



Draft for Comment

**Electricity Distribution:
Ring-Fencing Guidelines**

December 1999

SUBMISSIONS

The Queensland Competition Authority (the QCA or the Authority) considers public involvement to be an important element of its decision making processes. It therefore invites submissions from interested parties concerning its draft position on ring-fencing with respect to electricity distribution networks.

To facilitate the publication of submissions on the QCA's website, it is preferred if submissions could be made electronically by disk or by email. However, if this is not possible, submissions can be made in writing. **Submissions, comments or inquiries regarding this paper should be directed to:**

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The **closing date** for submissions is **Friday 25 February 2000**.

Confidentiality

In the interests of transparency and to promote informed discussion, the Authority would prefer submissions to be made publicly available. However, if a person making a submission does not want their submission to be public, that person should claim confidentiality in respect of the document (or any part of the document). Claims for confidentiality should be clearly noted on the front page of the submission and the relevant sections of the submission should be marked as confidential, so that the remainder of the document can be made publicly available. Again, it would be appreciated if each version (ie. the complete version and another excising confidential information) could be provided electronically (whether or not with a printed copy). Where it is unclear why a submission has been marked "confidential", the status of the submission will be discussed with the person making the submission.

While the Authority will endeavour to identify and protect material claimed as confidential as well as exempt documents (within the meaning of the *Freedom of Information (FOI) Act 1989*), it cannot guarantee that submissions will not be made publicly available. As stated in s187 of the *Queensland Competition Authority Act 1997*, the Authority must take all reasonable steps to ensure the information is not disclosed without the person's consent, provided the Authority is satisfied that the person's belief is justified and that the disclosure of the information would not be in the public interest.

Public access to submissions

Subject to the above, submissions will normally be made available for public inspection at the office of the Authority, or on its website at www.qca.org.au.

Information about the role and current activities of the Authority, including copies of reports, papers and submissions can also be found on the Authority's website.

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1. OVERVIEW

Over the past few years, Queensland's previously integrated electricity industry has been separated into generation, transmission, distribution, and retailing functions. Competition has been progressively introduced into those elements of the industry that were considered to be suitable for contestability, ie. generation and retailing, with a view to improving efficiency and lowering prices.

One entity, Powerlink, now operates the high voltage transmission network in Queensland, while two distribution entities, Energex Ltd and Ergon Energy Corporation Ltd, now operate all local distribution networks. These entities undertake the physical task of transmitting electricity from the generator to the end consumer. Both distribution entities in Queensland have subsidiary retailing operations.

The distribution entities are subject to economic regulation under the National Electricity Code (the Code), which appoints the Queensland Competition Authority (the QCA or the Authority) as the jurisdictional regulator for Queensland. The Code provides for the Authority to regulate distribution prices from 19 December 2000 and to prepare Distribution Ring-Fencing Guidelines. With respect to these Guidelines, the Code sets out aspects of ring-fencing that may be included, matters the Authority is required to consider, and consultation requirements.

In developing the Distribution Ring-Fencing Guidelines, the Authority outlined the objectives and principles that would underpin the exercise in its July 1999 Issues Paper. In particular, the Authority's objective in preparing draft Guidelines is to assist in creating an environment where the price, quantity and quality of electricity traded in the retail market, and the price, quantity and quality of distribution services used to deliver the energy, are not uneconomically biased by the vertical integration of distribution and other businesses – whatever that level of integration might be. This objective is supported by principles such as minimisation of the costs and intrusiveness of the exercise to the distribution entities, cost-benefit analysis with respect to each ring-fencing requirement, evaluation of the potential for unintended consequences from ring-fencing requirements and ensuring the draft Guidelines are simple, clear and easy to administer.

With the above objectives and principles in mind, the Authority then considered the applicability of various ring-fencing requirements in Queensland in light of the requirements of the Code. In particular, the Authority considered:

- the particular aspects of ring-fencing raised in the Code, such as legal separation, accounting separation, cost allocation, and controls over information flows;
- the matters that the Code requires consideration of, including:
 - consistency with the National Third Party Access Code for Natural Gas Pipeline Systems (the Gas Code),
 - consistency with the Australian Competition and Consumer Commission (ACCC);
 - consistency with other jurisdictional regulators;
 - consistency with any retailer of last resort arrangements;
- the consultation requirements under the Code;
- the definition of prescribed services which the Code requires Distribution Ring-Fencing Guidelines to be applied to; and

- a range of other issues raised in submissions to the Authority, such as ownership separation and separate branding of distribution and retailing businesses.

