Record No: D2008/234371
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Mr Alan Tregilgas
Utilities Commissioner
Utilities Commission
3rd Floor, 38 Cavenagh Street
Darwin NT 0801

Dear Alan

Re: Proposed Draft Electricity Ring-Fencing Code

Power and Water's submission on the Utilities Commission's Proposed Draft Electricity Ring-Fencing Code is at Attachment A. The changes proposed by the Commission are significant and I appreciate the additional time given by the Commission for Power and Water to prepare its response.

Power and Water has consulted with external advisers in preparing this submission, particularly with respect to matters of law raised by the proposed amendments. The three key areas of concern for Power and Water relate to timing in the context of broader electricity market reforms by the Northern Territory Government; the Commission exceeding its powers in the application of the Proposed Draft Code; and that the proposed Code is practically unworkable and inconsistent with generally accepted regulatory practice. By unworkable, we mean that it is simply impossible for Power and Water to comply with some of the Code's terms, regardless of effort and resources. This cannot be the Commission's intention.

As you are aware, Power and Water's Chairman has written to the Treasurer to convey these views.

I am hopeful that the Commission will take Power and Water's comments into full consideration in its further deliberations concerning the Proposed Draft Code.

If you have any further queries in relation to this matter please do not hesitate to contact Ms Djuna Pollard, Manager Regulation, Pricing and Economic Analysis, on (08) 8985 8431 or by email at djuna.pollard@powerwater.com.au.

Yours sincerely

Andrew Macrides
Managing Director
July 2008

Attachment A

POWER AND WATER CORPORATION

SUBMISSION TO THE UTILITIES COMMISSION ON THE REVIEW OF THE NT ELECTRICITY RING-FENCING CODE

PROPOSED DRAFT CODE – MAY 2008

JULY 2008

Contents

1 Executive Summary

Power and Water welcomes the opportunity to provide a submission to the Northern Territory Utilities Commission (Commission) in response to its "Review of the NT Electricity Ring-Fencing Code Proposed Draft" (Proposed Draft Code), released on 20 May 2008. This follows the release of the consultation paper "Review of the NT Electricity Ring-fencing Code: Proposed Variations" by the Commission in February 2008. Power and Water responded to the Commission's consultation paper in March 2008 highlighting its concerns with some aspects of the proposed changes.

This document is Power and Water's submission to the Commission's Proposed Draft Code.

Power and Water notes that it places a high priority on complying with the current NT Electricity Ring-fencing Code (Current Code), which has been in force since 2001 and that it does not support the Commission's decision to revoke the Current Code and promulgate a final version of the Code based on the Proposed Draft Code.

Power and Water has three key concerns with the Proposed Draft Code, specifically that:

1. The Current Code should not be amended until the Northern Territory Government has decided on the broader electricity industry reform program. This is because:
    - Any amendments to the existing Code by the Commission may not be consistent with the Government's ultimate reform objectives or the nature of other regulatory reforms that the Government may choose to adopt, including national arrangements; and
    - It would impose an additional unnecessary burden on Power and Water by requiring it to change its operating arrangements to comply with potentially two sets of regulatory changes – first the Commission's and then later the Government's.
2. The Commission is acting beyond its powers in two respects:
    - In extending the Code to mandate terms and conditions on which Electricity Entities must contract with third party customers and in deeming outsourced service providers to be bound by the Code as though they were the Electricity Entity to whom they provide services; and
    - The amendments in the Proposed Draft Code that would allow the Commission to release confidential information provided to it if, in the opinion of the Commission, there is a net public benefit, is inappropriate and in breach of confidentiality requirements.

3. There would be practical difficulties in attempting compliance with some of the new requirements, notwithstanding that some of the proposed amendments are inconsistent with generally accepted regulatory practice. For example:

   - By using its powers under Regulation 2 of the Utilities Commission Regulations to revoke the existing Code and promulgate the Proposed Draft Code, the Commission is going beyond its role as a regulator of ring-fencing issues and is instead undertaking regulatory reform in areas which are outside the traditional ambit of ring-fencing in a way which is inconsistent with generally accepted regulatory practice;
   - Amendments relating to nominated goods or services, particularly clause 4.1(a) of the Proposed Draft Code, impose requirements which are overly burdensome on Power and Water and require further clarification and explanation;
   - In its Proposed Draft Code the Commission has given effect to a range of provisions which extend beyond the boundaries of conventional ring-fencing issues, including in relation to the unduly prescriptive management of the terms and conditions of supply of goods and services between Power and Water's prescribed businesses and other related contestable businesses; and
   - The service classifications in the Proposed Draft Code are not consistent with the Commission's *"Price Control Mechanism Final Decision Paper"* released in May 2008, which establishes the regulatory framework for the 2008-09 Networks Revenue Reset.

