

**NORTHERN TERRITORY
ELECTRICITY
RING-FENCING CODE**

AS AMENDED APRIL 2002



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Foreword

This document is comprised of two parts:

1. the *Northern Territory Electricity Ring-Fencing Code*, as amended in April 2002; and
2. explanatory notes accompanying the Code, providing essential background as well as outlining the main features of the Code.

The Code has been re-issued in this form following the Commission's decision, explained in the *Amendments to the NT Electricity Ring-Fencing Code* Decision Paper (April 2002), to incorporate some definitional amendments into the Code.

Any questions regarding the Code should be directed in the first instance to the Executive Officer, Utilities Commission, at any of the following:

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NORTHERN TERRITORY ELECTRICITY RING-FENCING CODE

This Ring-Fencing Code is published by the Utilities Commission of the Northern Territory pursuant to section 24 of the Utilities Commission Act 2000.

This version of the Code includes some minor definitional amendments to the version of the Code published on 1 July 2001. The definitional amendments came into effect on 29 April 2002.

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Northern Territory Electricity Ring-Fencing Code

1. Authority

1.1

- (a) This **Code** is made by the **Commission** under section 24 of the **Act** and in accordance with the authority granted to the **Commission** by Regulation 2 of the *Utilities Commission Regulations*.
- (b) In making this **Code**, the **Commission** has had regard to the matters listed in section 6(2) of the **Act**.

2. Application

2.1 This **Code** will apply to all **Electricity Entities** that carry on a **Prescribed Business** in the Northern Territory as and from the **Commencement Date**.

3. Objectives

3.1 The objectives of this **Code** are to:

- (a) promote and safeguard competition and fair and efficient market conduct in the **Electricity Supply Industry** including by promoting the simulation of competitive market conduct and preventing the misuse of monopoly power; and
- (b) require that **Electricity Entities** have in place arrangements which ensure that **Related Businesses** are not treated in such a manner by a **Prescribed Business** as to confer a non-commercial discriminatory price or non-price advantage on the **Related Business** as compared to an arm's length third party in the same commercial circumstances.

4. Ring-Fencing Minimum Obligations

4.1 An **Electricity Entity** that carries on a **Prescribed Business** in the Northern Territory must:

- (a) establish and maintain a separate set of financial accounts and reports in respect of:
 - (i) each **Prescribed Business**; and
 - (ii) its **Electricity Business** as a whole,

which have been prepared in accordance with the **Accounting Procedures** applying to that **Electricity Entity** from time to time under clause 5;

- (b) allocate any costs that are shared between a **Prescribed Business** and a **Related Business** in a manner that:
 - (i) complies with the **Cost Allocation Procedures** applying to that **Electricity Entity** from time to time under clause 5; and
 - (ii) is otherwise fair and reasonable;

- (c) ensure that **Confidential Information** provided by a **Customer** to a **Prescribed Business** is:
- (i) used only for the purpose for which that **Confidential Information** was provided by that **Customer**;
 - (ii) only disclosed to a **Related Business** if the disclosure of that **Confidential Information** is not prohibited under the **Information Procedures** applying to that **Electricity Entity** under clause 5 from time to time; and
 - (iii) otherwise dealt with in accordance with the **Information Procedures** applying to that **Electricity Entity** under clause 5 from time to time;
- (d) ensure that any information (including **Confidential Information**):
- (i) obtained by that **Electricity Entity** (or by its employees, consultants, contractors or agents) in the course of conducting a **Prescribed Business**;
or
 - (ii) known to that **Electricity Entity** (or by its employees, consultants, contractors or agents) as a result of conducting a **Prescribed Business**;
and
 - (iii) which might reasonably be expected to materially affect the commercial interests of a competitor of a **Related Business** if disclosed to that **Related Business**; or
 - (iv) which might reasonably be expected to provide a competitive advantage to a **Related Business** over a competitor of that **Related Business** if disclosed to that **Related Business** without also being disclosed to that competitor,
- is:
- (v) used only for the purpose for which that information was provided or obtained;
 - (vi) only disclosed to a **Related Business** if the disclosure of that information is not prohibited under the **Information Procedures** applying to that **Electricity Entity** under clause 5 from time to time; and
 - (vii) otherwise dealt with in accordance with the **Information Procedures** applying to that **Electricity Entity** under clause 5 from time to time;
- (e) ensure that goods or services provided to a **Related Business** by a **Prescribed Business** are provided on a non-discriminatory arm's length commercial basis to other **Customers** who wish to obtain the same type of goods or services from the **Prescribed Business** (including competitors of that **Related Business**);
- (f) ensure that goods or services provided to a **Prescribed Business** by a **Related Business** are provided on a non-discriminatory arm's length commercial basis;
and
- (g) ensure that the **Marketing Staff** of its **Related Businesses** are not also used as **Marketing Staff** for its **Prescribed Businesses** and, in the event that the **Marketing Staff** of its **Prescribed Businesses** do become or are found to become involved in a **Related Business**, ensure that that involvement immediately ceases.

5. Compliance with Approved Procedures

5.1 In this clause 5 unless the context otherwise requires, a reference to “**Procedures**” includes in each case the **Accounting Procedures**, **Cost Allocation Procedures** and **Information Procedures**.

5.2 An **Electricity Entity** that carries on a **Prescribed Business** must within:

- (a) 3 months (in the case of the **Accounting Procedures** and the **Cost Allocation Procedures**); and
- (b) 6 months (in the case of the **Information Procedures**),

of the **Commencement Date** submit to the **Commission** for approval final draft **Procedures** for its **Prescribed Businesses** developed in accordance with clause 5.3.

5.3 The final draft **Procedures** submitted by an **Electricity Entity** under clause 5.2 must be:

- (a) designed to ensure compliance with the **Electricity Entity’s** obligations under clause 4;
- (b) otherwise consistent with the general principles set out in Schedule 2 to this **Code** for each type of **Procedure**; and
- (c) developed in conjunction with the **Commission** so as to ensure that the final draft **Procedures** when submitted can be approved by the **Commission** without the need for substantial amendments.

5.4 In considering whether to approve any draft **Procedures** submitted by an **Electricity Entity** under clause 5.2, the **Commission** will have regard to (among other things):

- (a) the matters set out in section 6(2) of the **Act**; and
- (b) whether the draft **Procedures** give effect to the principles set out in Schedule 2 to this **Code** for that type of **Procedures**.

5.5 The **Commission** may grant its approval of the draft **Procedures** submitted by an **Electricity Entity** under clause 5.2 subject to such conditions as the **Commission** considers are appropriate in the circumstances including conditions requiring that:

- (a) specific amendments be made to the draft **Procedures** submitted by the **Electricity Entity**;
- (b) the **Procedures** are approved for a fixed term;
- (c) the **Procedures** be reviewed at regular intervals by the **Commission** and the **Electricity Entity**;
- (d) the **Procedures** must be resubmitted for approval following any change to the **Code** affecting the **Procedures** or when otherwise requested by the **Commission**; and
- (e) the **Electricity Entity** report to the **Commission** concerning the implementation, application and/or compliance with the **Procedures** when requested by the **Commission**.

5.6 An **Electricity Entity** must comply with any **Procedures** approved by the **Commission** from time to time under clause 5.2 and any conditions attaching to the **Commission’s** approval of those **Procedures**.

5.7 An **Electricity Entity** may at any time apply to the **Commission** to approve a proposed variation to any existing **Procedures**. Unless the **Commission** considers that the application has been made on trivial or vexatious grounds (in which case the **Commission** may reject the application without further notice) an application to vary

existing **Procedures** will be dealt with by the **Commission** in accordance with the procedure set out in this clause 5 applying to an application to approve the initial **Procedures**.

5.8 The **Commission** must notify an **Electricity Entity** within 30 days after receiving an application from the **Electricity Entity** to approve any **Procedures** (or any variation to the existing **Procedures**) of:

- (a) whether the **Commission** approves those **Procedures** (or the proposed variation to the existing **Procedures**);
- (b) any conditions attaching to the **Commission's** approval of those **Procedures** (or the proposed variation to the existing **Procedures**).

The **Electricity Entity** must implement any **Procedures** within 30 days after the date upon which they are approved by the **Commission**.

5.9 If an **Electricity Entity**:

- (a) fails to submit any of the draft **Procedures** to the **Commission** within the time period specified in clause 5.2 for the submission of that type of **Procedures**; or
- (b) submits draft **Procedures** to the **Commission** which require substantial amendment before they can be approved by the **Commission**,

the **Commission** may issue its own **Procedures** which will be deemed for the purposes of this **Code** to be the **Procedures** applying to that **Electricity Entity** until such time as appropriate draft **Procedures** are submitted to the **Commission** and approved.

5.10 Until such time as **Procedures** are approved or issued by the **Commission** under this clause 5, an **Electricity Entity** must comply with the principles set out in Schedule 2 to this **Code** for that type of **Procedures** as if those principles were the **Procedures**.