In accommodating these issues, the Authority has adopted an approach to ring-fencing which:

- encompasses the major aspects of ring-fencing as identified in section 6.20.2c of the Code;
- uses the Gas Code as a template for ring-fencing in electricity, thereby ensuring broad consistency across energy markets;
- is largely consistent with the ACCC's approach to ring-fencing in electricity, in particular in terms of additional provisions for auditing accounts, although the Authority's approach differs in terms of:
 - the definition of a related business. The Authority has adopted a definition that is aligned with that in the Gas Code, which gives distributors the right to engage in related businesses as long as they do not relate to producing, purchasing or selling electricity, whereas the ACCC approach prohibits the regulated business from undertaking any other activities; and
 - detailed provisions for adding to or waiving ring-fencing obligations. The Authority has supported the inclusion of detailed procedural requirements in the interests of promoting transparency and certainty for market participants;
- is likely to be consistent with the approach to be adopted by the Independent Pricing and Regulatory Tribunal of New South Wales (IPART), pending further details of IPART's proposed ring-fencing arrangements, although it differs slightly from that currently proposed by the Victorian Office of the Regulator General (ORG) as ORG does not require legal separation or that the entity not carry on a related business;
- notes that a detailed definition of prescribed services is to be undertaken as part of the Authority's forthcoming distribution pricing review;
- notes there is support for ownership separation from some market participants, but that there are also arguments against such separation, and that consideration of the effectiveness of structural options will be further considered over time;
- notes that there is support for further managerial separation from some market participants, but that the need for this will be assessed over time in terms of the effectiveness of the currently proposed arrangements; and
- recognises that common branding can create a competitive advantage, but does not support separate branding of retail and distribution entities at this time;
 - however, the Authority proposes to pay particular attention to issues of cost allocation between retailers and distributors in ensuring compliance with the Guidelines, and in particular is of the view that marketing costs, for example, should be fully allocated to the retail side of the business as there appears little justification for a distribution entity to advertise its services.

The Authority believes there is currently insufficient evidence regarding the costs and benefits of various approaches to industry structure in terms of engendering competition. Accordingly, the Authority proposes at the present time to regard industry structure as a given and to adopt an approach to ring-fencing which would vary depending on the industry structure chosen.

However, the Authority expects that over time, evidence will emerge as to these benefits and costs, and that the effectiveness of the current structure of the electricity industry will be able to be more clearly determined. In the interim, the Authority notes that the costs of ring-fencing are likely to be significantly higher where an integrated structure is adopted, relative to those that would be incurred under a structure which had greater structural separation. It is also the Authority's view that these costs should be borne by the entities being regulated.

The Authority believes that, given the current structure of the Queensland electricity industry, the approach adopted provides the best balance in ensuring effective separation between distribution and retailing businesses in order to encourage competition, while minimising the regulatory compliance burden on distribution entities.

In preparing the draft Guidelines, the Authority has been mindful of the fact that Queensland's legal separation requirements have been in place for several years, while some other jurisdictions are only now moving to support legal separation. The Authority expects that, in the near future, legal separation will be introduced at the national level in transmission, as well as in New South Wales at the distribution level.

In addition, the Authority intends to monitor the Distribution Ring-Fencing Guidelines with a view to assessing their effectiveness and amending the Guidelines where necessary. As a consequence, and in accordance with good regulatory practice, the Authority intends to review its Distribution Ring-Fencing Guidelines at least once each regulatory period to ensure they are effective in achieving the Authority's objectives.

The Authority's draft Distribution Ring-Fencing Guidelines are at Attachment A. As per the consultation requirements of the Code, the Authority has made this report, which contains its conclusions on ring-fencing and the reasons for reaching such conclusions, available to all Code Participants and interested parties. A list of submissions received to date is contained at Attachment B. The Authority now invites comments on the draft Guidelines, including the analysis upon which they are based, to be forwarded to the Authority by Friday 25 February 2000.

2. CURRENT ARRANGEMENTS IN QUEENSLAND

Over the past few years, Queensland's previously integrated electricity industry has been separated into generation, transmission, distribution, and retailing functions. Competition has been progressively introduced into those elements of the industry that were considered to be suitable for contestability, ie. generation and retailing, with a view to improving efficiency and lowering prices.