Power and Water supports transparent and public discussion in relation to the effectiveness of the Current Code but does not consider that there is a strong basis for changing the Current Code at this stage. In particular:

- There have been no serious instances of non-compliance by Power and Water with the Current Code since its introduction in 2001. Power and Water has identified and brought to the Commission's attention the only two technical incidents of non-compliance, together with prompt corrective action in relation to these incidents; and
- There have been no formal complaints from retailers or other entities in relation to the existing ring-fencing provisions. The findings of the Allen Consulting Group in its review of Power and Water's cost allocation policies and practices related to policy matters and not ring-fencing matters.

As a consequence, Power and Water queries whether there is, in an absolute sense, any 'problem' to be solved by the Commission's promulgation of the Proposed Draft Code, at this time.

2 Introduction

2.1 Background

The Commission's "Review of the NT Electricity Ring-Fencing Code Proposed Draft" (Proposed Draft Code) follows the release of the consultation paper "Review of the NT Electricity Ring-fencing Code: Proposed Variations" (Consultation Paper) by the Commission in February 2008.

Power and Water responded to the Consultation Paper in March 2008 highlighting its concerns with some aspects of the proposed changes. Broadly, Power and Water's main points in that submission were that:

- Power and Water places a high priority on complying with the Code and working openly with the Commission;
- Many of the changes (proposed by the Commission) may have merit, but have the potential to impose substantial costs on Power and Water. Power and Water submitted that these costs should be borne in mind by the Commission, and that any decision to proceed with the changes must be informed by information on costs;
- Considerable time will be required to manage the transition from the existing Code to the new Code properly. Specifically, Power and Water noted that:
    - Defining coverage of the proposed Code would, in itself, be a major piece of work, at a time when resources are dedicated to major projects such as the 2009 Networks Regulatory Reset;
    - Consideration may need to be given to a risk-based approach to ring-fencing and staff awareness training, as opposed to all staff. This would require changes to the existing Information Procedures and a risk assessment and identification of key staff affected; and
    - A number of amendments will be required to the Accounting and Cost Allocation Procedures to reflect the proposed variations and to align with requirements under the Australian International Financial Reporting Standards.

The Proposed Draft Code has not addressed these matters adequately and has introduced further flaws, which is the basis of this submission.

2.2 Purpose of this submission

The purpose of this submission is to identify issues that Power and Water considers the Commission should have regard for in finalising its amendments.

The remainder of this submission is structured as follows:

- Section 3 sets out the reasons why the Code should not be amended until the Government has progressed the broader Northern Territory electricity industry reform program;

- Section 4 overviews why the Commission is acting beyond its powers by extending the Code's application to "third parties" including customers and "outsourced service providers"; and

- Section 5 sets out concerns regarding the practical application of some of the amendments in the Proposed Draft Code, and also where the amendments have not been based on regulatory precedent. Specifically:

    - The amendments in the Proposed Draft Code that would allow the Commission to release confidential information provided to it if, in the opinion of the Commission, there is a net public benefit, is inappropriate and in breach of confidentiality requirements;

    - The Commission is going beyond its role as a regulator of ring-fencing issues and is instead undertaking regulatory reform in areas which are outside the traditional ambit of ring-fencing in a way which is inconsistent with generally accepted regulatory practice;

    - Amendments relating to nominated goods or services, particularly clause 4.1(a) of the Proposed Draft Code, impose requirements which are overly burdensome on Power and Water and require further clarification and explanation;

    - The Commission has given effect to a range of provisions which extend significantly beyond the boundaries of conventional ring-fencing issues; and

    - Amendments to the Proposed Draft Code are unclear and in some cases flawed or inconsistent with existing work being done by the Commission.

3 Context of Broader Government Electricity Reform Program

The Commission's review of the Ring-Fencing Code is occurring in an environment where Government is considering major reforms to the Northern Territory electricity industry.

In considering the need for major reforms to the Northern Territory electricity industry, Government has made a number of observations which are pertinent in assessing the need for, and design of, any new ring-fencing regime, including that:

- The challenge for the Government is to introduce institutional and regulatory arrangements that strike a balance between the prospect of meaningful competition in the future, and the physical factors that have impeded competition to date, while in the interim to put in place effective incentives for the efficient and reliable provision of electricity services;

- Adopting the institutional and regulatory arrangements set out in the Australian Energy Market Agreement (AEMA), and applied in all jurisdictions except the Northern Territory and Western Australia, is the best option available to the Government to foster competition, efficiency and consumer confidence;

- Successful implementation of the national framework is subject to the availability of transitional arrangements, or conditions, to accommodate those physical characteristics of the Northern Territory that impose specific constraints on electricity supply and regulation. These transitional conditions are:

    - Northern Territory specific generation and network technical parameters, system operating standards and market monitoring requirements, including the option for retail price monitoring;
    - No impediments to retaining Power and Water as a vertically integrated electricity generation, networks and retail business, unless it becomes clear that the benefits of legal or structural separation outweigh the costs;
    - Provision for the Territory Government to introduce local measures that are complementary and supplementary to the national framework if deemed necessary to foster competition and efficiency, such as a price monitoring regime for large consumers and a local statutory body with responsibilities for setting and monitoring service standards across the Northern Territory; and
    - Provision for a complementary institutional and regulatory framework for regional and remote areas to improve transparency in electricity infrastructure investment and pricing decisions.

