



Australian Competition & Consumer Commission

DRAFT

Transmission Ring Fencing Guidelines

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These Transmission Ringfencing Guidelines are produced under Part G of Chapter 6 of the National Electricity Code. All Transmission Network Service Providers are required under clause 6.20.1 of the National Electricity Code to comply with these guidelines.

1. Introduction

Part G of Chapter 6 of the National Electricity Code (NEC) requires the Commission to develop ring fencing guidelines for the accounting and functional separation of the provision of prescribed services from the provision of other services by the Transmission Network Service Provider (TNSP). All TNSPs are required, under clause 6.20.1 of the NEC, to comply with these guidelines.

In setting out these Transmission Ring Fencing Guidelines, the Commission's objective is to reinforce the effectiveness of the regulatory processes by limiting the ability of the transmission networks to extend their monopoly powers from the network business into the contestable parts of the industry.

Ring fencing arrangements have been developed with varying degrees of success in the context of other monopoly industries. Most recently ring fencing arrangements were developed by the National Gas Reform Task Force and included in sections 4 and 7 of the National Gas Access Code.

In the *Draft Statement of Principles for the Regulation of Transmission Revenues* the Commission signalled its intention to adopt a set of ring fencing arrangements for electricity transmission networks which were very similar to the National Gas Access Code's ring fencing arrangements. This intention was based on the fact that the Commonwealth, State and Territory governments have agreed to the National Gas Access Code's ring fencing arrangements and their application to electricity transmission networks would ensure consistency between gas and electricity transmission networks. A set of draft transmission guidelines was circulated to interested parties on 27 May 1999 and then subsequently on 10 September 2001. These guidelines represent a revision of those guidelines, taking account of comments made by interested parties as well as recommendations made by various State Regulators. Further, clause 6.20.2(d)(d) of the NEC requires the Commission to consider the need, so far as practicable, for consistency between the Transmission Ring Fencing Guidelines and Federal and State regulation in each participating jurisdiction of ring fencing requirements of other utility businesses.

For these reasons the Commission has decided to use the National Gas Access Code ring fencing provisions as a model for the NEM. In doing so the Commission has been guided by the views of interested parties, the majority of whom were supportive of the development of ring fencing guidelines along the lines of the National Gas Access Code. In addition the Commission has selected a set of arrangements that provide the flexibility for the Commission to waive elements of the ring fencing arrangements where the costs of compliance outweigh any apparent benefit from imposing the ring fencing provisions.

It is to be stressed that in practice the Transmission Ring Fencing Guidelines must be read in conjunction with the Commission's information requirements for TNSP's - which sets out the information that the Commission requires transmission network owners to submit and verify or audit under clause 6.2.5 of the NEC. The Commission does not at this stage propose to publish accounting or auditing guidelines under the Transmission Ring Fencing Guidelines but does not rule out the need for such guidelines and/or additional provisions at some future date.

2. Commission objectives

These ring fencing guidelines require a TNSP to establish arrangements to segregate or ring fence its business of providing regulated transmission network services.

As a minimum, a TNSP must be a legal entity. In practice, legal separation can be thought of as structural separation in that the TNSP is prohibited from providing services in competition with the other firms using the network. The use of accounting separation alone does not effectively prevent discrimination of a competing network user, and accounting separation cannot effectively be used to promote entry into the contestable network user segment of the electricity market. These such implications of vertical integration in a setting of informational asymmetry are reason enough for stringent legal separation.

The TNSP must not carry on a related business. This is linked to but not limited to the TNSP being a legal entity in itself. The aim is to separate as far as possible the monopoly powers of the TNSP's from the contestable activities of generation and retail supply.

The TNSP must allocate its costs so that they reflect the use of its assets that are shared between both its competitive and regulated activities. For this reason, it is required that the TNSP establish and maintain separate accounts for the activity that is the subject of a revenue cap determination by the Commission for compliance purposes. The TNSP is also required to establish and maintain a consolidated set of accounts for all regulated activities undertaken. These procedures will allow the regulator to distinguish whether costs are allocated in a fair and reasonable manner.

