Length Contracting Procedures”.

1.16 The May Draft differed from the February Draft in a number of key respects.

1.17 First, provision was made for the phase in of arm’s length (third-party) contracts by Power and Water.

1.18 Secondly, in relation to both related-party and third-party contracts, the Commission’s role was redirected to the approval of processes to be followed by Power and Water rather than approval of the resultant contracts themselves, with an increased emphasis instead on the Commission’s compliance role.

1.19 Thirdly, in order to allow additional time to take into account the likely direction regarding the NT Government’s decisions regarding wholesale generation pricing arrangements, a nine month development period for draft “Default Terms and Conditions Procedures” was allowed, rather than the shorter development period proposed in the February Draft.

1.20 Finally, the Commission proposed an additional clause on ‘Decision Making, Public Consultation and Disclosure of Information by the Commission’, aimed at providing a comprehensive, but flexible, structure for public consultation by the Commission and the gathering of information which the Commission may require for its decision making. This clause included provision for the release of confidential information if, in the opinion of the Commission, there is a net public benefit.

1.21 Submissions on the May Draft were received from:

- Power and Water Corporation (Power and Water); and
- Northern Territory Treasury (NT Treasury).

October 2008 Draft Code

1.22 Following receipt of submissions on the May Draft, given that significant matters have been raised, the Commission decided to release a further draft for comment rather than going straight to a final decision. A revised draft Code (hereafter referred to as the “October Draft”) was released in October 2008.

1.23 The paper accompanying the October Draft Code re-iterated the rationale lying behind the main revisions to the Code and explained the positions taken by the Commission on the contentious issues.

1.24 The Commission again rejected Power and Water’s contention that the Commission would be acting beyond its powers in that the proposed Code has features that differ from ring-fencing codes in other jurisdictions.

1.25 The Commission noted that ring-fencing is achieved in different ways in different jurisdictions. In many places it has been achieved by requiring the different parts of the business to be conducted by separate entities. That has not happened in the Northern Territory. Further, in other jurisdictions, ownership and control of the distribution and transmission businesses is separated entirely from ownership of generation and retail businesses. That has not happened in the Northern Territory either.

1.26 The Commission re-iterated its position that there is no single model for ring-fencing. The regulation authorising the Commission to make a Code describes ring-fencing as the separate operation of related or associated businesses of a licensed entity in the electricity industry in the Northern Territory. To be effective, the Code has to be tailored to that industry. The fact that it is different from the model used in other places overlooks this important point.

1.27 However, in light of other views expressed in submissions, the Commission proposed further modifications and refinements to the Draft Code.

1.28 It was argued to the Commission that the requirement made of Power and Water in the February and May Drafts to prepare default contracts for the supply of services from the regulated part of the business to third parties would, among other things, impose an excessive operational burden on Power and Water.

1.29 After consideration, the Commission accepted these arguments and decided, on practical grounds, to delete the default third-party contract provisions from the revised draft Code attached to this Paper. To compensate, the October Draft clarified and made more practical the provisions relating to related-party contracts.

1.30 The October Draft retained the requirement that the terms and conditions of related party contracts be reduced to writing.

1.31 The confidentiality regime proposed in the May Draft was criticised on a number of grounds. The Commission accepted NT Treasury suggestion that a review of the relevant sections of the *Commission Act* would be a more effective approach and foreshadowed its intention to recommend to the Regulatory Minister that a provision similar to the public

interest exception to the regulator's obligation of confidentiality that currently exists under the National Electricity Regime and in the legislation in each of South Australia, Victoria and Queensland be inserted into the *Utilities Commission Act*. The relevant provisions relating to release of confidential information were therefore deleted from the October Draft.

1.32 Submissions on the May Draft were received from:

- Power and Water Corporation (Power and Water); and
- NT Major Energy Users Group (NTMEU).

Views in submissions on October Draft

1.33 The submissions received in relation to the October Draft Code did not raise any substantive issues that the Commission considered warranted further substantial redrafting of the proposed Code.

1.34 The NTMEU applauded the Commission's review process, noting that

"...it has provided stakeholders with ample opportunity to present views and to debate with the Commission. This interactive process has been facilitated by well-presented arguments, which comprehensively cover the range of views present."

