

Decision

**Statement of Principles for the Regulation of
Transmission Revenues**

Transmission Ring-Fencing Guidelines

Date: 15 August 2002

File Number:
C2001/1053

Commissioners:
Fels
Bhojani
Jones
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McNeill

1. Introduction

Part G of Chapter 6 of the National Electricity Code (the Code) requires that the Australian Competition and Consumer Commission (ACCC) develop ring-fencing guidelines. These Guidelines separate the accounting and functional aspects of prescribed services from those of other services provided by Transmission Network Service Providers (TNSPs). Under clause 6.20.1 of the Code, all TNSPs have to comply with these Guidelines.

In setting out the Transmission Ring-Fencing Guidelines, the ACCC's objective is to reinforce the effectiveness of the regulatory processes by limiting the ability of TNSPs to extend their monopoly powers into the contestable parts of the industry.

In the *Draft statement of principles for the regulation of transmission revenues*, the ACCC signalled its intention to adopt a set of ring-fencing arrangements for TNSPs that were very similar to those of the National Third Party Access Code for Natural Gas Pipeline Systems (National Gas Access Code). The reasons for this follow.

- The Commonwealth, State and Territory governments have agreed to the National Gas Access Code's ring-fencing arrangements. Their application to electricity transmission networks would ensure consistency between gas and electricity transmission networks.
- Clause 6.20.2(d)(2) of the Code requires the ACCC 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 other utility businesses' ring-fencing requirements.

Draft transmission guidelines were circulated to interested parties on 27 May 1999, 10 September 2001 and 17 December 2001. In developing these (final) Guidelines, the ACCC took into account comments by interested parties and recommendations by various State regulators. Most of the interested parties supported the development of ring-fencing guidelines along the lines of the National Gas Access Code.

The ACCC has therefore decided to use the ring-fencing provisions of the National Gas Access Code as a model for the National Electricity Market (NEM). The ACCC has also selected a set of arrangements that provide the ACCC with the flexibility to waive elements of the ring-fencing arrangements, where it considers that the costs of compliance outweigh the benefits.

The Transmission Ring-Fencing Guidelines must be read in conjunction with the ACCC's information requirements for TNSPs under clause 6.2.5 of the Code. The ACCC does not, at this stage, propose to publish accounting or auditing guidelines under the Transmission Ring-Fencing Guidelines that impose obligations in addition to those that apply under clause 6.2.5. However, the ACCC does not rule out the future need for such additional provisions.

2. ACCC objectives

The Transmission Ring-Fencing Guidelines require a TNSP to establish arrangements to segregate (ie. ring-fence) its business of providing regulated transmission network services from other services. The aim is to separate as far as possible the monopoly powers of TNSPs

from the contestable activities of generation and retail supply. In summary, under the Guidelines:

- (a) A TNSP must be a legal entity and, in general, not engage in electricity generation, distribution or retail. In practice, legal separation can be thought of as structural separation in that the TNSP is prohibited from competing with the other firms using its network. Legal separation between TNSPs' prescribed and other services is required:
 - as accounting separation alone:
 - does not effectively prevent discrimination against a competing network user; and
 - cannot effectively be used to promote entry into the contestable network user segment of the electricity market; and
 - due to implications of vertical integration and informational asymmetry.
- (b) A TNSP must establish and maintain separate accounts for the activities that are the subject of a revenue cap determination by the ACCC. TNSPs must allocate their costs to reflect the use of assets that are shared between contestable and regulated activities in a fair and reasonable manner to avoid cross-subsidisation.
- (c) A TNSP must not preferentially deal with itself and any related utility in such a way as to discriminate against other access seekers. The prices that the TNSP charges access seekers should not disadvantage them when competing with the TNSP or an associate of the TNSP in another market.
- (d) A crucial component to curtail the monopoly powers of the TNSP is to stem the flow of information between the TNSP's regulated activities and competitive activities. One of the objectives of the Guidelines is to ensure that other access seekers are not disadvantaged by not being privy to the TNSP's sales information. Hence marketing staff of a TNSP should not also work for an associate in a related business and vice versa. The Guidelines should ensure that decisions and actions in competitive activities (such as retail supply) are based on access prices that are published and verifiable.
- (e) TNSPs are required to establish procedures to ensure compliance with the ring-fencing obligations and to notify the ACCC of such compliance.
- (f) The ACCC may require the TNSP to meet additional ring-fencing obligations or dispense with some of the current requirements.

Annex A – Transmission Ring-Fencing Guidelines

Guidelines

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Transmission Ring-Fencing Guidelines

Background

1. 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*.
2. Clause 6.20.2(a) of the *Code* requires the Australian Competition and Consumer Commission (ACCC) to develop the *Transmission Ring-Fencing Guidelines*.
3. These Guidelines were *published* by the ACCC on 15 August 2002.

Preliminary

4. In these Guidelines, unless the contrary intention appears, italicised expressions have the meaning given to them in:
 - (a) this clause 4; or
 - (b) if they are not defined in this clause 4, the meaning given to them in the *Code*.