Once costs are allocated, the TNSP cannot preferentially deal with any related utility or itself in such a way as to discriminate against other access seekers. This will ensure that costs shared between different accounts are allocated in a fair and reasonable manner. The prices that the TNSP charges to access seekers will then not disadvantage those access seekers in comparison to the TNSP's own activities in markets where it is competing with the access seeker.

A fair and reasonable allocation of costs tackles the issue of cross-subsidisation. The regulator must be certain that the access prices of the TNSP's are based on the published access prices and not its true costs which are non-verifiable. This verification by the regulator is impossible without the implementation of ring fencing arrangements. The TNSP will otherwise have private information about its true costs. This will harm the contestability of the retail supply market as other users may be paying prices different to what the TNSP charges itself.

Further to a fair and reasonable allocation of costs, the regulator must be ensured that marketing staff of a TNSP are not also working for an associate that takes part in a related business; and vice versa. A crucial component to curtailing the monopoly powers of the TNSP, is to stem the flow of information between the TNSP's competitive and regulated activities. Marketing staff by nature will have sales information which would be advantageous for the TNSP's competitive activities.

Ring fencing guidelines ensure that the TNSP's decisions and actions in competitive activities (such as retail supply) are based on access prices that are published and verifiable. The ring fencing guidelines also ensure that other access seekers, apart from the TNSP, are not disadvantaged by not being privy to the sales information that the TNSP possesses.

In addition to these minimum requirements, the Commission may require the TNSP to meet additional ring fencing obligations. The Commission also has the discretion to dispense with some of the ring fencing obligations.

The TNSP is also required to establish procedures to ensure compliance with the ring fencing obligations and to notify the Commission of the procedures established.

Transmission Ring Fencing Guidelines

Background

- A. Clause 6.20.1 of the National Electricity Code (the *Code*) requires all *Transmission Network Service Providers* to comply with the *Transmission Ring Fencing Guidelines* prepared in accordance with clause 6.20.2 of the *Code*.
- B. Clause 6.20.2(a) of the *Code* requires the *ACCC* to develop the *Transmission Ring Fencing Guidelines*.
- C. This Guideline was *published* by the *ACCC* on **[DN date]**.

Preliminary

- D. In this Guideline, unless the contrary intention appears, italicised expressions have the meaning given to them in:

- (i) this clause D; or
- (ii) the National Electricity Code as in force from time to time.

‘Auditor’ means a person registered as an auditor, or taken to be registered as an auditor, under Part 9.2 of the Corporations Law.

‘Associate’, in relation to a *person*, has the meaning it would have under Division 2 of Part 1.2 of the Corporations Law if sections 13, 14, 16(2) and 17 of that Law were repealed.

Note: Schedule 1 section 13(7) of the Gas Pipelines Access (South Australia) Act 1997 (SA) contains an identical definition of ‘associate’.

‘Auditing standards’ means the Auditing Standards and Auditing Guidance Statements as in force or existing from time to time issued by the Auditing Standards Board of the Australian Accounting Research Foundation (and any succeeding bodies).

‘cross-subsidisation’ describes the situation where monopoly returns made in the regulated electricity transmission market are used to finance activities in contestable markets. So for any costs that are jointly incurred in providing prescribed services and excluded services, the costs allocated to excluded services is greater than the stand alone cost of supply, and the cost allocated to either one of the services is less than the incremental cost in providing both services.

‘economic entity’ has the meaning given in Accounting Standard AASB 1024: Consolidated Accounts as in force from time to time.

‘excluded services’ are transmission services, the costs of and revenues for which are excluded from the revenue cap which applies to prescribed services.

‘marketing staff’ means servants, consultants, independent contractors or agents directly involved in sales, sale provision or advertising (whether or not they are also involved in other functions) but does not include servants, consultants, independent contractors or agents involved only in:

- (i) strategic decision making, including the executive officer or officers to whom marketing staff report either directly or indirectly; or

(ii) technical, administrative, accounting or service functions.

Note: Schedule 2 section 10.8 of the Gas Pipelines Access (South Australia) Act 1997 (SA) contains an identical definition of 'marketing staff'.

'parent entity' has the meaning given in Accounting Standard AASB 1024: Consolidated Accounts as in force from time to time.