1.35 The NTMEU agreed with the Commission that the scope of the new revised Code is consistent with best practice as adopted in other Australian jurisdictions. Many NTMEU members operate in other Australian jurisdictions and agreed with the Commission on the requirement to prepare formal contracts for the supply of services from the regulated part of the business to an unregulated part, and to have the terms of these contracts approved by the Commission.

1.36 Power and Water raised some issues regarding clarification of the Commission's intentions and interpretations of the Code, but did not request amendments to the Code.

1.37 Power and Water submitted that:

"it accepted and supported, principally:

- *The removal of default third-party contract provisions;*
- *The removal of confidential information provisions; and*
- *The amendment to the third-party customer mandated terms and conditions."*

1.38 Power and Water noted, however, that:

"...amendments relating to nominated goods or services, particularly clause 4.1(a) of the Proposed Draft Code, would require significant internal work in order to meet these requirements and were open to significant interpretation. Power and Water sought clarification on the bounds of these amendments."

1.39 The Commission considers that all substantive concerns raised in Power and Water's submission are most appropriately addressed in guidelines to be developed and issued under clause 1.6 of the Code, which authorises the Commission to publish guidelines relating to the "application or interpretation" of the Code. The Commission flagged its intention to issue draft guidelines soon after commencement of the revised Code.

Final Decision

1.40 The Commission's Final Decision is that it will revoke the existing Code in its entirety, and promulgate a new version of the Code in the form of the Code as set out in Chapter 3 of this paper.

1.41 The final Code is the draft Code issued for comment in October 2008 with the following amendments:

- (a) clause 3.3(a)(iv) provides that, in addition to providing a copy of its related party terms and conditions to the Commission within 6 months of the commencement date of the revised Code, if the related party terms are subsequently revised then the revised related party terms must be provided to the Commission prior to the date on which any revisions take effect; and
- (b) clause 3.4(a) provides that if a prescribed business provides any nominated goods or services to a related contestable business then it must also offer to supply the same type of nominated goods and services to other customers.

CHAPTER**2****NT ELECTRICITY RING-FENCING CODE
PLAIN ENGLISH HIGHLIGHTS**

This “Plain English” highlights version of the Code has been produced as a high-level summary setting out the requirements and obligations imposed by the Code in a communication style more suitable for a general audience. It attempts to simplify the legal style of the Code that may be difficult for laypeople to read and understand.

While the Commission has taken all reasonable care in preparing the ‘Plain English’ document, it is provided for the purpose of general guidance only. Interested parties should refer to the Code itself rather than rely on the highlights document.

NT ELECTRICITY RING-FENCING CODE

SUMMARY

Version 3
1 January 2009

Background

The Utilities Commission of the Northern Territory (“*the Commission*”) is empowered to develop and publish a Ring-Fencing Code, monitor compliance with that Code, and enforce that Code.

The NT Ring-Fencing Code applies to the Power and Water Corporation (“*PWC*”).

“*Ring-fencing*” involves the operational separation of PWC’s monopoly and contestable electricity businesses, in order to minimise barriers to competition.

Breaches of the Code are breaches of the conditions imposed by PWC’s licence. The *Electricity Reform Act 2000* provides for licence condition breaches to attract fines of up to 2500 penalty points (\$275,000 as at 1 January 2009) per breach or withdrawal of the licence.

Version 2 of the Code commenced on 29 April 2002. This version 3 has effect from 1 January 2009. The provisions added to version 3 are of two types:

- additional ring-fencing obligations on PWC, highlighted below as follows: **additional obligations**; and
- additional guidance to PWC, highlighted below as follows: **additional guidance**.

All text which is not highlighted below describes provisions which are unchanged from those in Version 2 of the Code that commenced on 29 April 2002.

Distinguishing between monopoly and contestable businesses

PWC is what is called a vertically integrated business. It operates businesses within the NT’s electricity supply industry at each stage of the supply chain: generation, networks, system control and retail.