In order for the Government to introduce the institutional and regulatory arrangements set out in the AEMA, it will need to first decide the extent to which the "National Electricity Rules" can be applied in the Northern

Territory and then design derogations from these Rules which are appropriate within the context of the Northern Territory.

These are significant reform objectives which will result in a legislative and regulatory framework in the Northern Territory that bears little or no resemblance to that in operation today. This would in turn alter the nature of the functions performed by, and obligations faced by, Power and Water as a participant in that market.

The principal impacts on Power and Water could be as significant as:

- Power and Water System Control no longer being required, as its current functions could be taken over by the National Electricity Market Management Company (NEMMCO);

- Power and Water Generation facing new compliance and system operation responsibilities under the National Electricity Rules, including interface with NEMMCO, trading responsibilities and new ancillary services requirements which would impose additional costs compared to the current arrangements;

- Power and Water Networks being regulated by the Australian Energy Regulator (AER) which would in turn revise all of the regulatory instruments, including the Ring-Fencing Code, in setting distribution prices consistently with the framework already in place for other NEM jurisdictions; and

- Power and Water Retail facing new market risk and regulatory responsibilities including having to register as a 'market customer' with NEMMCO and being obligated to meet a range of new requirements.

Such legislative and regulatory change will therefore be a two stage process for Government which will likely span several years, comprising first an assessment of the extent to which the national arrangements can feasibly be superimposed onto the Northern Territory, and secondly in determining how this might be done and with what derogations. Concurrently with, and in response to, this regulatory reform process Power and Water will need to embark on internal process reviews and reforms, cultural change and compliance programs to ensure that it can "keep up" with the reform process, comply with new regulatory instruments and compete effectively in the new market. Ring-fencing will be a very small part of this, especially given that the Current Code is in effect and establishes high level principles which are almost identical to that operating in the NEM, as set out later in this submission.

The Northern Territory Government is only in the first stage of its reform process. Early indications are that elements of the national regime can be tailored to the Northern Territory, but there is no detail at this stage as to which elements or how. Government has not yet considered the range of legislative and regulatory instruments that will need amendment, how they might be amended, and how these changes will impact on the overall objectives of reform.

Given this, now is not the appropriate time for the Commission to review the Code. A more appropriate time would be to wait until the Government has further progressed its reform program, assessed its objectives and communicated its policy needs to the Commission for implementation.

Power and Water:

- Considers there is significant benefit in waiting until Government has finalised its policy development before determining what, if any, amendments are required to the Current Code. There have been no material instances of non-compliance and there are no retailers that could be disadvantaged by the ordinary operation of the Current Code. There is therefore no urgent need to change. On the other hand, designing and implementing a Code which turns out to be inconsistent with the direction subsequently taken by Government policy, or the remainder of the regime once reform has taken place, will render the Commission's effort redundant and possibly stall the reform process; and

- Notes that the national reform process is still ongoing. Indeed, since the Commission commenced reviewing the Code, more national reforms have been announced which will in turn require review by the Northern Territory Government. In June 2008, the Ministerial Council on Energy issued a policy paper for the National Energy Customer Framework[1], which is proposed to form a single national framework for regulating the supply of electricity (and gas) to retail customers. This Framework references similar issues to that being pursued (by the Commission), arguably beyond its power in relation to a Ring-Fencing Code, such as customer protection arrangements.

[1] MCE A National Framework for Regulating Electricity and Gas (Energy) Distribution and Retail Services to Customers, June 2008. Found at http://www.mce.gov.au/assets/documents/mceinternet/MCE%5FSCO%5FNational%5FFramework20080613111731%2Epdf

4 Areas Where the Proposed Code is Outside Powers

4.1 Application of the Proposed Draft Code to Third Parties

The Commission has a general power to revoke the existing Code in its entirety and promulgate a new version of the Code in the form of the Proposed Draft Code. These powers are dealt with in Regulation 2 of the Utilities Commission Regulations 2001 (NT) which states:

> *(1) The Utilities Commission is authorised to make a code relating to ring fencing in a regulated industry.*
>
> *(2) In subregulation (1) – "ring fencing" means the separate operation of related or associated businesses of a licensed entity in a regulated industry.*

However, the Commission is acting beyond its power in seeking to use the Code to require prescribed businesses to offer to enter into contracts with "third parties" on the basis of default terms and conditions that have been approved by the Commission.

Clause 4.1 and clause 6.2 of Schedule 1 to the Proposed Draft Code (the Third Party Contract Requirements) require an Electricity Entity that carries on a Prescribed Business in the Northern Territory to develop and publish default terms and conditions for each of the nominated goods or services of the Electricity Entity. The default terms and conditions must:

(a) Set out each of the terms and conditions (including prices and terms and conditions relating to prices) upon which the relevant goods or services would be provided or offered to a Customer (including a Related Contestable Business of that Electricity Entity) by a Prescribed Business of that Electricity Entity;

(b) Be offered to any Customer seeking to be provided with those goods or services (although the parties are not precluded from entering into a negotiated agreement).