'person' includes an individual or a body politic or corporate.

'prescribed services' are transmission services provided by *Transmission Network Service Providers* using transmission network assets or associated connection assets or associated connection assets which are determined by the commission as not being contestable.

'ring fenced services' means *prescribed services*.

'related business' means the activities of generation, distribution and retail supply.

'relevant commencement date' means, the later of the following dates:

- (i) 3 months after publication of ring fencing guidelines; or
- (ii) the date on which the ACCC, pursuant to section 44ZZA of the Trade Practices Act 1974 (Cth), accepts an access undertaking provided by the *Transmission Network Service Provider* in accordance with clause 2.5(b) of the *Code*.

'reporting entity' has the meaning given in Accounting Standard AASB 1024: Consolidated Accounts as in force from time to time.

'revenue cap' is the maximum allowed revenue for a year determined by the regulator for *prescribed services* applicable to the Transmission Network owner as according to parts B and C of Chapter 6 of the National Electricity Code. Or the aggregate annual revenue requirement for a year determined by the Jurisdictional Regulator applicable to a Distributional Network Service Provider as according to parts D and E of the National Electricity Code.

'stand-alone cost' is the cost another service provider, apart from the Transmission Network owner, would incur if it served the same customers by itself.

'Transmission Network Service Provider' is a *person* who engages in the activity of owning, controlling or operating a transmission system.

Unregulated activities are activities other than the supply of prescribed services or a related business.

E. Where this Guideline authorises the making of an instrument or decision:

- (i) the power includes the power to amend or repeal the instrument or decision; and
- (ii) the power to amend or repeal the instrument or decision is exercisable in the same way, and subject to the same conditions, as the power to make the instrument or decision.

F. In this Guideline:

- (i) words in the singular include the plural; and
- (ii) words in the plural include the singular.

Ring fencing minimum obligations

1. A *Transmission Network Service Provider* must comply with the following provisions as from the *relevant commencement date*:

1.1 A TNSP that supplies *ring fenced services*:

- (i) must be a legal entity incorporated pursuant to the Corporations Law, a statutory corporation or an entity established by royal charter; and
- (ii) must not carry on a *related business*. To avoid doubt, if the entity is a member of a partnership, joint venture or other unincorporated association, the entity is carrying on the activities of the partnership, joint venture or unincorporated association.

1.2 (i) The Directors of a TNSP that provides ring fenced services are to act in the best interest of the entity in respect of all decisions relating to the provision of ring fenced services and the terms and conditions on which these services are provided; and

- (ii) The TNSP that provides ring fenced services must not make decisions or act in a manner that positively discriminated in favour of an Associate in the provision of ring fenced services, or in the terms or conditions on which those services are provided. For the avoidance of doubt the TNSP that provides ring-fenced services must offer the same services, terms and conditions to customers of its ring fenced services that it provides to itself or its Associates.

1.3 (i) An entity that provides *ring fenced services* must establish and maintain:

- (a) a separate set of accounts in respect of the provision of *ring fenced services*; and
- (b) if applicable, a separate consolidated set of accounts in respect of the entire business of that entity.

- (ii) The accounts must be prepared in accordance with any guidelines that apply to the entity under clause 3.

Note: Where the entity is a *Transmission Network Service Provider*, clause 1.3(i)(b) does not impose any additional obligations as clause 1.1(ii) prohibits the entity from carrying on a related business. Clause 1.3(i)(b) will be relevant if the ACCC, under clause 6, waives the entity's clause 1.1(ii) obligations.

1.4 An entity that provides *ring fenced services* must allocate any costs that are shared between an activity that is covered by a set of accounts described in clause 1.3(i)(a) and any other activity according to a methodology for allocating costs that complies with any guidelines that apply to that entity under clause 3.

Note: Clause 1.4 regulates the allocation of costs between *ring fenced services* and any other activity including activities undertaken by other entities. The purpose of clause 1.3 is to prevent *Transmission Network Service Providers* subsidising contestable activities through regulated activities.