5.11 An **Electricity Entity** that carries on a **Prescribed Business** must provide to any person upon request copies of the accounts provided to the **Commission** under clause 4(a) for the most recent annual reporting period upon payment by that person of the fee approved for that purpose by the **Commission**.

6. Adding to or Amending this Code

6.1 The **Commission** may at any time vary or revoke this **Code** (or any part of this **Code**) in accordance with section 24 of the **Act**.

6.2 An **Electricity Entity** may request that the **Commission** vary or revoke any part of this **Code**. Unless the **Commission** considers that the application has been made on trivial or vexatious grounds (in which case the **Commission** may reject the application without further notice) an application to vary or revoke any part of this **Code** will be dealt with by the **Commission** in accordance with the procedure set out in this clause 6.

6.3 Without limiting the powers of the **Commission** under section 24 of the **Act** to vary or revoke the **Code**, the **Commission** may vary the **Code** to require that an **Electricity Entity** comply with an obligation in relation to the conduct of a **Prescribed Business** which differs from or is in addition to the minimum obligations set out in clauses 4 and 5 (including by requiring the **Electricity Entity** to comply with procedures issued by the **Commission** which vary or are additional to the **Procedures** approved or issued by the **Commission** under clause 5 from time to time).

6.4 In deciding whether to vary or revoke this **Code** (or any part of this **Code**) under clauses 6.1 or 6.2, or impose any additional or varied obligation on an **Electricity Entity** under clause 6.3, the **Commission** will have regard to:

- (a) the matters listed in section 6(2) of the **Act**; and
- (b) in the case of a variation to the **Code** which imposes an additional or varied obligation on a particular **Electricity Entity**, the general principle that the administrative cost to that **Electricity Entity** of complying with the additional or varied obligation should not, or should not be likely to in the opinion of the **Commission**, outweigh the benefits to the public from compliance with that additional or varied obligation.

6.5 Before varying or revoking this **Code**, or imposing any additional or varied obligation on an **Electricity Entity**, under this clause 6, the **Commission** will consult with each **Electricity Entity** in accordance with the procedure set out in clause 7 and otherwise comply with the other requirements of the **Act** and clause 7.

6.6 An **Electricity Entity** must comply with any additional or varied obligation imposed upon that **Electricity Entity** under this clause 6 as and from the date upon which that obligation takes effect under section 24 of the **Act**.

7. Procedures for Adding To or Amending Ring-Fencing Obligations

7.1 The **Commission** must, before varying or revoking this **Code** (or any part of this **Code**) or imposing an additional or varied obligation on an **Electricity Entity**, inform each person known to the **Commission** (whom the **Commission** believes has a sufficient interest in the matter) that the **Commission** is considering varying or revoking this **Code** (or any part of this **Code**) or imposing an additional or varied obligation on an **Electricity Entity** by publishing a written notice which at least:

- (a) states the nature of the proposed variation, revocation or additional or varied obligation; and
- (b) requests submissions by a date specified in the notice (not being a date earlier than 30 days after the date of the notice).

7.2 The **Commission** will also give a copy of any notice published in accordance with this clause 7 to each **Electricity Entity** to which the notice relates.

7.3 The **Commission** must consider any submissions received by the date specified in the notice published under clause 7.1(b) and may (but is not obliged to) consider any submissions received after that date.

7.4 Within 30 days (or such longer period as the **Commission** notifies) after the last day for submissions specified in the notice published under clause 7.1(b), the **Commission** must issue a draft decision stating whether or not it intends to proceed with the proposed variation, revocation or additional or varied obligation.

7.5 The **Commission** must:

- (a) provide a copy of its draft decision to each **Electricity Entity**, any person who made a submission on the matter and any other person who requests a copy; and
- (b) request submissions from persons to whom it provided the draft decision by a specified date (not being a date earlier than 30 days after the date the draft decision was issued).

7.6 The **Commission** must consider any submissions it receives by the date specified by the **Commission** under clause 7.5(b) and it may (but is not obliged to) consider any submissions received after that date.

7.7 Within 30 days (or such longer period as the **Commission** notifies) after the last day for submissions on the draft decision specified by the **Commission**, the **Commission** must issue a final decision stating:

- (a) whether or not it will proceed with the proposed variation, revocation or additional or varied obligation; and
- (b) the final form of that proposed variation, revocation or additional or varied obligation.

7.8 A notice in relation to a variation, revocation or additional or varied obligation will have effect 30 days after the notice is given to each **Electricity Entity** and published in the *Gazette* (or such later date as the **Commission** specifies in the notice).

8. Compliance Procedures and Compliance Reporting

8.1 An **Electricity Entity** that carries on a **Prescribed Business** must within 6 months of the **Commencement Date** establish and maintain appropriate internal procedures to ensure that it complies with its obligations under this **Code**. The **Commission** may require the **Electricity Entity** to demonstrate the adequacy of, and level of, compliance with these procedures upon reasonable notice. However, any statement made or assurance given by the **Commission** concerning the adequacy of an **Electricity Entity's** compliance procedures will not affect the **Electricity Entity's** obligations under this **Code**.

8.2 An **Electricity Entity** must provide a report to the **Commission**, at reasonable intervals determined by the **Commission**, describing the measures taken by the **Electricity Entity** to ensure compliance with its obligations under this **Code**. This report, along with the **Commission's** assessment of compliance, will be made publicly available by the **Commission** subject to the **Commission** first complying with its obligations under section 26 of the **Act**.

8.3 The **Commission** may, upon reasonable notice to an **Electricity Entity**, appoint an independent auditor to undertake an audit of the **Electricity Entity's** compliance with any of its obligations under this **Code**.

8.4 If the **Commission** nominates standards or requirements to apply to an audit under clause 8.3, the auditor will report in accordance with those standards or requirements.

8.5 The **Commission** will provide a copy of the auditor's report to the **Electricity Entity** as soon as reasonably possible after it has been received from the auditor.

8.6 The **Electricity Entity** will be responsible to pay the costs of undertaking that audit if the auditor discovers any failure by the **Electricity Entity** to comply with a material obligation under this **Code**.

8.7 An **Electricity Entity** must report any breach of its obligations under this **Code** to the **Commission** as soon as reasonably possible after becoming aware that the breach has occurred and advise of the remedial action that is being undertaken to rectify the breach.

9. Exemption from Compliance with Specified Obligations

9.1 As at the **Commencement Date** each **Electricity Entity** listed in column 1 of Schedule 1 is exempt from complying with the obligations under this **Code** set out in column 2 of Schedule 1 in relation to the **Prescribed Business** or the **Electricity Business** set out in column 3 of Schedule 1 until such time as the **Commission** revokes that exemption in accordance with clause 6 of this **Code**.

9.2 An **Electricity Entity** may apply to the **Commission** for an exemption from compliance with any obligation (or component of an obligation) under this **Code**. A

notice requesting an exemption must include all information and materials necessary to support the **Electricity Entity's** application for exemption.

9.3 In determining whether to grant any exemption, the **Commission** will have regard to:

- (a) the matters listed in section 6(2) of the **Act**; and
- (b) the general principle that the **Commission** will only grant an exemption if it is satisfied that the benefit, or likely benefit, to the public of compliance with the relevant obligation will be outweighed by the administrative cost to that **Electricity Entity** of complying with that obligation.

9.4 The **Commission** may grant an exemption:

- (a) on different terms to those sought by the **Electricity Entity**; or
- (b) subject to such conditions as the **Commission** considers are appropriate in the circumstances, including conditions requiring that:
 - (i) the exemption be for a fixed term;
 - (ii) the continuation of the exemption be subject to review by the **Commission** on such terms as the **Commission** considers appropriate in the circumstances;
 - (iii) the **Electricity Entity** report to the **Commission** concerning any matter relating to the operation or impact of the exemption; and
 - (iv) the grant of the exemption be conditional upon the occurrence of a nominated event (for example, the variation of the **Code** to impose an additional or varied obligation on the **Electricity Entity** or the implementation of agreed compliance procedures).

9.5 When the **Commission** receives an application under clause 9.2 the **Commission** must:

- (a) if it considers that the application has been made on trivial or vexatious grounds, reject the application without further consideration; or
- (b) in all other cases within 14 days after receipt of the application, inform each person known to the **Commission** whom the **Commission** believes has a sufficient interest in the matter, that the **Commission** has received the application by publishing a written notice which at least:
 - (i) identifies the **Electricity Entity** that has applied for the exemption and the nature of the requested exemption;
 - (ii) states how copies of the application can be obtained; and
 - (iii) requests submissions by a date specified in the notice (not being a date earlier than 30 days after the date of the notice).

9.6 The **Commission** must provide a copy of the application to any person within 7 days after the person requests a copy and pays any reasonable fee required by the **Commission**.

9.7 The **Commission** must consider any submissions received by the date specified in the notice published under clause 9.5 and it may (but is not obliged to) consider any submissions received after that date.