Note: To avoid doubt, *Code* means the National Electricity Code as in force from time to time.

associate, in relation to a *person*, has the meaning it would have under Division 2 of Part 1.2 of the *Corporations Act* if sections 13, 14, 16(2) and 17 of that Act 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).

auditor means a *person* who qualifies as an auditor under Part 2M.4 of the *Corporations Act*.

Corporations Act means the *Corporations Act 2001* (Cth) as in force from time to time.

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

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:

- (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.

Note: Section 10.8 of the National Third Party Access Code for Natural Gas Pipeline Systems contains an identical definition of 'marketing staff'.

operational activities means activities common to the production of both *ring-fenced services* and *unregulated activities*.

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.

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

relevant commencement date means the later of the following dates:

- (a) 1 November 2002; or
- (b) the date on which the ACCC, under s. 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 of the *Code*.

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

ring-fenced services means *prescribed services*.

TNSP means a *Transmission Network Service Provider*.

unregulated activities means activities other than the supply of *ring-fenced services*, and includes but is not limited to carrying on a *related business*.

5. Where these Guidelines authorise 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 instrument or decision is exercisable in the same way, and subject to the same conditions, as the power to make the instrument or decision.

6. In these Guidelines:

- (a) words in the singular include the plural; and
- (b) words in the plural include the singular.

Ring-fencing minimum obligations

7. A *TNSP* must comply with the following provisions on and from the *relevant commencement date*:

7.1 (a) A *TNSP* that supplies *ring-fenced services*:

- (i) must be a legal entity incorporated under the *Corporations Act*, a statutory corporation or an entity established by royal charter; and
- (ii) subject to clause 7.1(b), must not carry on a *related business*. To avoid doubt, if the *TNSP* is a member of a partnership, joint venture or other unincorporated association, the *TNSP* is carrying on the activities of the partnership, joint venture or unincorporated association.

(b) A *TNSP* is not subject to clause 7.1(a)(ii) if it carries on *related businesses* that, in total, attract revenue of less than or equal to 5 per cent of the *TNSP*'s total annual revenue.

7.2 (a) The directors of a *TNSP* that provides *ring-fenced services* must act in the best interest of the *TNSP* in respect of all decisions relating to the provision of *ring-fenced services* and the terms and conditions on which those services are provided.

(b) A *TNSP* that provides *ring-fenced services* must not make decisions or act in a manner that discriminates in favour of an *associate* in relation to the terms or conditions on which those services are provided. To avoid doubt, a *TNSP* providing *ring-fenced services* must offer those services to its customers on terms and conditions no less favourable than it provides to itself or its *associates*.

7.3 (a) A *TNSP* that provides *ring-fenced services* must establish and maintain:

- (i) a separate set of accounts for the provision of *ring-fenced services*; and
- (ii) a separate amalgamated set of accounts for its entire business.

- (b) The accounts must be prepared in accordance with any guidelines that apply to the *TNSP* under clause 8.

Note: Since clause 7.1(a)(ii) prohibits a *TNSP* from carrying on a *related business*, clause 7.3(a)(ii) will only impose additional obligations on a *TNSP* if (a) the *TNSP* is carrying on any *unregulated activities* other than a *related business*; (b) clause 7.1(b) applies to the *TNSP*; and/or (c) the *ACCC*, under clause 11, has waived the *TNSP*'s obligation under clause 7.1(a)(ii).

- 7.4 A *TNSP* that provides *ring-fenced services* must allocate any costs that are shared between an activity covered by a set of accounts described in clause 7.3(a)(i) and any other activity, in accordance with a methodology that complies with any guidelines that apply to the *TNSP* under clause 8.

Note: Clause 7.4 regulates the allocation of costs between *ring-fenced services* and any other activity including activities undertaken by other entities. The purpose of clause 7.4 is to prevent *TNSPs* subsidising contestable activities through regulated activities.

- 7.5 If a *TNSP* that provides *ring-fenced services* is part of an *economic entity*, the *TNSP* must ensure that:

- (a) a separate amalgamated set of accounts in respect of the provision of *ring-fenced services* by that *economic entity* is established and maintained; and
- (b) the accounts are prepared in accordance with any guidelines that apply under clause 8.

Note: Accounting Standard AASB 1024: Consolidated Accounts requires a *parent entity* in an *economic entity* that 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 7.5 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*.

- 7.6 A *TNSP* that provides *ring-fenced services* must:

- (a) ensure that information it provides in relation to its *ring-fenced services*, to any *associate* that takes part in a *related business* is available to any other party; and

Note: The purpose of clause 7.6(a) is to restrict access to information that may give the associated entity an unfair advantage over other participants in the national electricity market.

- (b) ensure that preferential treatment is not given to an *associate* that takes part in a *related business*, through sharing of *operational activities*.

7.7 A *TNSP* that provides *ring-fenced services* must:

- (a)
 - (i) 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
 - (ii) 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 7.7(a)(i), procure their immediate removal from its *marketing staff*; and
- (b)
 - (i) 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
 - (ii) 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 7.7(b)(i), procure their immediate removal from their position with the *TNSP*.