The Commission has the power to regulate through the Code ring-fencing issues which entrench the separate operation of related or associated businesses of a licensed entity in a regulated industry. However, the Commission's power under the *Utilities Commission Act* and Regulations does not extend to regulating, particularly at this micro level, how the related or associated businesses of a licensed entity in a regulated industry must interact with third parties. In addition, the decision of the Commission to regulate Power and Water in this way is without precedent – no other ring-fencing arrangements (as distinct from consumer protection arrangements, which put in place default contracts for supply to certain classes of customers or photovoltaic buy-back arrangements such as in South Australia, as noted in section 2.28 of the Consultation Paper) in any

other jurisdictions regulate contractual arrangements between an integrated entity and third parties for ring-fencing purposes. [2]

Power and Water submits that the Code should be limited to dealings only between an Electricity Entity's Prescribed Businesses and its related or associated businesses. This is consistent with the definition of 'ring-fencing' used in the Utilities Commission Regulations.

In addition, Clause 10.1 of the Proposed Draft Code requires an Electricity Entity which uses an Outsourced Service Provider to perform any of its business functions in relation to a Prescribed Business of that Electricity Entity to ensure that the Outsourced Service Provider complies with the Code as if it were the Electricity Entity. This obligation could potentially operate to require an Electricity Entity to ensure that its Outsourced Service Provider adheres to the Code in respect of all of the Outsourced Service Provider's other dealings including its dealings with third parties unrelated to the Electricity Entity. This is clearly not the intended operation of this requirement and extends significantly beyond the requirements of any other ring-fencing arrangements in any other jurisdiction in Australia.

Power and Water submits that clause 10 should be amended to provide that, even where an Electricity Entity sub-contracts or outsources any of its business functions in relation to a Prescribed Business, the Electricity Entity is still required to comply with the Code in relation to the sub-contracted or outsourced business functions. This will clarify that:

(a) The intended scope of this requirement is only in relation to sub-contracting or outsourcing of a business function in relation to a Prescribed Business; and

(b) The obligation to comply with the Code remains imposed on the Electricity Entity, rather than the Outsourced Service Provider.

Power and Water considers that by extending the Code's application to “third parties” the Commission is acting beyond its powers because:

- Ring-fencing relates to "the separate operation of related or associated businesses of a licensed entity in a regulated industry"[3]; and
- A Ring-fencing Code should therefore only deal with arrangements between business divisions within an integrated electricity entity in order to promote effective competitive neutrality and non-discriminatory behaviour. Such a Code should not deal with a contractual relationship between an Electricity Entity and unrelated third parties, such as a customer or “outsourced service provider”.

[2] Power and Water's review considered ring-fencing arrangements in NSW, Queensland, Victoria and South Australia.

[3] See the definition of "ring fencing" in Regulation 2(2) of the Utilities Commission Regulations.

4.2 Confidential Information

Power and Water considers that the amendments in the Proposed Draft Code that would allow the Commission to release confidential information provided to it if, in the opinion of the Commission, there is a net public benefit, is inappropriate and in breach of confidentiality requirements. Power and Water is strongly opposed to these amendments.

Clause 13.6 of the Proposed Draft Code empowers the Commission to disclose confidential information provided to it where:

(a) The disclosure is authorised under section 26(2) of the *Utilities Commission Act*; or

(b) Where the Commission is of the opinion that:

- The disclosure of the confidential material would not cause detriment to the disclosing person or any other person; or

- Although the disclosure of the confidential material may cause detriment to the disclosing person or any other person, either:

    - The public benefit in disclosing it outweighs the detriment;
    - Disclosure would better promote or achieve the objectives of the Code; or
    - Disclosure is necessary or desirable in order to enable the Commission to perform more effectively its functions under the Code.

Section 26(1) of the *Utilities Commission Act* provides that *information gained under the Act* that could affect the competitive position of a licensed entity or other person or is commercially sensitive for some other reason is, for the purposes of the Act, confidential information. Section 26(2) of the Act sets out the circumstances in which confidential information can be disclosed. Those circumstances do not extend to the grounds set out in clause 13.6(c)(ii) of the Proposed Draft Code.

Power and Water's legal advice is that clause 13.6 is an inherently invalid provision of the Proposed Draft Code because of its inconsistency with section 26(2) of the *Utilities Commission Act*, and that it should be deleted from the Proposed Draft Code. Instead, the capacity of the Commission to deal with confidential information and the rights and obligations of the Commission relating to that information should be left to section 26 of the *Utilities Commission Act*.