9.8 Within 30 days (or such longer period as the **Commission** notifies) after the last day for submissions specified in the notice published under clause 9.5 the **Commission** must issue a draft decision stating whether or not it intends to grant the exemption sought in that application.

9.9 The **Commission** must:

- (a) provide a copy of its draft decision to the relevant **Electricity Entity**, any person who made a submission on the matter and any other person who requests a copy; and
- (b) request submissions from persons to whom it provides the draft decision by a specified date (not being a date earlier than 30 days after the date the draft decision was issued).

9.10 The **Commission** must consider any submissions it receives by the date specified by the **Commission** under clause 9.9 and it may (but is not obliged to) consider any submissions received after that date.

9.11 Within 30 days (or such longer period as the **Commission** notifies) after the last day for submissions on the draft decision specified by the **Commission**, the **Commission** must issue a final decision stating whether or not it will grant the exemption sought in that application.

9.12 A final decision under clause 9.11 has effect 30 days after the decision is issued to the **Electricity Entity** or such later date as the **Commission** specifies in the notice.

9.13 An **Electricity Entity** may at any time request that the **Commission** consider whether the requirements set out in paragraph (b) of the definition of '**Prescribed Business**' have been satisfied. A request under this clause 9.13 will be dealt with by the **Commission** in the same manner as an application for an exemption from compliance with any obligation (or component by obligation) under clause 9.2.

10. Preservation of Other Obligations

10.1 Nothing in this **Code** will derogate from any obligation imposed upon an **Electricity Entity** under the **Act**, the *Electricity Reform Act 2000*, any regulation made under those Acts, any condition of a licence issued to the **Electricity Entity** or any other code made by the **Commission** under the **Act**.

11. Interpretation

11.1 In this **Code**, words appearing like **this** will have the meaning set out in clause 11.2.

11.2 In this **Code**, unless the contrary intention appears:

"**Accounting Procedures**" means the procedures of that name approved or issued by the **Commission** under clause 5 for the purposes of this **Code**;

"**Act**" means the *Utilities Commission Act 2000*;

"**Associate**" means in relation to:

- (a) an **Electricity Entity** that is a legal entity incorporated pursuant to the *Corporations Law*, a person that is an associate of that **Electricity Entity** under Division 2 of Part 1.2 of the *Corporations Law* if sections 13, 14, 16(2) and 17 of the *Corporations Law* were repealed; and
- (b) an **Electricity Entity** that is not a legal entity incorporated pursuant to the *Corporations Law*, a person that would be an associate of that **Electricity Entity** under Division 2 of Part 1.2 of the *Corporations Law* if sections 13, 14, 16(2) and 17 of the *Corporations Law* were repealed and if that **Electricity Entity** were a legal entity incorporated pursuant to the *Corporations Law*;

“**Code**” means this Ring-Fencing **Code**;

“**Commencement Date**” means the date set out in the notice published in the *Gazette* making this **Code** from which this **Code** will take effect;

“**Commission**” means the Utilities Commission of the Northern Territory established by the *Utilities Commission Act 2000*;

“**Confidential Information**” means information which is or has been provided to, or has otherwise been obtained by, an **Electricity Entity** in connection with the carrying on of a **Prescribed Business** and which is confidential or commercially sensitive and includes information which is derived from any such information;

“**Contestable Market**”¹ means a market within the **Electricity Supply Industry** in which more than one **Electricity Entity** is operating in the market or in which there are no statutory impediments to the entry of new **Electricity Entities** into that market;

“**Cost Allocation Procedures**” means the procedures of that name approved or issued by the **Commission** under clause 5 for the purposes of this **Code**;

“**Customer**” means a person who engages (or proposes to engage) in the activity of purchasing goods or services from a **Prescribed Business**;

“**Directors**” includes in the case of the Power and Water Authority its chief executive officer from time to time and each of the persons appointed to the Power and Water Authority by the Minister under the *Power and Water Authority Act*.

“**Electricity Business**” means in relation to an **Electricity Entity**, all of the businesses conducted by that **Electricity Entity** in the **Electricity Supply Industry**;

“**Electricity Entity**” has the same meaning as is given to that term in the *Electricity Reform Act 2000* and includes, where the context requires, the **Associates** of that entity;

“**Electricity Supply Industry**” has the same meaning as in the *Electricity Reform Act 2000*;

“**Information Procedures**” means the procedures of that name approved or issued by the **Commission** under clause 5 for the purposes of this **Code**;

“**Marketing Staff**” means an employee, consultant, contractor or agent of an **Electricity Entity** who is directly involved in the sale, promotion or advertising of any goods or services provided by the **Electricity Entity** to **Customers** (whether or not that employee, consultant, contractor or agent is involved in other functions) but does not include an employee, consultant, or agent who is only involved in:

- (a) strategic decision making, including the executive officer or officers to whom **Marketing Staff** report either directly or indirectly; or
- (b) technical, administrative, accounting or service functions;

“**Prescribed Business**” means:

- (a) a business (or component of a business) carried on by an **Electricity Entity** which consists of:
 - (i) the operation of an electricity network and the provision of network access services in relation to that electricity network to **Customers**;
 - (ii) the provision of power system control and dispatch services in relation to any electricity network;

¹ Added April 2002.

- (iii) the sale of electricity to non-contestable **Customers**; or
- (iv) a business (or component of a business) carried on by an **Electricity Entity** which consists of the provision of any other goods or services:
 - (A) to which the Regulations authorising the making of this **Code** extend to; and
 - (B) which the **Commission** determines in accordance with clause 6 are not reasonably contestable and should be included within the definition of '**Prescribed Business**' for the purposes of this **Code**; or
- (b) the business carried on by the Power and Water Authority of generating electricity for sale (whether to third parties or notionally to another business division of the Power and Water Authority) carried on by the Power and Water Authority, until such time as the **Commission** is satisfied that having regard to factors set out in section 6(2) of the **Act** and such other matters as the **Commission** considers are appropriate:
 - (i) the Power and Water Authority 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) this **Code** should no longer apply to that business;

"**Procedure**" has the meaning given to it by clause 5.1 of this **Code**; and

"**Related Business**"² means, in relation to a particular **Prescribed Business** of an **Electricity Entity**, any business carried on or activities undertaken in the **Electricity Supply Industry** by that **Electricity Entity** or an **Associate** of that **Electricity Entity** operating in a **Contestable Market** which do not form part of that **Prescribed Business**.

11.3 In this **Code**, unless the context otherwise requires:

- (a) if a term is defined in the *Electricity Reform Act 2000* and is not otherwise defined in clause 11.2, that term will have the same meaning as is given to that term under the *Electricity Reform Act 2000*;
- (b) headings are for convenience only and do not affect the interpretation of this **Code**;
- (c) words importing the singular include the plural and vice versa;
- (d) words importing a gender include any gender;
- (e) an expression importing a natural person includes any company, partnership, trust, joint venture, association, corporation or other body corporate and any governmental agency and vice versa;
- (f) a reference to any thing includes a part of that thing;
- (g) a reference to a clause, Schedule or part of a clause or Schedule is a reference to a clause, Schedule or part of this **Code**;
- (h) a reference to any statute, regulation, proclamation, ordinance or by-law includes all statutes, regulations, proclamations, ordinances or by-laws varying, consolidating, re-enacting, extending or replacing them and a reference to a statute includes all regulations, proclamations, ordinances, by-laws and determinations issued under that statute;
- (i) other parts of speech and grammatical forms of a word or phrase defined in this **Code** have a corresponding meaning;

² Amended April 2002.

- (j) mentioning an example or anything after the words “include”, “includes” or “including” will not limit what else might be included;
 - (k) a period of time:
 - (i) which dates from a given day or the day of an act or event is to be calculated exclusive of that day; or
 - (ii) which commences on a given day or the day of an act or event is to be calculated inclusive of that day;
 - (l) a reference to:
 - (i) a day is a reference to a period commencing immediately after midnight and ending the following midnight; and
 - (ii) a month is a reference to a calendar month; and
 - (m) a reference to an accounting term is to be interpreted in accordance with accounting standards under the *Corporations Law* and, if not inconsistent with those accounting terms, generally accepted principles and practices in use from time to time in Australia in the ***Electricity Supply Industry***.
- 11.4 Where this **Code** authorises the making of an instrument or decision:
- (a) the power includes the power to amend or repeal the instrument or decision; and
 - (b) the power to amend or repeal the decision is exercisable in the same way, and subject to the same conditions, as the power to make the instrument or decision.