One entity, Powerlink, now operates the high voltage transmission network in Queensland, while two distribution entities operate all local distribution networks. These entities undertake the physical task of transmitting electricity from the generator to the end consumer. Of the two distribution entities, Energex Ltd (Energex) operates distribution networks in south east Queensland. From 1 July 1999, a second entity, Ergon Energy Corporation Ltd (Ergon), has operated distribution networks across the remainder of Queensland.

Both these distribution entities are owned by the Queensland Government, and have legally separate but subsidiary retailing operations. Legislation specifically prevents any distribution entity from holding a retail authority (section 298E of the *Electricity Regulation 1994*). The role of retailers in the market is to undertake financial or risk management functions, such as trading in the wholesale market and offering different price/service packages to consumers.

The retailing subsidiaries of the distribution entities have been created through legislation and are also owned by the State Government. These entities are established as company Government Owned Corporations under the Corporations Law and are separate legal entities from their parent distribution companies. As such, they are subject to the same public reporting and disclosure requirements as any other limited liability company. Beyond this, there are no formal legislative or regulatory requirements to separate these retailing entities from their parent entities. Operationally, the retailing functions remain significantly integrated with the day to day operations of the distribution entities, with a substantial degree of overlap between staffing, including senior management.

The retailing subsidiaries of Energex and Ergon Energy were initially given exclusive franchises to retail in specified geographic areas. However, licensing arrangements now allow for new retailers into the market, while at the same time franchises granting exclusive retailing rights to incumbent retailers are being progressively phased out through the introduction of customer contestability.

3. THE ROLE OF THE AUTHORITY

Queensland's distribution entities are subject to economic regulation under the National Electricity Code, which appoints the Queensland Competition Authority (the Authority) as the jurisdictional regulator for Queensland.

The Authority's responsibilities with respect to electricity are set out in the *Electricity – National Scheme (Queensland) Act 1997*, which commenced on 22 May 1997 and gives effect to the National Electricity Code. The Code sets out the objectives for the National Electricity Market, and in particular promotes “a regime of light-handed regulation of the market to achieve the market objectives”. The Code provides for the Authority to regulate distribution prices from 19 December 2000 and to prepare Distribution Ring-Fencing Guidelines. The Authority also has responsibilities under the *Electricity Act 1994*, which provides that the Authority may prepare and enforce conduct rules, and requires the Authority to monitor standards of service quality should such standards be issued by the Minister for Mines and Energy.

Chapter 6 Part G of the Code states that Distribution Ring-Fencing Guidelines must be developed by each Jurisdictional Regulator. In particular, the Authority's task is defined by the following statements in the Code:

- all transmission and distribution network service providers must comply with the relevant Ring-Fencing Guidelines (6.20.1). Any breach of these requirements may be reported to the National Electricity Code Administrator (NECA), with potential civil penalties where a breach is determined to have occurred;
- Transmission Ring-Fencing Guidelines, for the accounting and functional separation of prescribed services (those determined by the regulator not to be contestable) provided by transmission service providers, must be prepared by the ACCC in consultation with other Jurisdictional Regulators (such as the Authority) (6.20.2a);
- Distribution Ring-Fencing Guidelines, for the accounting and functional separation of prescribed services (those determined by the regulator as being subject to regulation) provided by distribution service providers, must be prepared by each Jurisdictional Regulator in consultation with the ACCC and other Jurisdictional Regulators (6.20.2b);
- these Guidelines may include, but are not limited to, provisions for (6.20.2c):
 - legal separation of a network services entity from any other entity through which it conducts business;
 - the establishment and maintenance of consolidated and separate accounts for prescribed services and other services provided by network service providers;
 - allocation of costs between prescribed services and other services provided by network service providers;
 - limitations on the flow of information between network service providers and any other person;
 - limitations on the flow of information where there is the potential for a competitive disadvantage; and
 - the relevant regulator to add to or waive a network service provider's obligations under the Guidelines;

- in developing Ring-fencing Guidelines, the ACCC and Jurisdictional Regulators are to consider, but are not limited to, the following matters (6.20.2d):
 - the need for consistency in Distribution Ring-Fencing Guidelines between participating jurisdictions;
 - the need for consistency with Federal and State regulation in each participating jurisdiction of ring-fencing requirements for other utilities;
 - the need for consistency between Transmission and Distribution Ring-Fencing Guidelines; and
 - the need for Distribution Ring-Fencing Guidelines to be consistent with the arrangements for the retailer of last resort for that jurisdiction;
- in developing Ring-fencing Guidelines, the ACCC and each Jurisdictional Regulator must consult with participating jurisdictions, Code participants and other interested parties (6.20.2e); and
- for the purposes of this part of the Code, the Queensland Competition Authority is the Jurisdictional Regulator for the State of Queensland (6.20.3e).