1.5 If an entity that provides *ring fenced services* is part of an *economic entity*, the entity that provides *ring fenced services* must ensure that:

- (i) a separate consolidated set of accounts in respect of the provision of *ring fenced services* by that *economic entity* is established and maintained; and
- (ii) the accounts are prepared in accordance with any guidelines that apply under clause 3.

Note: The Corporations Law and Accounting Standard AASB 1024: Consolidated Accounts require a *parent entity* in an *economic entity* which is a *reporting entity* to prepare consolidated accounts to reflect the *economic entity* as a single *reporting entity*. Principally, adjustments will be necessary whenever entities within an *economic entity* have had transactions with each other.

The purpose of clause 1.5 is to ensure that the cost of providing the *ring fenced services* is adjusted to reflect any transactions between the entities within the *economic entity* that relate to the provision of the *ring fenced services*.

1.6 An entity that provides *ring fenced services* must:

- (i) ensure that information it provides from its regulated activities to its contestable activities is available to any other party.

Note: the purpose of this clause is to ensure that access to information which may give the associated entity an unfair advantage over other participants in the market is restricted.

1.7 An entity that provides *ring fenced services* must:

- (i)
 - (a) ensure that preferential treatment is not given to an Associate that takes part in a related business through sharing of operational activities. Operational separation encompasses the provision of services common to both regulated activities and contestable activities.
 - (b) ensure that its *marketing staff* are not also servants, consultants, independent contractors or agents of an *Associate* that takes part in a *related business*; and
 - (c) in the event that its *marketing staff* become or are found to be servants, consultants, independent contractors or agents of such an *Associate* contrary to clause 1.5(i)(a), procure their immediate removal from its *marketing staff*; and
- (ii)
 - (a) ensure that none of its servants, consultants, independent contractors or agents are *marketing staff* of an *Associate* that takes part in a *related business*; and
 - (b) in the event that any of its servants, consultants, independent contractors or agents are found to be the *marketing staff* of such an *Associate* contrary to clause 1.5(ii)(a), procure their immediate removal from the *marketing staff* that provides *ring fenced services*.

Note: In addition, clause 8.6.1(d) of the *Code* states that the officers of a *Transmission Network Service Provider* participating in *transmission service* pricing must not be involved in or associated with competitive electricity trading activities of any other *Code Participant*.

1.8 An entity that provides *ring fenced services* must notify the ACCC if:

- (i) any of its servants, consultants, independent contractors or agents are, or will be, servants, consultants, independent contractors or agents of an *Associate* that takes part in a *related business*; or
 - (ii) any servants, consultants, independent contractors or agents of an *Associate* that takes part in a *related business* will be servants, consultants, independent contractors or agents of it.
2. A notification under clause 1.6 must be provided to the *ACCC* on or before the later of the following dates:
- (i) the *relevant commencement date*; or
 - (ii) five *business days* prior to:
 - (a) in relation to clause 1.8(i), the date on which the servant, consultant, independent contractor or agent of the entity that provides *ring fenced services* will be a servant, consultant, independent contractor or agent of the *Associate*;
 - (b) in relation to clause 1.8(ii), the date on which the servant, consultant, independent contractor or agent of the *Associate* will be a servant, consultant, independent contractor or agent of the entity that provides *ring fenced services*.
3. In complying with clauses 1.3, 1.4 and 1.5, a *Transmission Network Service Provider* must:
- (i) if the *ACCC* decides to *publish* accounting guidelines for *Transmission Network Service Providers* which apply to the accounts being prepared, comply with those guidelines; or
 - (ii) if the *ACCC* has not *published* such guidelines, comply with any guidelines that are prepared by the *Transmission Network Service Provider* and approved by the *ACCC*.
- Additional ring fencing obligations**
4. The *ACCC* may, by notice to the *Transmission Network Service Provider*, require the *Transmission Network Service Provider* to comply with obligations in addition to those contained in clause 1 provided that the *ACCC* is satisfied that the administrative cost to the *Transmission Network Service Provider* and its *Associates* of complying with the additional obligations is, or is likely to be, outweighed by the benefit to the public.
5. Without limiting the additional obligations that may be imposed under clause 4, the *ACCC* may require that:
- (i) the *Transmission Network Service Provider* ensure its servants, consultants, independent contractors or agents are not also servants, consultants, independent contractors or agents of an *Associate* that takes part in a *related business* and, in the event that they become or are found to be involved in such an *Associate*, ensure their immediate removal from their position with the *Transmission Network Service Provider*;
 - (ii) at least one director of the *Transmission Network Service Provider* is not also a director of a company (whether or not an *Associate*) that takes part in a *related business* or is a *Code Participant* or *Intending Participant*; and