SCHEDULE 1**Exemptions as at Commencement Date**

Column (1) – Electricity Entity	Column (2) – Code Obligation	Column (3) – Prescribed Business
Power and Water Authority	Clause 5.11	Franchise Retail
Power and Water Authority	Clause 5.11	Generation Business
Power and Water Authority	Clause 5.11	Electricity Business as a whole

SCHEDULE 2

Accounting, Cost Allocation and Information Principles

1. Common Principles

1.1 In addition to the matters referred to in clause 5.4 of the **Code**, the **Commission** will, when considering whether to:

- (a) approve any **Procedures** submitted by an **Electricity Entity** under clause 5.3;
- (b) impose any conditions upon the grant of its approval; or
- (c) issue its own **Procedures**,

have regard to the need to achieve an appropriate balance between the public benefits of requiring an **Electricity Entity** to comply with those obligations or conditions and the administrative costs to the **Electricity Entity** of complying with those obligations or conditions.

2. Accounting Principles

2.1 The **Accounting Procedures** will only be approved by the **Commission** if:

- (a) they ensure compliance with the relevant ring-fencing minimum obligations stated in clause 4 of this **Code**;
- (b) they are consistent with the accounting policies and procedures for other regulatory instruments;
- (c) their utilisation involves a recognisable and rational economic basis;
- (d) the resultant financial information satisfies the concepts of relevance and reliability, thereby ensuring that the substance of the underlying transactions and events is reported; and
- (e) they comply with the principles set out in this Schedule 2.

2.2 The **Accounting Procedures** must be presented to the **Commission** in a manner that ensures that the **Commission** may readily understand the methodologies and procedures comprising such **Accounting Procedures** and the resultant financial statements and reports of each **Prescribed Business** and its **Electricity Business** as a whole.

2.3 The **Accounting Procedures** must conform to Australian Accounting Standards wherever possible.

2.4 The **Accounting Procedures** must ensure the reporting of the substance of transactions by:

- (a) where substance and form differ, reporting the substance rather than the legal form of a transaction or event;
- (b) in determining the substance of a transaction, considering all its aspects and implications, including the expectations of and motivations for, the transaction; and
- (c) for the purposes of determining the substance of a transaction, viewing in aggregate a group or series of transactions that achieves, or is designed to achieve, an overall commercial effect.

2.5 An **Electricity Entity** must maintain accounting and reporting arrangements which:

- (a) enable financial statements and reports to be prepared for each **Prescribed Business** and its **Electricity Business** as a whole; and
- (b) provide information in the financial statements and reports that can be verified.

2.6 Information must be presented in financial statements and reports in the most understandable manner, without sacrificing relevance or reliability.

2.7 The financial statements and reports prepared by an **Electricity Entity** in compliance with its obligations under this **Code** must:

- (a) give a fair and reasonable view of the profit and loss and the balance sheet relating to each **Prescribed Business** and its **Electricity Business** as a whole;
- (b) be capable of certification as such by an auditor when and if required by the **Commission**;
- (c) be derived from the statutory accounts or their equivalent of the **Electricity Entity**; and
- (d) contain the entirety of the activities of each **Prescribed Business** and its **Electricity Business** as a whole by:
 - (i) eliminating costs not related to each **Prescribed Business** and (where applicable) its **Electricity Business** as a whole;
 - (ii) not consolidating amounts from statutory accounts of different entities; and
 - (iii) consolidating or disaggregating statutory account amounts within an entity in order to prepare financial statements.

2.8 If some or all of the activities of an **Electricity Entity** are carried out by an entity that does not have statutory accounts, all financial representations of **Prescribed Business** activities by such an entity must be capable of being audited by an external independent auditor.

2.9 An **Electricity Entity** must present on a fair and consistent basis, from the accounting records that underlie its statutory accounts, the costs, revenues, assets employed and liabilities that may be reasonably attributed to each **Prescribed Business** and its **Electricity Business** as a whole.

2.10 The financial statements and reports of each **Prescribed Business** and its **Electricity Business** as a whole must, in so far as is reasonably practicable, be prepared in accordance with the accounting principles and policies applicable to the statutory accounts.

2.11 The financial statements and reports of each **Prescribed Business** and its **Electricity Business** as a whole must, in so far as is reasonably practicable, be prepared in a consistent manner so that the **Commission** can make comparisons between them over time.

2.12 An **Electricity Entity** must provide to the **Commission** full and detailed documentation of any policies and procedures that the **Electricity Entity** may have used to prepare the financial statements and reports, that are additional to or in place of, the accounting principles and policies used to prepare its statutory accounts.

2.13 The **Directors** of an **Electricity Entity** will be responsible for the purposes of this **Code** for the preparation and presentation of the financial statements and reports, and the information they contain.

2.14 The **Directors** of an **Electricity Entity** must ensure that the **Electricity Entity** keeps accounting records that:

- (a) correctly record and explain the transactions and financial position of each **Prescribed Business** and its **Electricity Business** as a whole;
- (b) enable financial statements and reports to be prepared in accordance with this **Code**; and
- (c) are capable of allowing an auditor to conveniently and properly form an opinion on the basis of those financial statements and reports as to the level of compliance by the **Electricity Entity** with the requirements of this Schedule, the **Accounting Procedures** and the provisions of clause 4 of the **Code**.

3. Cost Allocation Principles

3.1 The **Cost Allocation Procedures** will only be approved by the **Commission** if:

- (a) they ensure compliance with the relevant ring-fencing minimum obligations stated in clause 4 of this **Code**;
- (b) they are consistent with the accounting policies and procedures for other regulatory instruments;
- (c) their utilisation involves a recognisable and rational economic basis;
- (d) the resultant financial information satisfies the concepts of relevance and reliability, thereby ensuring that the substance of the underlying transactions and events is reported; and
- (e) they comply with the principles set out in this Schedule 2.

3.2 The **Cost Allocation Procedures** must be presented to the **Commission** in a manner that ensures that the **Commission** may readily understand the methodologies and procedures comprising such **Procedures** and the resultant financial statements and reports prepared by the **Electricity Entity**.

3.3 The cost allocations prepared by the **Electricity Entity** in compliance with its obligations under this **Code** must be capable of certification as such by an auditor when and if required by the **Commission**.

3.4 For the purpose of financial statements and reports required to be provided to the **Commission** under this **Code** or for other regulatory purposes, the allocation of accounts between each **Prescribed Business** and the activities of the **Electricity Business** as a whole and across segments of a **Prescribed Business** are to be based on the principle that:

- (a) items which are directly attributable to a **Prescribed Business** or to the **Electricity Business** as a whole and segments of a **Prescribed Business** are assigned accordingly; and
- (b) items not directly attributable, are to be allocated to a **Prescribed Business** or to the **Electricity Business** as a whole and across segments of the **Prescribed Business** using an appropriate allocator, as indicated in following paragraphs.

3.5 An item may be directly attributable to a **Prescribed Business** or to the **Electricity Business** as a whole but not directly attributable to a segment of a **Prescribed Business**. In these circumstances, the allocation across segments of **Prescribed Businesses** will be made using an appropriate allocator as indicated in the following paragraphs.

3.6 Items that are not directly attributed either to a **Prescribed Business** or to the **Electricity Business** as a whole or to a segment of a **Prescribed Business** are to be allocated on a causation basis. Allocation based on avoidable cost is not permitted.

3.7 An **Electricity Entity** must produce for each item that has not been directly attributed to a **Prescribed Business** or the **Electricity Business** as a whole and/or **Prescribed Business** segment supporting paper work that includes:

- (a) the amounts that have been allocated to the **Prescribed Business** or the **Electricity Business** as a whole and/or **Prescribed Business** segment and amounts that have not been so allocated; and
- (b) the numeric quantity of each allocator.

3.8 If an item is immaterial and a causal relationship cannot be established without undue cost and effort, the **Electricity Entity** may effect an allocation of these items on a non-causal basis, provided it is accompanied by a supporting note documenting for each such item:

- (a) a defensible basis of allocation (which must not be avoidable cost);
- (b) the reason for choosing that basis; and
- (c) an explanation why no causal relationship could be established.

3.9 A non-causal basis of allocation may only be applied to the extent that:

- (a) the aggregate of all items subject to all non-causal bases of allocation is not material to the financial statements or reports; or
- (b) an **Electricity Entity** can demonstrate that there is likely to be a strong positive correlation between the non-causal basis and the actual cause of resource or service consumption or utilisation that those costs represent.

3.10 An item is material if its omission, misstatement or non-disclosure has the potential to prejudice the understanding of the financial position and nature of the **Prescribed Business** or the **Electricity Business** as a whole (whichever is applicable), gained by reading the financial statements and reports.

3.11 All bases of allocation must be explained and documented in the **Cost Allocation Procedures**.

4. Information Principles

4.1 The **Information Procedures** will set out the procedures to be followed by staff of an **Electricity Entity** involved in the conduct of a **Prescribed Business** for the purpose of identifying, and then appropriately handling, storing, sharing and publishing, information that is either:

- (a) deemed to be **Confidential Information**; or
- (b) capable of materially affecting the commercial interests of a competitor of a **Related Business**.

4.2 The proposed **Information Procedures** must contain procedures for ensuring that the identification and the handling, storing, sharing and publishing of such information will not provide a competitive advantage to the **Related Business** over any competitor of a **Related Business**.