Power and Water's legal advice also suggests that the Commission does not have the power to insert into the Proposed Draft Code provisions dealing with the rights and obligations of the Commission with respect to the preservation of confidentiality. This is because the rights and obligations of

the Commission in this regard are fully dealt with by section 26(2) of the Act. Power and Water's legal advice suggests that the specification in the Proposed Draft Code of any provisions that are inconsistent with these requirements will be beyond the power of the Commission and result in legal invalidity.

In particular, Power and Water's legal advice suggests that the Commission has no power under the Act to use the Proposed Draft Code as an instrument to "extend the legal authorisation given to the Commission to disclose confidential information in certain circumstances" (Explanatory note for clause 13.6). This is because as a recipient of a statutory power, the Commission must not stray beyond the extent of the power granted by the Act.

The grounds for disclosure set out in clause 13.6 go well beyond the circumstances that the Act identifies as permitted disclosures of confidential information. Power and Water's legal advice suggests that these should be deleted.

5 Practical Workability and Inconsistency With General Regulatory Precedent

5.1 The Commission as instigator of regulatory reform in areas outside the traditional ambit of ring-fencing

Power and Water notes that the Commission is using the discretion available to it under Regulation 2 of the Utilities Commission Regulations to revoke the existing Code and promulgate the Draft Code. Regulation 2 states:

> *(1) The Utilities Commission is authorised to make a code relating to ring fencing in a regulated industry.*
>
> *(2) In subregulation (1) – "ring fencing" means the separate operation of related or associated businesses of a licensed entity in a regulated industry.*

In doing so, the Commission is:

- Giving effect to a range of provisions which extend significantly beyond the boundaries of traditional ring-fencing requirements. Conventionally, ring-fencing relates only to issues such as accounting separation, cost allocation, controls over information flows and arrangements between prescribed businesses and related businesses[4]. This is discussed in detail in section 5.2 of this submission; and
- Going beyond its role as a designer and enforcer of ring-fencing requirements and is undertaking the role of regulatory reform beyond the traditional parameters of ring-fencing. This is because the Commission is implementing market reform under the banner of ring-fencing regulation.

In relation to the latter point, in the National Electricity Market (NEM), institutional arrangements have been developed to ensure a clear separation of powers - i.e. separation of the "rule maker" and "rule administrator", as it is explicitly acknowledged that this is essential if regulatory outcomes are to be consistent, transparent and predictable[5].

Power and Water notes, however that even where the Commission is acting within its power under the Northern Territory framework and in particular Regulation 2 of the Utilities Commission Regulations, it does not consider that the role of a Regulator should be to "make the rules" nor that this is compatible with the Northern Territory Government's objectives to remain consistent with the AEMA. In particular, the AEMA makes clear that Government should have responsibility for policy oversight of, and future strategic directions for, the energy market and the legislative and regulatory

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[4] See for example: ESCOSA - http://www.escosa.sa.gov.au/webdata/resources/files/030610-G-Guideline9-Ringfencing-Final.pdf, QCA - http://www.qca.org.au/files/ACF187C.pdf and ESC - http://www.esc.vic.gov.au/NR/rdonlyres/20F26AC6-7C80-42C9-9965-3A4C5576086B/0/FinalGuidelineRingFencingMar05.pdf

[5] The separation of powers of the rule maker from the rule administrator was established in the Australian Energy Markets Agreement. Refer to the MCE Report to CoAG, December 2003. Found at http://www.mce.gov.au/assets/documents/mceinternet/MCE%2DDec03%2DRpttoCOAG20031211171443200407291310 23%2Epdf

framework within which the market operates and natural monopolies are regulated, while the role of the Regulator is to regulate under the framework provided for it by Government.

Power and Water considers that there are good reasons, outside of its inclusion in the AEMA, for the Commission not to make public policy. This is because many of the checks, balances and accountabilities that are required by Government bodies when developing policy are not required to be followed by the Commission.

Accordingly, the introduction of default contracts, as required under clause 4 of the Proposed Draft Code, is a public policy initiative that would normally be undertaken through legislative amendment and would be subject to a requirement that Government undertake a regulatory impact assessment. Power and Water considers that this would encourage a more rigorous examination of the issues since a regulatory impact assessment would:

- Identify the nature of the "problem" that has given rise to the new ring-fencing requirements. This is the fundamental flaw with the Commission's proposals. More specifically,:
    - There are ring-fencing provisions currently in place in the Northern Territory;
    - There have only been two instances of technical non-compliance of Power and Water with those provisions since the Current Code's introduction in 2001; and
    - There have been no formal complaints from retailers or other entities in relation to the provisions.