Note: Clause 8.6.1(d) of the *Code* also states that the officers of a *TNSP* participating in *transmission service* pricing must not be involved in or associated with competitive electricity trading activities of any other *Code Participant*.

7.8 A *TNSP* that provides *ring-fenced services* must notify the *ACCC* if:

- (a) 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
- (b) 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 the *TNSP*.

7.9 A notification under clause 7.8 must be provided to the *ACCC* on or before the later of the following dates:

- (a) the *relevant commencement date*; or
- (b) five *business days* prior to the date:
 - (i) on which the servant, consultant, independent contractor or agent of the *TNSP* will be a servant, consultant, independent contractor or agent of the *associate*; or

Note: See clause 7.8(a).

- (ii) on which the servant, consultant, independent contractor or agent of the *associate* will be a servant, consultant, independent contractor or agent of the *TNSP*.

Note: See clause 7.8(b).

8. In complying with clauses 7.3, 7.4 and 7.5, a *TNSP* must:
- (a) if the *ACCC* decides to *publish* accounting guidelines for *TNSPs* that apply to the accounts being prepared, comply with those guidelines; or
 - (b) if the *ACCC* has not *published* such guidelines, comply with any guidelines that are prepared by the *TNSP* and approved by the *ACCC*.

Note: To avoid doubt, clause 8(b) does not require a *TNSP* to prepare guidelines.

Additional ring-fencing obligations

9. The *ACCC* may, by notice to the *TNSP*, require the *TNSP* to comply with obligations in addition to those contained in clause 7 provided that the *ACCC* is satisfied that the administrative cost to the *TNSP* and its *associates* of complying with the additional obligations is, or is likely to be, outweighed by the benefit to the public.
10. Without limiting the additional obligations that may be imposed under clause 9, the *ACCC* may require that:
- (a) the *TNSP* 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 with such an *associate*, ensure their immediate removal from their position with the *TNSP*;
 - (b) at least one director of the *TNSP* 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
 - (c) the electronic, physical and procedural security measures employed in respect of the offices of the *TNSP* and of all offices of its *associates* are satisfactory to the *ACCC*.

The examples given in this clause 10 shall not be construed as limiting the types of action a *TNSP* may have to take to comply with clause 7.

Waiver of ring-fencing requirements

11. The *ACCC* may, by notice to the *TNSP*, waive any of the *TNSP*'s obligations under clause 7 provided that the *ACCC* is satisfied that the benefit, or any likely benefit, to the public is outweighed by the administrative cost to the *TNSP* and its *associates* of complying with the obligation.

Note: In deciding whether to waive any of the *TNSP*'s obligations under clause 7, the *ACCC* may consider any additional obligations that can be imposed under clause 9.

Compliance procedures and compliance reporting

12. A *TNSP* 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 *TNSP* to demonstrate the adequacy of these procedures upon reasonable notice. However, any statement made or assurance given by the *ACCC* about the adequacy of the *TNSP*'s compliance procedures does not affect the *TNSP*'s obligations under clause 6.20.1 of the *Code*.
13. A *TNSP* must provide a report to the *ACCC*, at reasonable intervals determined by the *ACCC*, describing the measures taken 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.
14. A *TNSP* that is required to prepare documents in accordance with clauses 7.3, 7.4 and/or 7.5 must provide those documents to the *ACCC* at least once a year or at reasonable intervals determined by the *ACCC*.
15. (a) The *ACCC* may, on reasonable notice, require a *TNSP* to:
 - (i) appoint an independent *auditor* approved by the *ACCC* to report on such matters as specified by the *ACCC*; and
 - (ii) provide a copy of the *auditor's* report to the *ACCC* by a date specified by the *ACCC*.
- (b) If the *ACCC* nominates *auditing standards* to apply to an audit under clause 15(a), the *auditor* must report in accordance with those *auditing standards*. To avoid doubt, the *ACCC* may nominate one or more *auditing standards*.
- (c) For the purpose of clause 15(a), the *ACCC* may *publish* auditing guidelines with which a *TNSP* must comply.

Note: The *ACCC* need not *publish* auditing guidelines to impose an obligation on a *TNSP* under clause 15(a). It is intended that auditing guidelines will be *published* where obligations are to apply generally to *TNSPs* on an on-going basis.

16. When a *TNSP* becomes aware of a breach of any of its obligations under clause 6.20.1 of the *Code*, it must immediately inform the *ACCC*.

Consultation

17. In deciding whether to:
- (a) amend the *Transmission Ring-Fencing Guidelines*;
 - (b) impose additional obligations on a *TNSP* under clause 9; or
 - (c) waive a *TNSP*'s obligations under clause 11;

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

Note: Under this consultation process, the *ACCC* will:

- (a) publish a notice on its website and notify relevant parties about the possible amendments, imposition of additional obligations or waiving of obligations (as the case may be);
- (b) specify a time by which any comments or submissions are to be received;
- (c) issue a draft decision seeking comments; and
- (d) issue a final decision.