4.3 If an **Electricity Entity** proposes to allow the disclosure of information of the type referred to in clause 4(d) to an employee, consultant, contractor or agent involved in the conduct of a **Related Business**, the **Information Procedures** must identify categories of information which will also be made available to competitors of the **Related Business**.

4.4 Without limiting the matters which may be covered in the **Information Procedures**, those **Procedures** should deal with the electronic, physical and procedural security measures that the **Electricity Entity** proposes to employ in respect of the conduct of a **Prescribed Business** (including separation of office space, access to information systems and procedures for the minimisation of **Customer** confusion and opportunities for preferential treatment or other unfair competitive advantage).

5. Scope of Principles

5.1 Nothing in these principles will limit the matters which the **Commission** may take into account in approving or issuing any **Procedures** or imposing any conditions upon its approval of any **Procedures**.

EXPLANATORY NOTES ACCOMPANYING THE NT ELECTRICITY RING-FENCING CODE

The following explanatory material is a slightly updated version of the explanations first published with the Code on 1 July 2001.

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Explanatory Notes to the Northern Territory Electricity Ring-Fencing Code

1. Legislative Authority and Requirements

1.1 When announcing a package of further reforms to the Territory's electricity supply industry on 20 October 1999, the Treasurer stated that:

“PAWA’s network business will also be separated (or ‘ring-fenced’) from its retail and generation functions to ensure that PAWA’s contestable activities gain no advantage – or cross subsidies – from its ongoing monopoly activities.”

1.2 The authority to impose ring-fencing obligations on licensees operating monopoly businesses was included in the *Electricity Reform Act 2000* (“ERA”). In particular, the ERA provides that the Commission may make certain licences subject to the condition that the business authorised by the licence be kept separate, in the manner and to the extent specified in the licence conditions:

- for a business licensed to operate an electricity distribution network – from a related body corporate licensed to generate or sell electricity (section 26(1)(h));
- for a business licensed to sell electricity to non-contestable customers – from a related body corporate licensed to generate electricity or to sell electricity to contestable customers (section 27(1)(a)); and
- for a business licensed to undertake the role of system control over a power system – from a related body corporate licensed to generate electricity (section 29(1)(a)).

1.3 The Commission gave effect to these licence conditions by including in each of the licences granted to the Power and Water Authority (“PAWA”) a condition to the effect that the licensee must comply with all applicable provisions of a ring-fencing code after such a code is made by the Commission.

1.4 The power of the Commission to make industry codes and rules is conferred by section 24 of the *Utilities Commission Act 2000* (“UCA”). Section 24(1) provides that the Commission may make codes or rules relating to the conduct or operations of a regulated industry or licensed entities. Section 24(2) of the UCA provides that the Commission may only make a code or rule under subsection (1) if authorised to do so by the relevant industry regulation Act or by regulations under the UCA.

1.5 Regulation 2 of the *Utilities Commission Regulations*, notified in the *Northern Territory Government Gazette* of 4 June 2001, provides that:

“(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.”

1.6 The Commission is restrained by section 6(2) of the UCA with respect to matters it can have regard to when, inter alia, making a ring-fencing code. The Commission must have regard to the need:

- to promote competitive and fair market conduct;
- to prevent misuse of monopoly or market power;
- to facilitate entry into relevant markets;
- to promote efficiency;

- to ensure consumers benefit from competition and efficiency;
- to protect the interests of consumers with respect to reliability and quality of services and supply in regulated industries;
- to facilitate the maintenance of the financial viability of regulated industries; and
- to ensure an appropriate rate of return on regulated infrastructure assets.

2. Development of the Code

Interim Code

2.1 On 3 February 2000, the Interim Utilities Commissioner provided PAWA with a document entitled 'Draft Ring-Fencing Guidelines' ("Draft Guidelines"). Based on that document, the Commission published an interim ring-fencing code ("the Interim Code") in April 2000. The aim of the Interim Code was to provide guidance to PAWA and other industry participants about the conduct expected of vertically integrated participants in the Territory's electricity supply industry, following the introduction of competition into that industry.

2.2 At that time, however, the Commission recognised that:

- parties (including PAWA) had not had the opportunity to fully consider the Interim Code – although PAWA did have the benefit of the Draft Guidelines on which the Interim Code was based; and
- the Interim Code was largely specified in terms of 'targeted outcomes' – with the Commission leaving it to PAWA management in the first instance to propose the internal policies and procedures to achieve the specified outcomes.

2.3 The Commission therefore proposed that the Interim Code be in place only until a replacement code was developed through a public consultation process.

Initial consultations

2.4 To commence the public consultation process, the Commission required PAWA to develop the policies, practices and procedures which PAWA considered would most cost-effectively give effect to the ring-fencing outcomes set out in the Interim Code. Specifically, within three months of issue of its licences, PAWA was required to submit certain proposals to the Commission for review and approval.

2.5 In particular, by 30 June 2000, the Commission sought two contributions from PAWA:

- PAWA's comments on the Interim Code and any suggested amendments to assist the Commission in drafting a replacement code; and
- a detailed statement by PAWA, capable of being made public, setting out the policies, practices and procedures that PAWA proposed to put in place to meet the requirements of the Interim Code.

2.6 The Commission indicated that, following receipt of PAWA's proposals and comments, it would issue a discussion paper setting out its analysis of PAWA's proposals, and inviting public comment on both PAWA's and the Commission's views.

2.7 PAWA provided its proposed ring-fencing policies, practices and procedures to the Commission in early July 2000.

2.8 Later in July 2000, the Commission published its assessment that PAWA's response fell short of meeting the minimum requirements for the undertaking sought

by the Commission. PAWA's response was judged to be closer to a broad statement of principles and intentions than to a set of detailed policies, practices and procedures.

2.9 In the circumstances, the Commission issued a draft replacement code ("the initial draft Code") derived from guidelines developed for the electricity supply industry by regulators in other jurisdictions (the ACCC and the Queensland Competition Authority, for example) based on the 'National Gas Code' model. The National Gas Code model establishes a number of minimum obligations, with the regulator being provided with the ability to waive certain obligations, and provides for a mechanism whereby the regulator may impose additional obligations.

Need for a ring-fencing regulation

2.10 In its submission commenting on the initial draft Code, PAWA drew the Commission's attention to the fact that the various ring-fencing provisions in the ERA – obliging related or associated monopoly and contestable electricity businesses to be operated separately – may not work as intended with respect to PAWA on account of a faulty definition of "related body corporate" in the ERA.

2.11 The Commission subsequently received legal advice that amendments to the ERA were unnecessary, provided any ring-fencing code made by the Commission was made binding in its own right. A code would be binding under section 24(2) of the UCA only if the Commission was authorised to make such a code by either the relevant industry regulation Act or by a regulation made under the UCA itself.

2.12 In light of the above, the Regulatory Minister (the Treasurer) approved the drafting of a regulation under the UCA to authorise the Commission to make ring-fencing codes with respect to industries declared to be regulated industries under relevant industry regulation Acts.

2.13 Under the UCA, when making codes and rules, the Commission is required to follow strict procedures. Notably (under section 24) the Commission must:

- consult with the Minister and representative bodies and participants on the making of the code or rule, as the Commission considers appropriate;
- provide notice of the making of the code or rule to the Minister and licensed entities; and
- publish notice of the making of the code or rule and its commencement date in the *Northern Territory Government Gazette*.

Further consultations

2.14 Following its consideration of submissions received in response to the initial draft Code, in December 2000 the Commission issued a revised draft replacement Code ("revised draft Code") together with detailed explanatory material dealing with the revisions that had been made to the initial draft Code.

2.15 The Commission then had an opportunity to review submissions received in response to the revised draft Code. A final draft replacement ring-fencing Code ("final draft Code") was released by the Commission in April 2001, addressing some of the issues raised in the submissions and a number of additional matters which came to the attention of the Commission as a result of the preparation of the final draft.

2.16 The Commission undertook a final round of consultations following notice in the *Gazette* of the *Utilities Commission Regulations* on 4 June 2001. Regulation 2 (hereafter "the Ring-fencing Regulation") authorised the Commission to make a ring-fencing code with respect to the electricity supply industry.

2.17 After the deadline for final submissions passed and the Regulatory Minister was consulted as required by section 24(4) of the UCA, the Commission formally adopted the Code.

2.18 On 27 June 2001, the Commission published the making of the Code by notice in the *Northern Territory Government Gazette*. The Code came into effect on 1 July 2001. The Code replaced the Interim Code that commenced with effect on 1 April 2000.

April 2002 definitional amendments to the Code

2.19 In January 2002, the Commission identified a deficiency in the Code as published on 1 July 2001. Contrary to the Commission's intentions, the Code as initially published was insufficient to prevent PAWA's monopoly businesses (e.g. Networks and System Control) from sharing commercially-sensitive information with PAWA Generation or otherwise favouring PAWA Generation to the detriment of its competitors. This deficiency arose because, as initially published, PAWA Generation was defined solely as a 'prescribed business' under the Code.