4. OBJECTIVES AND PRINCIPLES

In opening up the retailing market to greater competition, it is important that the separation of prescribed services (the monopoly distribution function) from non-prescribed or excluded services (other, contestable functions) is effective. This will provide two main benefits:

- it will ensure that new players in the contestable elements of the market (particularly retailing) can compete on a fair and equal basis, without fear of vertically integrated incumbents being able to gain a competitive advantage, thereby creating confidence in the integrity of the market. Greater competition in the retail market will ensure the benefits of greater efficiencies, in the form of price reductions or better service, are passed on to customers. In addition, increased competition will create greater pressure in wholesale markets as retailers compete to secure lower energy prices. In stipulating the rules for separation, ring-fencing is therefore critical to the development of the retail market;
- it will provide a clear definition as to what constitutes prescribed services or the monopoly elements of the market, which will be subject to economic regulation. In particular, costs that belong to these monopoly activities will be separated from costs that relate to contestable activities, ensuring there are no distortions in terms of under-recovery of costs in competitive markets. In addition, this will distinguish between non-contestable and potentially contestable functions within the distribution entity, providing the opportunity to develop contestable markets for a range of functions that are currently provided by the (monopoly) entity, eg. meter installation.

Taking these factors into account, the Authority's objective in preparing draft Distribution Ring-Fencing Guidelines is to assist in creating an environment where the price, quantity and quality of electricity traded in the retail market, and the price, quantity and quality of distribution services used to deliver the energy, are not biased as a result of the vertical integration of distribution and other businesses – irrespective of the degree of integration.

While ring-fencing can provide benefits in terms of removing potential barriers to competition, it also imposes costs. In particular, it constrains the commercial behaviour of a firm by requiring particular forms of conduct. As such, it is an inherently intrusive activity. Monitoring compliance with ring-fencing arrangements, for example, will mean the regulator will require ongoing information about the operations of the business. In summary, the greater the upfront requirements for formal separation of activities, the lower the ongoing intrusiveness of regulation is likely to be. For example, complete ownership separation would not require ring-fencing monitoring once implemented.

As a consequence, in developing the draft Distribution Ring-Fencing Guidelines, the Authority has been cognisant of the potential for upfront costs and disruption to the business, as well as the ongoing intrusiveness of compliance requirements.

In achieving the objectives of ring-fencing, each requirement will invoke particular benefits as well as costs. The Authority has assessed the expected benefits of each requirement in the draft Guidelines against its potential costs in determining which ring-fencing requirements should be included.

Ring-fencing can also have unintended consequences in terms of its impact on the market. The Authority has also taken this into consideration.

Finally, the Authority has reviewed the draft Guidelines to ensure they are as simple, clear and easy to administer as possible.

5. ISSUES

Having established these objectives and principles, the Authority then considered the applicability of various ring-fencing requirements in the Queensland context, in light of the requirements of the Code. In particular, the Authority considered:

- particular aspects of ring-fencing raised in the Code, such as legal separation, accounting separation and cost allocation;
- matters the Code requires consideration of, including:
 - consistency with the Gas Code,
 - consistency with the ACCC;
 - consistency with other jurisdictional regulators;
 - consistency with any retailer of last resort arrangements;
- consultation requirements under the Code;
- the definition of prescribed services which the Code requires Distribution Ring-Fencing Guidelines to be applied to; and
- a range of other issues raised in submissions to the Authority, including ownership separation and separate branding of distribution and retailing businesses.

5.1 Aspects of ring-fencing raised in the National Electricity Code

In preparing these draft Distribution Ring-Fencing Guidelines, the Authority has considered each aspect of ring-fencing raised in section 6.20.2c of the Code. In summary, these include:

- legal separation;
- accounting separation;
- cost allocation;
- limitations on information flows; and
- provisions to add to or waive ring-fencing obligations.