    That is, any 'problems' with the Current Code are quite different to what the Proposed Draft Code is proposing to 'resolve'.
- Clarify the objectives that Government is seeking to achieve through the introduction of the new ring-fencing requirements. The Commission has not identified a solution that it is seeking, rather it has designed a complicated and far reaching set of provisions which will fundamentally alter the manner in which Power and Water operates;
- Identify and assess all the options, both regulatory and non-regulatory. The Commission has not assessed any other alternative options for dealing with its perceived problem, because:
    - It has not identified clearly the problem that it is attempting to solve; and
    - It is likely that many of the possible other options are beyond its power, illustrating Power and Water's view that the Commission is not the appropriate entity to be undertaking these public policy initiatives;
- Provide an assessment of the costs, benefits and risks of reform on businesses and consumers, having regard for the Government's policy objectives;

- Determine whether the benefits justify the costs associated with amending the existing Code. The proposed new ring-fencing requirements will result in an increase in Power and Water's costs. However, it is not clear that there will be benefits associated with the new requirements. In particular:
    - The new ring-fencing requirements are expected to significantly increase Power and Water's administrative and compliance costs, whereas potential market entrants may not be subject to ring-fencing arrangements;
    - At present Power and Water is the only retailer in the Northern Territory. Accordingly, there are no competing parties which will benefit from the imposition of more stringent ring-fencing arrangements on Power and Water; and
    - The increased costs associated with the new requirements will inevitably be passed to customers. At present, there are no benefits to customers to offset these costs.

Accordingly, on the basis of a cost benefit assessment, which would be required to be undertaken by any other Government body seeking to introduce changes to the existing Code, there would be little, if any, support for the imposition of new ring-fencing requirements at this time.

In summary, Power and Water does not disagree with the Commission's right to design and enforce the Ring-Fencing Code under its Regulation, however notes that the Commission is straying, by virtue of its extension of the Code to third parties, and to the design and implementation of default contracts, into public policy.

5.2 Inconsistency of the Proposed Draft Code with General Regulatory Precedent

It is highly unusual for a Ring-Fencing Code to deal with the range of matters that the Commission currently intends to regulate in the Proposed Draft Code. As noted above, ring-fencing conventionally relates only to issues such as accounting separation, cost allocation, controls over information flows and arrangements between prescribed network businesses and related retail and or generation businesses[6].

While the current Code is very similar to Codes and Guidelines which are in operation interstate, the Proposed Draft Code is without precedent.

In particular, the ring-fencing of information flows between related businesses are dealt with by Jurisdictional Regulators both:

[6] See for example AER Transmission Ring-fencing Guidelines 2002. Found at http://www.aer.gov.au/content/index.phtml/itemId/660138 and ESCOSA - http://www.escosa.sa.gov.au/webdata/resources/files/030610-G-Guideline9-Ringfencing-Final.pdf, QCA - http://www.qca.org.au/files/ACF187C.pdf and ESC - http://www.esc.vic.gov.au/NR/rdonlyres/20F26AC6-7C80-42C9-9965-3A4C5576086B/0/FinalGuidelineRingFencingMar05.pdf

- Directly, through information handling provisions contained within Ring-Fencing Codes and Guidelines; and
- Indirectly, through provisions which influence the flow of information to and from regulated businesses such as requirements for legal and physical separation of regulated businesses from other businesses.

All jurisdictions have direct information handling provisions which are very similar to those already in effect in the Northern Territory, specifically:

- That confidential information provided by a customer or prospective customer is used only for the purpose for which that information was provided and that such information is not disclosed without the approval of the customer or prospective customer who provided it[7];
- That confidential information which might reasonably be expected to affect materially the commercial interests of a customer or prospective customer is not disclosed without the approval of the customer or prospective customer to whom that information pertains[8];
- That there be physical separation of staff and infrastructure between distribution and retail businesses. In New South Wales, Victoria and Tasmania there are specific requirements that related businesses must be physically separate. In Queensland and South Australia, there is no such requirement; and
- That shared staff be transparently identified. Shared staff requirements and restrictions are, in a practical sense, the same across all jurisdictions and require specific exemption from the jurisdictional regulator where staff are to be shared between businesses. The most prescriptive measures are in Queensland where maintenance of a shared staff register is mandatory.

In its Proposed Draft Code the Commission has given effect to a range of provisions which extend significantly beyond the boundaries of these interstate ring-fencing measures. For example the publication of contracts, as envisaged by clause 3.4(j), raises significant confidentiality issues, is without precedent nationally, and is strongly opposed by Power and Water. Clause 3.4(j) states:

> *The Commission may by written notice require an Electricity Entity:*
>
> *(i) if the contracting parties are not separate legal entities, to publish in the prescribed manner or publish in another manner specified by the Commission:*
>
> *(A) an approved related party contract; or*
>
> *(B) an instrument of approval by the Commission of an approved related party contract; and*
>
> *(ii) in respect of a notional agreement of that Electricity Entity which is not an approved related party contract and in relation to which*

[7] Unless required by law or if the information is already in the public domain.

[8] Unless required by law or if the information is already in the public domain.

the approval of the Commission has not been sought under clause 3.4(d) :

(C) to give to the Commission; and publish in the prescribed manner or publish in another manner specified by the Commission, a declaration signed by a Director of the Electricity Entity certifying on behalf of the Electricity Entity that it is not required in the circumstances to make application to the Commission for approval of the notional agreement.