2.20 In accordance with the amendment provisions set out in the Code (clauses 6 and 7), the Commission consulted industry participants and other interested parties regarding its proposed amendments to address the deficiency identified in the published Code. In April 2002, the Commission published a Decision Paper entitled 'Amendments to the NT Electricity Ring-Fencing Code' outlining certain definitional amendments to the Code.

2.21 The amendments to the Code were restricted to an amendment to the clause 11.2 definition of 'related business' and a subsequent inserted definition of 'contestable market'. The effect of these definitional amendments is that, for the purposes of the Code, PAWA Generation (as a whole) is to be treated as:

- a 'related business' for the purposes of the conduct of PAWA's other prescribed businesses (Networks, System Control and Non-Contestable Retail); and
- a 'prescribed business' for the purpose of PAWA Generation's conduct with respect to PAWA's other related businesses (Contestable Retail).

3. The Purpose of Ring-Fencing

NT context

3.1 Over recent years, the Territory Government has implemented a number of initiatives aimed at reforming the Territory's electricity supply industry. Most notably, on 1 April 2000, PAWA's effective monopoly over the supply of electricity ceased with the commencement of the phased introduction of competition among generators and retailers, and the associated provision for third-party access to electricity networks.

3.2 Under these reformed industry arrangements, PAWA still retains its monopoly status as owner of the electricity network and as the power system controller. It also remains the sole supplier of electricity to non-contestable customers.

3.3 At the same time as agreeing to introduce competition into the Territory's electricity supply industry, the Government rejected the option of separating PAWA's related businesses, preferring instead to retain PAWA as a horizontally and vertically integrated entity.

3.4 Together, these arrangements see PAWA operating both monopoly and contestable businesses.

3.5 The resultant corporate integration and affiliation of monopoly and contestable businesses gives rise to the possibility that decisions could be made by a monopoly business in ways that discriminate against a competitor of a related business in an upstream or downstream market, or financially or competitively advantage that related business.

3.6 In these circumstances, the Government recognised the requirement for effective ring-fencing arrangements between monopoly and contestable businesses and, in the ERA, empowered the Commission, when issuing licences, to require monopoly businesses to be kept separate – or ‘ring-fenced’ – from contestable businesses.

Broad objectives

3.7 Effective ring-fencing is necessary to promote the object of the ERA relating to the promotion of efficiency and competition in the electricity supply industry.

3.8 The integration and affiliation of monopoly and contestable businesses gives rise to the possibility – not available otherwise – for market conduct that reduces the efficiency of network price regulation or results in anti-competitive advantages for an affiliated retailer. Examples of conduct that could have this effect are:

- cross-subsidisation by a network operator of affiliated retailer activities;
- giving an affiliated retailer preferential access to network services;
- joint marketing between a network operator and a retailer; and
- giving an affiliated retailer access to information held by the network operator.

3.9 Ring-fencing therefore aims at providing two related benefits:

- improvement in the effectiveness of retail competition, by preventing a monopoly service provider from extending its market power into a contestable sector; and
- improvement in the efficiency with which monopoly service providers are regulated, by preventing contestable costs being recovered through regulated charges.

3.10 Hence, as provided in clause 3 of the Code, the overarching objectives of the Code are:

- to promote and safeguard competition and fair and efficient market conduct in the Territory’s electricity supply industry, including by promoting the simulation of competitive market conduct and preventing the misuse of monopoly power; and
- to require that electricity entities have in place arrangements which ensure that contestable businesses are not treated in such a manner by a related monopoly business as to confer a non-commercial discriminatory price or non-price advantage on the related business as compared to an arm’s length third party in the same commercial circumstances.

4. Types of Businesses to which Ring-Fencing Applies

Requirements of the Code

4.1 Not all businesses operating in the Territory’s electricity supply industry are subject to ring-fencing obligations. Such obligations are only placed on the business (or component of a business) of an operator in the Territory’s electricity supply industry described as a “Prescribed Business” under the Code.

4.2 In principle, obligations under the Code are not placed on any contestable businesses in the electricity industry (termed a “Related Business” in the Code), but rather on a prescribed business.

4.3 Notwithstanding this, unless the businesses are legally separate, it is only possible to impose an obligation upon an entity as a whole. In these circumstances, the ring-fencing obligations extend to the electricity entity as a whole, as opposed to only that part of the entity that operates as a prescribed business.

Statutory monopoly electricity businesses

4.4 Under paragraph (a) of the definition of a prescribed business in clause 11.2, the Code specifically places ring-fencing obligations on the business (or component of a business) carried on by an electricity entity which consists of:

- the provision of network access services (sub-paragraph (i));
- the provision of power system control and dispatch services (sub-paragraph (ii)); or
- the sale of electricity to non-contestable customers (sub-paragraph (iii)).

4.5 Given current operations within the Territory’s electricity supply industry, only businesses operated by PAWA currently qualify as prescribed businesses subject to the Code. Notwithstanding this, the Code has been drafted so that it applies broadly to all electricity entities that carry on a prescribed business. This allows for future developments in the industry.

4.6 For the purposes of the remainder of this document, and for ease of reference, the respective businesses of PAWA subject to the Code’s ring-fencing obligations on account of their statutory monopoly status in the electricity supply industry are referred to as:

- PAWA Networks;
- PAWA System Control; and
- PAWA Retail (Franchise).

4.7 Each of these businesses currently has a statutory monopoly, with only a single licence to be issued under the ERA, for each of these types of operations, in a particular geographical area.

PAWA’s other statutory monopoly businesses

4.8 Under paragraph (a) of the definition of a prescribed business in clause 11.2 of the Code, sub-paragraph (iv) extends the definition of a prescribed business also to a business (or component of a business) carried on by an electricity entity which the Commission determines, in accordance with clause 6, is not reasonably contestable and should be included within the definition of ‘Prescribed Business’ for the purposes of the Code.

4.9 In this way, the definition of prescribed business can be extended to other monopoly or near monopoly businesses carried on by an electricity entity outside of the electricity supply industry. The Ring-fencing Regulation authorising the Commission to make the Code specifically extends to the making of ring-fencing codes with respect to industries declared to be regulated industries under relevant industry regulation Acts.

4.10 This authority entitles the Commission to make a ring-fencing code, in relation not only to the electricity supply industry but also to the water supply services industry and the sewerage services industry (with the businesses operated by PAWA in

the latter industries together being referred to in the remainder of this paper as PAWA Water).

4.11 At this stage, the Commission does not propose to exercise its power under sub-paragraph (iv) such that the provision of goods or services outside the electricity supply industry is covered by the Code. It is the Commission's intention instead to make a ring-fencing code for these other industries in the near future, and to investigate the possibility of amalgamating these two codes into one general ring-fencing code.

4.12 Notwithstanding this fact, if – in advance of making these other codes – it becomes apparent to the Commission that a related business is gaining an unfair advantage over its competitors as a result of the activities of any monopoly or near monopoly business carried on by the relevant electricity entity outside of the electricity supply industry (including the provision of goods or services on non-commercial terms, cross-subsidisation or disclosure of commercially valuable information) the Commission would reconsider its decision concerning the scope of the definition of a prescribed business under the Code.

4.13 In that regard, the Commission believes there is no logical reason why activities which would be prohibited if undertaken by a prescribed business operating in the electricity supply industry should not also be prohibited should the same activities be undertaken by a monopoly or near monopoly business outside of the electricity supply industry, if the net effect of those activities is to unfairly advantage a related business in a competitive market.

Businesses with substantial market power

4.14 Finally, paragraph (b) of the definition of a prescribed business in clause 11.2 of the Code specifically places ring-fencing obligations also on the business carried on by PAWA of generating electricity for sale to third parties or notionally to PAWA Retail. Hereafter, this business is referred to as PAWA Generation.

4.15 In contrast with PAWA's other businesses subject to the Code, PAWA Generation does not have a statutory monopoly and itself competes in a contestable market.

4.16 However, paragraph (b) provides that PAWA Generation is to be a prescribed business for the purposes of ring-fencing only until such time as the Commission is satisfied that, having regard to factors set out in section 6(2) of the UCA and such other matters as the Commission considers appropriate:

“(i) the Power and Water Authority 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) this Code should no longer apply to that business...”

4.17 In this way, the Commission has extended the definition of a prescribed business to the business of generating electricity carried on by PAWA until such time as the Commission is satisfied that PAWA Generation no longer possesses substantial market power in the Territory's market for the generation of electricity.

4.18 As a result, there should be a transparent relationship in particular between PAWA Generation and PAWA Retail's business of selling electricity to contestable customers (“PAWA Retail (Contestable)”).

4.19 PAWA Generation has been made subject to the Code, notwithstanding the fact that – in contrast to the case of PAWA's statutory monopoly businesses where the ERA explicitly states that there must be separation – there is no explicit legislative statement in section 25 of the ERA authorising PAWA Generation to be kept separate from other PAWA contestable businesses.