A fundamental distinction in the Code is between two types of electricity businesses run by PWC: monopoly businesses (termed in the Code as “Prescribed Businesses”) which are businesses where there is only one party allowed to operate that type of business, and contestable businesses (termed in the Code as “Related Contestable Businesses”) which are businesses where any party appropriately licensed may operate that type of business and compete with other providers.

For the purposes of the Code, a “*Monopoly Business*” means:

- PWC’s electricity networks business;
- that part of PWC’s electricity retail business which sells electricity to non-contestable customers;
- in respect of the market for the generation of electricity for sale in a particular geographical area, PWC’s electricity generation business while it possesses a substantial degree of market power in that market; and
- PWC’s power system control business, **other than in the capacity as an agent of, or service provider to, NEMMCO**.

For the purposes of the Code, “**Contestable Business**” means any business carried on by PWC in the electricity supply industry other than a Monopoly Business, namely:

- that part of PWC’s electricity retail business which sells electricity to contestable customers; and
- in respect of the market for the generation of electricity for sale in a particular geographical area, PWC’s electricity generation business for such time as it does not possess a substantial degree of market power in that market.

Objectives and scope of the Code

The objectives of the Code are to:

- promote and safeguard competition and fair and efficient market conduct in the NT electricity supply industry; and
- achieve an appropriate balance between the public benefits of requiring PWC to comply with the Code and the administrative costs of doing so.

The Code:

- requires PWC to comply with certain minimum ring fencing obligations;
- specifies what those the minimum ring fencing obligations are; and
- establishes a mechanism for the development and approval of certain accounting procedures, cost allocation procedures and information procedures with which PWC must comply.

Minimum Ring-Fencing Obligations

The following obligations placed on PWC are required to ensure that PWC’s Contestable Businesses are not treated by its Monopoly Businesses in a manner which confers a non-commercial, discriminatory advantage on the Contestable Business over any Competitor.

“**Competitor**” means an entity (whether identifiable, actual or notional) which either actually or potentially may be in competition with PWC in the NT electricity supply industry.

(1) Financial Accounts

PWC must:

- establish and maintain a separate set of financial accounts and reports in respect of:
 - each Monopoly Business; and
 - its electricity business as a whole,which have been prepared in accordance with accounting procedures approved by the Commission; and
- allocate any costs that are shared between a Monopoly Business and a Contestable Business in a manner that:
 - complies with cost allocation procedures approved by the Commission; and
 - is otherwise fair and reasonable.

(2) Related Party Goods and Services

Where PWC provides any goods or services of a Monopoly Business to a Contestable Business, or vice versa, it must ensure that such related party goods and services are provided on terms and conditions that are at arm's length. That is, the Monopoly Business must treat the Contestable Business no differently than it would treat any third party business seeking similar goods and services.

A transaction between related parties is only at “*arm's length*” if in fact:

- the parties to the transaction have dealt with each other in relation to negotiation and conclusion of the transaction as if the parties were unrelated to each other;
- each party, in relation to the dealings between the parties in relation to the transaction, takes no account of the commercial circumstances of or likely benefits accruing to the other parties from the transaction other than to the extent that would be prudent between unrelated parties; and
- the outcome of the dealings between the parties in relation to the transaction is a matter of real bargaining between the parties.

If requested by the Commission, PWC must provide the Commission with such particulars concerning the terms and conditions on which related party goods and services are provided as are necessary for the Commission to assess whether those terms and conditions are at arm's length, within 30 days of receipt of the Commission's request.

(3) Provision of nominated goods or services of a Monopoly Business to a Contestable Business

In addition, where PWC provides any nominated goods or services of a Monopoly Business to a Contestable Business, it must:

- reduce to writing in the form of a contract or contract-like agreement the terms and conditions (including prices and terms and conditions relating to prices) on which it supplies those nominated goods or services to a Contestable Business (*'related party terms'*);
- provide a copy of its related party terms to the Commission by 30 June 2009; and
- ensure that those nominated goods or services are only supplied by the Monopoly Business to a Contestable Business on terms and conditions which are consistent with the related party terms (as if the Monopoly Business and the relevant Contestable Business were conducted by separate legal entities and the related party terms constituted a contract between the Monopoly Business and that Contestable Business for the supply of those goods and services).