Further, there is no known precedent in the NEM for:

- A generation business being required to publish a negotiated wholesale electricity contract;
- A network business being required to publish a negotiated use of system agreement, albeit that default terms and conditions are published for customer protection and photovoltaic buyback arrangements elsewhere; and
- A retail business being required to publish negotiated contracts for services that it provides to other parts of its business.

Power and Water therefore considers that it should be clarified that the Commission could only ask for a declaration from a Director if the circumstances in clause 3.4(d) did not hold.

There is also no known regulatory precedent in NEM jurisdictions which would support the Commission regulating the contractual relationships between a generation business and a related retail business. Commercial arrangements between generators and retailers are necessarily bilateral and are defined by the unique characteristics of the individual parties. This means that there is no place for default terms and conditions in this relationship.

The Proposed Draft Code requires that the Commission determine what is 'fair and reasonable' and whether contracts have been negotiated on an 'arm's length' basis. This would require the Commission to gain detailed knowledge of Power and Water's business, to seek to understand the complex and technical operational arrangements surrounding these services, as well as to establish criteria to test what fair and reasonable and arm's length conditions mean, in a practical sense, and then whether these have been met. Clearly, an arbitrary and ambiguous "fair and reasonable" test would impose risk to Power and Water.

The role of the Commission should be confined to promoting and enforcing effective competitive neutrality and non-discriminatory behaviour, whatever the actual terms and conditions of supply. This is because the Commission has no proper role in approving the precise manner and detail of the terms and conditions.

While the explicit capturing of generation under the Draft Code is well-intentioned, it will result in a situation where Power and Water Generation:

- Will need to explicitly identify the services that it provides in a way that is impossible. For example, when it supplies specific load shapes to retailers, it will need to design default contracts for this service;
- Will need to standardise the prices that it charges for this myriad of services;
- Will need to standardise the terms and conditions that it provides for these services, and then monitor whether it is entering into other agreements which are not consistent with these default terms and conditions; and
- Will be forced to publish a negotiated wholesale electricity contract, which is without precedent in the NEM.

Power and Water considers that the Commission is deviating from regulatory practice adopted in other jurisdictions and in doing so imposing unnecessarily complex and onerous requirements on Power and Water and other potential suppliers in seeking to use the Proposed Draft Code to approve the default terms and conditions under which different parts of Power and Water (as an Electricity Entity) provide and receive goods and services to and from one another.

5.3 Practical Workability of the Proposed Draft Code

Several of the amendments to the Proposed Draft Code are unclear and unworkable from a practical perspective and in some cases flawed or inconsistent with existing work being done by the Commission. In particular Power and Water notes that:

- The amendments in the Proposed Draft Code have not been drafted in a way that is clear and understandable;
- The specific amendments relating to the default terms and condition are flawed particularly the requirements relating to:
    - Applying default terms and conditions for dealings between business units of Power and Water; and
    - The process for varying the default terms and conditions for dealings between business units of Power and Water;
- The Service Classifications in the Proposed Draft Code are not consistent with the Commission's *"Price Control Mechanism Final Decision Paper"* determination.

Each of these issues is discussed in turn below.

The amendments to the Proposed Draft Code are generally unworkable

The amendments to the Proposed Draft Code are not drafted in a way which makes them easy to follow and therefore implement. The complex drafting of the Proposed Draft Code will make it more difficult for Power and Water to comply with and therefore more costly as more time and effort is required to ensure compliance with the amendments.

A more simply drafted Code, which focuses on setting out high level ring-fencing principles, could achieve the same purposes with:

- Less costs associated with compliance; and
- Likely a higher rate of compliance.

Other Australian jurisdictions have implemented more simply drafted ring-fencing instruments with the same purposes in mind.

The default terms and condition – applying default terms and conditions to dealings between business units

Power and Water notes that the nominated services to which the default terms and conditions required under clause 4.1(a) of the Proposed Draft Code may relate are many and varied, specific to the needs of the individual customers that order them, and that it would be impossible to define and standardise all services, variants of services, terms and conditions of variants of services and prices for services.

This is particularly the case for dealings between Power and Water Generation and Power and Water Retail. While Power and Water Retail currently purchases wholesale energy from Power and Water Generation on an average cost basis, the emergence of contestability or new retailers will involve a change in wholesale energy arrangements which will likely involve sculptured or load shape based products. Such products simply cannot be defined and standardized under standard default term and conditions.

Further, it is administratively difficult for Power and Water to delegate responsibility, as well as design operational protocols and delegation, for responsibility for arms-length dealings, to staff at an operational level. Many of these decisions are strategic decisions and should be retained by the Managing Director. To force Power and Water to do otherwise is inappropriate.

Power and Water Networks also provides a range of services to Power and Water Retail which extend far beyond conveyance of electricity. As noted previously, if the Commission's intention is to extend the definition of services to cover all possible "B2B" services, then the range of default terms and conditions will become very large.