- (iii) the electronic, physical and procedural security measures employed in respect of the offices of the *Transmission Network Service Provider* and of all offices of its *Associates* are satisfactory to the ACCC.

The examples given in this clause 5 shall not be construed as limiting the types of action a *Transmission Network Service Provider* may have to take in order to comply with clause 1.

Waiver of ring fencing requirements

6. The ACCC may, by notice to the *Network Service Provider*, waive any of the *Transmission Network Service Provider's* obligations under clause 1 provided that the ACCC is satisfied that the benefit, or any likely benefit, to the public is outweighed by the administrative cost to the *Transmission Network Service Provider* and its *Associates* of complying with the obligation. TNSP's conducting unregulated activities need not apply for a waiver if those activities attract revenue of less than or equal to 5% per cent of total annual revenue.

Note: In deciding whether to waive any of the *Transmission Network Service Provider's* obligations under clause 1, the ACCC may take into consideration any additional obligations that can be imposed under clause 4.

Compliance procedures and compliance reporting

7. A *Transmission Network Service Provider* must establish and maintain appropriate internal procedures to ensure it complies with its obligations under clause 6.20.1 of the *Code*. The ACCC may require the *Transmission Network Service Provider* to demonstrate the adequacy of these procedures upon reasonable notice. However, any statement made or assurance given by the ACCC concerning the adequacy of the *Network Service Provider's* compliance procedures does not affect the *Transmission Network Service Provider's* obligations under clause 6.20.1 of the *Code*.
8. A *Transmission Network Service Provider* must provide a report to the ACCC, at reasonable intervals determined by the ACCC, describing the measures taken by the *Transmission Network Service Provider* to ensure compliance with its obligations under clause 6.20.1 of the *Code*, and providing an accurate assessment of the effect of those measures.
9. (i) The ACCC may, upon reasonable notice, require a *Transmission Network Service Provider* to:
- (a) appoint an independent *auditor* approved by the ACCC to report on such matters as are specified by the ACCC; and
 - (b) provide a copy of the *auditor's* report to the ACCC by a date specified by the ACCC.
- (ii) If the ACCC nominates *auditing standards* to apply to an audit under clause 9(i), the *auditor* must report in accordance with those *auditing standards*. To avoid doubt, the ACCC may nominate one or more *auditing standards*.
- (iii) For the purpose of clause 9(i), the ACCC may *publish* auditing guidelines with which a *Transmission Network Service Provider* must comply.

Note: The ACCC need not *publish* auditing guidelines in order to impose an obligation on a *Transmission Network Service Provider* under clause 9(i). It is intended that auditing guidelines will be *published* where obligations are to apply generally to *Transmission Network Service Providers* on an on-going basis.

10. A *Transmission Network Service Provider* must provide a report of any breach of any of its obligations under clause 6.20.1 of the *Code* to the *ACCC* immediately upon becoming aware that the breach has occurred.

Consultation

11. In deciding whether to:

- (i) amend the Transmission Ring Fencing Guidelines;
- (ii) waive a TNSP's obligation under the Transmission Ring Fencing Guidelines; or
- (iii) impose additional obligations on a TNSP under the Transmission Ring Fencing Guidelines;

the *ACCC* will follow a consultation process that complies with clauses 6.20.2(a) and 6.20.2(e) of the code.

Note: To accommodate the Consultation process, the Commission will publish on its website notice that it

- a) Proposes to amend, waive or impose additional obligations (as the case may be)
- b) Write to relevant parties to inform them of the proposition.
- c) Specify a time by which comments or submissions are to be submitted.
- d) Issue a draft decision seeking comments.
- e) Issue a final decision.