“*Nominated goods and services*” relate to certain core functions of PWC, and cover:

- the generation of electricity by PWC for sale or supply to a licensed retailer of electricity (“wholesale electricity generation services”); and
- the connection services or use of network services provided to network users by PWC (“network access services”).

(4) Offers to provide nominated goods or services to a competitor of a Contestable Business

Furthermore, where PWC provides any nominated goods or services of a Monopoly Business to a Contestable Business, it must:

- also offer to supply the same type of nominated goods and services to a competitor of that Contestable Business; and
- ensure that any offer to supply the same type of nominated goods or services to that competitor is on comparable terms.

“**Comparable terms**” are terms and conditions of an offer to supply the same type of nominated goods or services that either:

- are no less favourable to the competitor than the relevant related party terms and are non-discriminatory; or
- have otherwise been approved by the Commission.

Terms and conditions upon which goods or services are provided or offered are “**non-discriminatory**” if the terms or conditions:

- do not unreasonably discriminate between:
 - different customers or classes of customers; or
 - PWC’s Contestable Business and any Competitor; and
- do not unreasonably disadvantage (whether competitively or financially) a Competitor compared with a Contestable Business.

However, non-discriminatory does not always mean the terms and conditions (including terms and conditions relating to prices) must be identical. There may be valid commercial reasons for terms and conditions to differ between customers.

When requested to do so, the Commission will approve as comparable terms proposed terms and conditions of supply that differ from the related party terms for the same type of nominated goods or services only if:

- the differences result from the application of another applicable law to the supply of the relevant type of nominated goods and services; or
- the Commission concludes that the differences are fair and reasonable in the circumstances having regard to:
 - the particular characteristics of the relevant type of nominated goods or services; and
 - the commercial impact on the Monopoly Business of the proposed terms and conditions of supply having regard to such matters as the duration of the proposed contract for the supply of the relevant nominated goods or services, the likely consumption of the Monopoly Business’s resources in fulfilling the proposed contract, or the credit risks associated with the proposed contract.

(5) Marketing Staff

PWC must ensure that the marketing staff of its Monopoly Businesses are not also used as marketing staff for its Contestable Businesses.

(6) Branding and marketing

PWC must brand and market itself in a manner that minimises any potential for customer confusion between its Monopoly Business and a Contestable Business.

(7) Claims about service standards

PWC:

- must not market to customers any goods or services in the electricity supply industry offered or provided by the Contestable Business based on the reliability, quality, safety or other attribute of the goods or services provided by one of its Monopoly Businesses; and
- must confine any representations it makes to customers about the service standards of any goods or services in the electricity supply industry provided by the Contestable Business to those associated with those goods or services directly provided by the Contestable Business.

(8) Websites

PWC must:

- identify on each page of its website whether the Monopoly Business or the Contestable Business is responsible for the contents of that page; and
- separate the contents of the website dealing with a Monopoly Business from the contents of the website dealing with the Contestable Business as far as practicable.

(9) Confidential Information

PWC must ensure that confidential information provided to a Monopoly Business by or in respect of a customer is:

- used only for the purpose for which that confidential information was provided; and
- only disclosed to its Contestable Business if the disclosure of that confidential information is not prohibited under information procedures approved by the Commission or disclosure is otherwise permitted by law, and is otherwise dealt with in accordance with those information procedures.

PWC must also ensure that any information (including confidential information):

- obtained in the course of, or known as a result of, conducting a Monopoly Business; and
- which might materially affect the commercial interests of a Competitor of its Contestable Business if disclosed to that Contestable Business or which might provide a competitive advantage to its Contestable Business over a Competitor if disclosed to that Contestable Business without also being disclosed to that Competitor,

is:

- used only for the purpose for which that information was provided or obtained; and
- only disclosed to its Contestable Business if the disclosure of that information is not prohibited under information procedures approved by the Commission or is otherwise

permitted by law, and is otherwise dealt with in accordance with those information procedures.

CHAPTER

3

NT ELECTRICITY RING-FENCING CODE