The default terms and condition – the process for varying the default terms and conditions for dealings between business units of Power and Water

Power and Water considers that clause 6.4 of Schedule 1 of the Proposed Draft Code, which deals with amendments to the default contract, is also unclear and unworkable. Clause 6.4 of Schedule 1 states:

> *If the default terms and conditions of an Electricity Entity are varied the Electricity Entity must:*
>
> *(a) make an offer within three business days to each Customer with which it has a default contract to enter into a replacement default contract, for the period of the remaining unexpired terms of the existing default contract, in the form of the new default terms and conditions; and*

(b) if such offer is accepted, terminate the existing default contract.

Power and Water notes that the clause is both unclear and unworkable because:

- It suggests that a customer can choose to remain on an existing default contract for the remaining term of that contract. Power and Water notes that default contracts typically do not have defined durations, rather they are an ongoing arrangement. Power and Water understands that default contracts in the NEM and in other industries, for example in the telecommunications industry, are amended from time to time without providing customers with a choice about whether to retain them;
- The proposed approach effectively means that Power and Water will be negotiating with customers to determine which default contract the customers would prefer. This is again inconsistent with the concept of a default contract and would be unduly administratively burdensome; and
- Providing default contract customers with the option to remain on their existing contract or enter into a replacement (varied) default contract means that, where customers choose to remain on existing contracts, Power and Water will have a series of "old" default contracts as well as the "new" default contract.

  Importantly, this appears to make the concept of a default contract redundant since there is no "single" default contract, but rather a series of default contracts.

Accordingly, Power and Water's position is that only one set of default terms and conditions should be required to be in place at any one time.

The services classifications in the Code are not consistent with the Commission's Determination entitled "Price Control Mechanism Final Decision Paper"

Power and Water notes that the approach under clause 3 of Schedule 1 of the Proposed Draft Code, which sets out matters relating to cost allocation, is now not consistent with the Commission's existing determination entitled *"Price Control Mechanism Final Decision Paper"* released in May 2008, which establishes the regulatory framework for the 2009 Regulatory Reset.

Under this determination the Commission requires that Power and Water develop a new classification of services consistent with the requirements of section 6.2.1 of the National Electricity Rules and allocate costs in accordance with Power and Water's approved Cost Allocation Procedures.

This means that there may now be an inconsistency between the regulatory accounts for networks and the basis on which network tariffs have been set.

5.4 Issues with the Default Terms and Conditions Provisions

Clause 4.1(a) of the Proposed Draft Code states:

> *"An Electricity Entity that carries on a Prescribed Business in the Northern Territory must develop, and publish in the prescribed manner, default terms and conditions for each of the nominated goods or services of the Electricity Entity".*

Clause 4.2(a) further states that:

> *"For the purposes of clause 4.1(a), the Commission may by written notice given to each Electricity Entity to which the notice relates specify goods or services, or a class of goods or services, of a type provided or offered in the Electricity Supply Industry by a Prescribed Business of that Electricity Entity to a Related Contestable Business of that Electricity Entity as nominated goods or services."*

And Clause 4.2(c) clarifies that:

> *"For the purposes of clause 4.1(a) nominated goods or services includes the sale of electricity generated by PWC to an Electricity Entity issued with a licence authorising the selling of electricity."*

Power and Water considers that the requirements of the above clauses would be extremely difficult for it to comply with and would impose a significant burden on it. Clause 4.1(a) requires considerable clarification in order to enable Power and Water to effectively meet this requirement.

This is because the range of services provided by each of Power and Water's business units is considerable, in particular:

- Power and Water Generation provides a range of energy sale, entry, exit, ancillary, maintenance, and special request services for networks, independent power producers and retailers; and
- Power and Water Networks provides standard control and alternative control services including conveyance of electricity, "B2B" type services including disconnections, meter reads and reconnections, and quoted services such as relocation of mains.

Power and Water notes that it does not currently have documented default terms and conditions for all of the services that it provides between its business lines. If the definition of "service" includes all of the individual services that Power and Water's businesses currently provide, there will be a need for Power and Water to develop extensive new default terms and conditions if the Commission nominates a broad spectrum of goods or services requiring default terms and conditions.

In relation to services provided by Power and Water Networks, Power and Water notes that the terms and conditions by which "B2B" services are provided in the NEM is through the B2B service order procedures issued by NEMMCO, albeit that the service standards are developed by the relevant

jurisdictional Government. Power and Water's expectation to date has been that Government would set these standards through reform processes prior to implementing Full Retail Contestability (FRC), and considers that it should be made clear that a single set of default terms and conditions could be made to apply to multiple (and potentially all of an Electricity Entity's) nominated goods and services, i.e. there need not be a separate set of default terms and conditions for each good or service.

Power and Water therefore considers that clause 4.2(a) should therefore specify the basis on which the Commission may nominate goods and services, and how it might define these goods and services. Defining services will allow Power and Water to better estimate the likely compliance burden associated with the Proposed Draft Code.