In particular, the Authority has noted there are provisions in the Gas Code which relate to each of these aspects (see separate section below). Further, the ACCC's proposed ring-fencing arrangements for transmission also include elements of each matter raised in the Code.

The Authority has separately considered the merits of each of these issues.

Legal separation

Legal separation requires the monopoly and contestable functions to be separately located in legal entities under Corporations Law. This requirement still permits monopoly and contestable businesses to be both owned by a holding company, or contestable businesses to be subsidiaries of the monopoly business.

Legal separation allows the regulator to more clearly identify the services and assets associated with monopoly and contestable functions. It also requires the monopoly and contestable businesses to enter into more formal contractual and reporting arrangements, and as a consequence requires each business to better identify their respective roles. Specifically, the relationship between the monopoly and contestable businesses would become more formally transparent, with the benefit of less ongoing regulatory intervention. In this regard, legal separation reduces the requirement for more prescriptive ring-fencing arrangements and therefore the associated costs.

However, while legal separation can provide a basis for separation of contestable and non-contestable functions, it is unlikely of itself to prevent entities that retain common ownership from collaborating in a manner which provides the incumbent retailer with the ability to exercise a competitive advantage over new entrants in the retailing market. This is particularly so given the degree of integration that still exists between Queensland electricity distributors and retailers. As long as common ownership remains, incentives or opportunities to share information and costs will continue to exist. Ring-fencing arrangements can however make it difficult for commonly owned entities to act upon such incentives and opportunities.

While the Code requires consideration of legal separation of prescribed or network services from contestable services, legal separation is generally taken as referring to the separation between distribution and retailing functions. Legal separation of the distribution businesses from the retailing businesses has already been effected in Queensland. However, it is possible there are additional contestable elements within distribution businesses which should be separated, depending on how prescribed services are defined (see separate section on this issue).

Legal separation of distribution and retailing functions was broadly supported in most submissions received by the Authority. However, the incumbent distributors noted there are costs associated with such separation, particularly in terms of public reporting requirements which were considered to create a competitive disadvantage relative to other, integrated businesses in southern markets. The consistency of the legal separation requirement with the Gas Code was also noted.

The Authority notes that legal separation is already in place between Queensland distribution and retail entities, and that this requirement is material in defining the structure of the electricity industry. As the Authority is of the view that the matter of industry structure is to be taken as given until such time as there is evidence as to the effectiveness of different industry structures, it has prepared the draft Distribution Ring-Fencing Guidelines to be consistent with this existing situation. Accordingly, the Authority has confirmed legal separation in the draft Distribution Ring-Fencing Guidelines. In the event that a change in the structure of the industry in terms of these separation requirements is contemplated, the Authority will revisit the Guidelines to ensure that they remain appropriate to the circumstances.

While recognising that legal separation is a useful starting point in ring-fencing contestable and non-contestable activities, the Authority is of the view that legal separation alone is insufficient to ensure that incentives and opportunities to share information and costs are mitigated.

Accounting separation

Given that legal separation is in place, there are already requirements in place for separate reporting by distribution and retail entities. These accounting requirements contribute to ring-fencing between distribution and contestable entities through transparency of accounts, which must demonstrate that revenues are related to costs associated with each of these businesses. These accounts are available from the Australian Securities and Investments Commission, and are also tabled in the Queensland Parliament.

Submissions to the Authority from the existing distributors/retailers argued the level of separate financial reporting was already sufficient to ensure accountability and transparency of the two separate businesses, and that such separation was also important to ensure commercial decisions were made on a sound basis. However, a number of other submissions were of the view that accounting separation requirements needed to be tightened, specifically with respect to cost allocation issues (see below).

The Authority notes that legal separation requires certain detailed accounting and reporting arrangements, and that this information is publicly available. However, the Authority has not yet had an opportunity to make a detailed assessment of these requirements, and is therefore not currently in a position to determine their effectiveness with respect to ring-fencing. A detailed analysis of this nature will be undertaken as part of the Authority's pricing review over the next twelve months.

In the interim, the Authority proposes to include in the draft Distribution Ring-Fencing Guidelines provisions to formalise existing accounting arrangements as currently required under Corporations Law, in addition to the following requirements:

- the distributor must maintain a separate set of accounts in respect of prescribed distribution services, as well as a separate set of accounts in respect of any other services provided;
- compliance reports are to be provided to the Authority; and
- these accounts may be required to be audited (see separate section relating to consistency with the ACCC).