4.20 In addition and as a consequence of amendment to the Code in April 2002, the Commission's intention that PAWA Generation remain a related business with respect to PAWA's other prescribed businesses was clarified.

4.21 The Commission has been influenced instead by the fact that the driving force behind the Government's recent regulatory reforms has been the creation of competition in the Territory's electricity supply industry. Just because a sizeable share of the market will eventually be opened to competition does not negate the possibility that PAWA Generation could remain the dominant generator – in possession of substantial market power – for the foreseeable future. In this case, were the Code not extended to apply to PAWA's generation business, it is unlikely that any independent retailers would consider operating in the Territory's electricity retail market.

4.22 Market power is defined as the ability of a firm to raise and maintain price above the level that would prevail under effective competition. If it so chooses, a firm with substantial market power is able to provide a lower level of service quality or choice, or charge a higher price, without suffering a decline in profit.

4.23 If an incumbent firm (like a generator) possesses substantial market power, this does not mean that that it is abusing – or will abuse – that market power. However, it does establish the grounds for economic regulation aimed at preventing cases of abuse from arising, and providing assurance to competitors that anti-competitive conduct would be punished if it did occur.

4.24 The Commission acknowledges that economic regulation has no role to play where competition exists. Competition exists in a market where firms or sellers independently strive for the patronage of buyers in order to achieve their business objectives, e.g. profits or market share. Competition is an important process by which firms are forced to become efficient and offer greater choice of products and services at lower prices.

4.25 Efficient competition requires that all incumbent and prospective firms be given equal opportunities to compete for customers.

“... In the context of competitive sports, fair rules are supposed to show no partiality toward any team or individual. They should result in outcomes that depend solely on the skills of the participants – that is, the best should always win. In the marketplace, fair rules should produce winners on the basis of their ability to satisfy customers, nothing else. This means that new entrants should have the same opportunities as incumbents to succeed while, at the same time, incumbents are not unduly restricted in their market activities.”

4.26 Only where an electricity business dominates a market – in that it enjoys a position of economic strength such that it can behave to an appreciable extent independently of its competitors and customers – does economic regulation have a role to play.

4.27 The Commission acknowledges that section 46 of the *Trade Practices Act 1974 (Cth)* provides a level of protection against any exploitation of PAWA Generation's market dominance. However, the Commission does not believe that a simple prohibition on anti-competitive conduct is likely to be effective if the incentive and opportunity to engage in such conduct still exists. It has therefore sought to exercise its responsibility to seek to modify anti-competitive behaviour by developing a clear code of competitive conduct by specifying the behaviour required with regard to activities involving substantial market power.

4.28 At this stage, the Commission does not propose to issue a definitive set of criteria to be applied when determining whether PAWA Generation still has a substantial degree of market power within a defined geographical area.

4.29 There exists a considerable body of authority concerning the determination of the degree of market power held by a market participant. It is a common feature of

these authorities that, when determining whether a particular participant has a substantial degree of market power, the particular circumstances of the participant and the market need to be considered.

4.30 Accordingly, the Commission believes it would be inappropriate to limit the manner in which it can exercise this power by including detailed criteria in the Code. Rather, the Commission will have regard to the approach adopted by other regulators within Australia and, in particular, the approach adopted by the ACCC from time to time in relation to the determination of the degree of market power held by a participant operating in a particular market.

5. 'Conduct' versus 'Structural' Approaches to Ring-Fencing

Need to define ring-fencing

5.1 Under the Ring-fencing Regulation, ring-fencing has been defined as:

"...the separate operation of related or associated businesses of a licensed entity in a regulated industry."

As 'separate operation' is not defined, it has been the Commission's task to specify and operationalise this term. This Chapter sets out the reasons for the Commission's decisions on this matter.

Conduct rules and guidelines

5.2 "Separate operation" has potentially two different meanings:

- structural separation; or
- the simulation of the types of conduct expected under structural separation.

5.3 The Code focuses on the latter approach. The Code's approach to ring-fencing therefore mainly involves regulatory intervention to simulate the market behaviour expected were there no corporate integration or affiliation. Ring-fencing arrangements are therefore implemented through the application and enforcement of measures affecting the relationship between the related businesses of an integrated entity. The focus is on conduct rules and guidelines designed to proscribe the behaviour that would potentially restrict competition if allowed to exist.

Weighing costs and benefits

5.4 The Commission has assessed these alternative approaches by considering the relative costs and benefits of each approach in the Territory context.

5.5 The Commission has taken this approach because it is conscious that the promotion of effective competition is a means towards promoting efficiency in the delivery and pricing of energy services to the ultimate benefit of customers and the community. The Commission has not sought to impose regulation with the singular goal of facilitating competitive entry, irrespective of the social costs and benefits involved. Policies designed to facilitate competitive entry and effective competition must be weighed against the possibility that they will reduce customer benefits by eliminating existing economic efficiencies.

5.6 The Commission is restrained by section 6(2) of the UCA with respect to matters it can have regard to when performing its function of making the Code. The Commission has had regard to those factors and has sought to balance the public benefits of the Code against the potential costs that will be incurred by electricity entities and the public as a whole from requiring compliance with those obligations.

5.7 The Commission recognises that there is a trade-off between the benefits of effective competition on the one hand and the economies of scale and scope that can be achieved by an integrated and coordinated entity on the other. Ring-fencing obligations should be put in place where there is a net public benefit in doing so. As with all regulatory regimes, the Commission has considered the costs associated with adopting the ring-fencing obligations. These include compliance costs and monitoring costs, which can arise as a result of an administrative burden, and the loss of economies of scale and/or scope.

5.8 Ring-fencing obligations impose compliance and monitoring costs on PAWA. The Commission has sought to impose ring-fencing obligations with manageable costs, particularly because the requirements parallel those of management in isolating and monitoring the performance of individual businesses.

5.9 The loss of economies of scope is potentially of more significance in PAWA's case. Economies of scope involve the efficiencies that derive from providing a variety of services. Apart from the spreading of corporate overheads, economies of scope are particularly evident in:

- the application of information technology;
- billing systems;
- field operations; and
- call centres.

5.10 PAWA's existing multi-utility structure allows it to take advantage of scope economies. This is very important to the overall potential cost efficiency of PAWA because of its lack of scale. Hence, the anti-competitive aspects of horizontal and vertical integration need to be balanced against the efficiency benefits that result from economies of scope (for example, the spreading of overheads) and operating synergies which exist, particularly between network and retail functions.

5.11 The Commission has deliberately focused on a 'conduct' rather than 'structural' approach to ring-fencing, to ensure that any losses of economies of scope are minimised.

Structural separation

5.12 The main forms of structural separation applicable in the Territory context are legal separation and functional separation.

Legal separation

5.13 Legal separation requires monopoly and contestable functions to be separate legal entities as defined by the *Corporations Law*. The requirement still allows monopoly and contestable businesses to be both owned by a holding company, or contestable businesses to be subsidiaries of a monopoly business.

5.14 The Code does not require legal separation, on the grounds that the Commission considers the costs of implementing such separation in the Territory context would outweigh the benefits to the public. Apart from the establishment costs of the holding/subsidiary companies, there would be ongoing costs such as those associated with public reporting requirements and the operation of separate boards.

Functional separation

5.15 Functional separation requires the related businesses of an integrated entity to be carried out in different locations, using separate or partitioned systems. Complete functional separation prohibits sharing of facilities, equipment, information systems, employees and resources.

5.16 The Code does not require strict functional separation, on the grounds that the Commission considers the costs of implementing such separation in the Territory context would outweigh the benefits to the public. If implemented, strict functional separation would act to erode the economies of scope necessarily held by PAWA.

Structural elements in the Code

5.17 There are only two structural-like obligations imposed in the Code.

Marketing separation

5.18 Clause 4(g) of the Code obliges prescribed businesses to keep their marketing staff separate from the marketing staff for related (contestable) businesses. This provision acts to dismiss concern that joint marketing activities have the potential to distort customer understanding of the relationship between the businesses.

5.19 In the Commission's view, this separation is the minimum structural separation required. The cost should not be too great given the different competencies that are expected between marketing at the retail level and that in the wholesale market (involving other licensed retailers and generators).

Accounting separation

5.20 Under clause 4(a) of the Code, electricity entities must establish and maintain a separate set of financial accounts and reports in respect of their electricity businesses as a whole.

5.21 Accounting separation contributes to ring-fencing through transparency of accounts and is essential to assessing the extent to which revenues with each of these businesses are related to their costs.

5.22 The Commission recognises that the objectives of the Code would be significantly impeded if it did not have access to a separate set of financial accounts and reports in relation either to PAWA's prescribed businesses or to its electricity business as a whole (as compared to PAWA's total business operations).

5.23 In doing so, and in order to preserve the confidentiality of commercially sensitive information, clause 9.1 of the Code exempts PAWA's generation and franchise retail businesses – and PAWA's electricity business as a whole – from the requirement to make publicly available the separate financial reports that it prepares for the Commission.

6. Nature of Desirable (and Undesirable) Conduct

Focus on behaviour, not performance

6.1 The Code focuses on an entity's behaviour and not its performance. Specifically, the Code:

- is primarily aimed at directly facilitating the behaviour (conduct) expected as if the businesses were structurally separated; and
- does not involve regulating performance as such (either price or quality).

Reasonable allocation of costs

6.2 Under clause 4(b) of the Code, a prescribed business is required to establish accounting policies and procedures that ensure the appropriate allocation of costs between different regulated businesses and between regulated and non-regulated activities.

6.3 Correct cost allocation is at the forefront of the rationale behind establishing such accounting policies and procedures. Cost allocation refers to the process of assigning a single cost to any activity, function or process. In many cases, there are direct cost drivers that enable costs to be causally allocated. However, indirect costs such as the cost of corporate support and IT functions often do not have a simple cost driver and thus create a more complex allocation of non-attributable, common costs.

6.4 The focus of cost allocation principles is therefore on the allocation of common costs to prescribed businesses. The generally accepted principle among regulators in Australia is that common costs should be allocated to a prescribed business on a “causation” – and not avoidable cost – basis. This sees costs generally allocated to a prescribed business on a fully distributed cost (FDC) basis.

6.5 Appropriate allocation of these costs aims to promote economic efficiency while limiting the ability of an entity:

- to extend its monopoly powers from the regulated business to contestable parts of the industry;
- to ensure effective price regulation of the monopoly business; and
- to ensure that regulated activities do not cross subsidise non-regulated (or contestable) activities within the regulated business itself or within associated businesses.

6.6 While the Code contains no specific reference to the avoidance of cross-subsidisation, this is the fundamental aim of the Code’s requirement for the consistent application of rules for cost/revenue attribution and for an appropriate allocation of common or joint costs, including overhead costs.

Appropriate use and disclosure of information

6.7 Under sub-clauses 4(c) and (d), limitations are placed on information flows, imposing controls on the sharing of information between prescribed and related businesses in order to minimise any potential competitive advantages that a prescribed (i.e. monopoly) business could provide any related (i.e. contestable) businesses.

6.8 While information is one of the critical ways by which retailers may gain a competitive advantage, ring-fencing with respect to information flows is difficult to implement and monitor.

6.9 The Code aims at controlling the use of information rather than merely access to it. This is consistent with the approach adopted by regulators elsewhere in Australia and overseas. As a consequence, the Code requires a prescribed business:

- to ensure that all 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 to any other related business or any other person without the approval of the customer or prospective customer who provided it; and
- to not provide any commercially-sensitive information to a related business unless that information is made equally available to all competitors of that related business.

6.10 The Commission recognises that a blanket prohibition on disclosure of all information would be inappropriate because, in relation to various types of information, the administrative costs of complying with that prohibition would outweigh the potential benefits to the public.

6.11 However, there are clearly some types of information which are so critical to the ability of a related business to compete in a contestable market that they should not

be allowed to be disclosed by a prescribed business to a related business without equal disclosure to competitors of that related business.

6.12 The Commission considers the restriction on information flows to be critical, and it will monitor compliance accordingly. Breaches of this section of the Code will be dealt with swiftly.

Decision-making independence

6.13 Independent decision making by management in an integrated entity is an integral part of the Code.

6.14 Clause 4(e) of the Code emphasises that the Commission is concerned with ensuring that goods and services acquired by a related business from a prescribed business are provided on an arm's length commercial basis and are available on the same basis to other customers including competitors of the related business.

6.15 For example, the Commission will be concerned if a prescribed business was providing an accounts processing service to a related business on non-arm's length commercial terms (i.e. less than cost) because the net effect would be to provide a competitive advantage to the related business as compared to the competitors of the related business.

6.16 Clause 4(f) of the Code proscribes this behaviour by requiring that an electricity entity ensures that services provided between prescribed and related businesses be provided on a non-discriminatory ('arms length') commercial basis.

Undesirable conduct

6.17 In summary, the types of market conduct deemed undesirable by the Code are:

- cost shifting to a monopoly business from related contestable (and non-regulated) businesses;
- the provision of confidential information by a monopoly business to a related contestable business in a manner that advantages the related business over competitors of that related business; and
- decisions by management of a monopoly business as to the terms and conditions of the supply of services to, or the purchase of services from, a related business being made with the purpose or effect of discriminating unfairly in favour of the related business vis-à-vis competitors of that related business.

7. Approach to Implementing Conduct Regulation

7.1 The Code's primary focus is on regulating the conduct of integrated businesses.

7.2 Having established the types of conduct to be discouraged by a ring-fencing code, this part explains the particular approach taken in the Code to implementing the requisite conduct regulation.

Preventative rather than reactive approach

7.3 The Code takes what can be described as an ex-ante or 'preventative approach' to the regulation of the conduct of prescribed businesses. A preventative approach identifies the potential for specific circumstances to arise, and then seeks to reduce the risk that it will occur by providing appropriate incentives.

7.4 This contrasts with an ex-post or 'reactive approach' to conduct regulation which involves a reaction to anti-competitive behaviour that has already taken place in

the market. This approach, by definition, is not 'pro-active' and does not see corrective action until it is too late.

7.5 The Commission regards a preventative approach as serving to strengthen its conduct approach. While advocates of structural separation may argue that structural measures amount to the ultimate form of prevention, a preventative approach to conduct regulation – by putting in place arrangements that directly discourage undesirable behaviour from occurring in the first place – is more likely to achieve the goals of ring-fencing than a purely reactive approach.

7.6 Preventative measures also provide market participants with more certainty. Incumbents are more certain about what they can or cannot do. New entrants are better able to evaluate whether to enter the market.

7.7 Finally, preventative measures are generally simpler and easier to enforce, and are particularly necessary when a market is in the early stage of its development, and therefore vulnerable to anti-competitive behaviour.

7.8 The view of the Commission is that a preventative approach is consistent with its objectives. The Commission has a responsibility to ensure the maintenance of a competitive environment that will benefit consumers, and it therefore has a responsibility to consider the potential for anti-competitive conduct before it arises.

7.9 Preventative measures are not of themselves more onerous or intrusive than reactive measures. The principal difference is that preventative measures provide greater regulatory certainty and transparency. The Commission has considered costs and benefits in formulating the Code. It has adopted preventative measures aimed at supporting and promoting competition and delivering long-term customer benefits.

Flexible rather than determined approach

7.10 The Commission has erred on a more expansive approach in some respects, by including certain possibly onerous obligations and then relying on provisions in the Code for exemptions to be granted from compliance with specified obligations where that can be justified. Clause 9 of the Code sets out the procedure by which the Commission must determine whether an exemption should be granted in a particular case.

7.11 In this way, clauses 9.3 and 9.4 of the Code provide a greater degree of flexibility to fine-tune an application made by an entity under clause 9.2, relating to particular obligations under the Code. This is consistent with the approach adopted in other jurisdictions.

Open rather than prescriptive approach

7.12 Under clause 5, the Code permits electricity entities to develop their own specific procedures by reference to a general set of principles enunciated by the Commission. Broadly, the procedures required refer to:

- accounting policies and practices;
- cost allocation policies and practices; and
- information sharing policies and practices.

The procedures proposed will only be approved by the Commission if they are consistent with the requirements of Schedule 2 to the Code (Clause 5.3).

7.13 This contrasts with an approach whereby the Commission would itself develop the details of specific procedures to be followed by the prescribed businesses.

7.14 The inclusion in the Code of a procedure for the development by electricity entities of accounting, cost allocation and information procedures – and the approval of the proposed procedures by the Commission – allows:

- consideration of various requirements at a micro level; and
- the achievement of an appropriate balance between the costs of complying with those requirements and the likely benefits to the public in promoting competition.

7.15 In effect, the Commission will:

- establish a set of high-level ring-fencing accounting, cost allocation and information sharing principles;
- allow the prescribed business to propose the necessary policies and procedures to give effect to the principles; and
- review and, when satisfied that the procedures (as amended) are consistent with the principles set out in the Code and elaborated by the Commission, approve the policies and procedures proposed by the prescribed business.

Compliance

7.16 The Commission considers a clear set of compliance arrangements (compliance programs and sanctions for breaches) to be important support for its preventative approach.

7.17 Under clause 8, the Code requires that licensees:

- develop and implement internal policies and procedures to ensure compliance with the Code;
- demonstrate on reasonable notice to the Commission that the measures put in place are adequate;
- report to and be assessed by the Commission at reasonable intervals describing the steps taken to ensure compliance; and
- if required by the Commission, appoint an independent auditor to review compliance with the Code.

7.18 Clause 8.6 of the Code provides that, unless a breach of the Code is found, the Commission will fund any Commission-initiated compliance audits undertaken by a business entity. This provision imposes a discipline on the Commission, and so should serve to keep review costs to a minimum.