Cost allocation

Cost allocation issues arise when costs cannot be allocated precisely and unambiguously to particular customers or services. In particular, costs may jointly relate to the operation of contestable and non-contestable activities, such as network and metering activities within the distribution entity, or between distribution and retail businesses. In such circumstances, the potential exists for costs that correctly belong to the contestable business to be allocated to the regulated distribution business, creating a competitive advantage for the contestable activity. An appropriate cost allocation methodology is therefore critical to effective ring-fencing.

Submissions received by the Authority argued strongly that cost allocation was a key ring-fencing requirement, particularly given the small profit margins in retailing, which require only a small subsidy to distort the competitive balance.

As a starting point, the Authority believes that there should be no cross subsidy between the prescribed and non-prescribed services. A cross subsidy exists where, for example, for any costs that are jointly incurred by the distribution and retailing entities, the costs allocated to one entity are less than the long run avoidable cost of their supply. The Distribution Ring-Fencing Guidelines therefore contain a provision that prohibits cross subsidisation between prescribed services and any other services.

Notwithstanding the prohibition of cross subsidies, cost allocation will still need to be undertaken in a manner that the Authority considers is fair and reasonable (as is also required under the Gas Code). In addition, the Gas Code states that where the regulator requires that a different methodology be used to determine cost allocation to that proposed by the service provider, the regulator must provide a detailed explanation of the methodology it requires.

Given the legal separation requirement in place between distribution and retail entities, costs are already allocated in some manner to arrive at the required accounts for the separate businesses. The Authority is therefore supportive of an approach to cost allocation which allows distributors to put forward their cost allocation methodologies to the Authority for approval, rather than prescribing how costs must be allocated. Current methodologies will then be assessed in the context of the objectives of the Code and to ensure their effectiveness in meeting the Authority's ring-fencing objectives, thereby promoting competition in related markets. The Authority will consider the need for more detailed cost allocation guidelines in light of this analysis.

Limitations on information flows

With respect to ring-fencing, limitations on information flows involve imposing controls on the sharing of information between related businesses in order to minimise any potential competitive advantages that the monopoly business can provide to any related businesses. Alternatively, requirements to publish certain information, or make information available to all retailers or related contestable businesses on an equal basis, may be used.

One example of a possible information advantage concerns the hot water load. The Queensland distribution businesses control about 10 per cent of maximum demand through hot water load that may be switched off or on to avoid overloads to the distribution system (and resulting higher prices). Knowledge by a retailer of when such a significant proportion of load is to be switched can give the retailer an enhanced ability to manage risks.

A further area of concern is the treatment of customer information held by the distribution entity, particularly information relating to consumption patterns, including competing retailers' customers. Such information should be treated in a confidential manner by distribution entities, unless there is a legitimate commercial need for such information to be disclosed. In such circumstances, information should be made publicly available and therefore accessible on the same basis to all retailers.

There is a significant degree of common staffing between distribution and retail entities at present, eg. common customer care centres and elements of the senior management structure. With respect to Board membership, Energex has only one common Director (who is also the Chair of the distribution entity), while Ergon has three (again including the distribution Chair).

In general, ring-fencing with respect to information flows is very difficult to implement and monitor. However, information is one of the critical ways by which retailers may gain a competitive advantage. Submissions to the Authority from the distributors note that there are some shared facilities between distribution and retail businesses that make use of common information, such as customer service centres. However, distributors argue the implementation of legal separation has ensured that information flows are quarantined in a manner not seen in other jurisdictions. Other submissions, in contrast, have argued that information flows should be further restricted through requirements for separate staffing, physical separation of the businesses and controls on customer data.

The Authority has considered the merits and costs of such limitations, and considers that, based on its stated objectives and principles, they may be warranted in certain areas such as:

- sharing of marketing staff; and
- establishing protocols for information sharing.

This will provide clear separation of responsibilities between the legally separate entities, and remove the potential for unintended sharing of information both at an operational level, and in terms of managerial decision making. The Authority therefore supports the inclusion of ring-fencing arrangements to this effect. In particular, the draft Distribution Ring-Fencing Guidelines require that:

- marketing staff do not work for both the distribution and retailing businesses;
- the distributor must 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 person without the approval of the customer or prospective customer who provided it;
- a DNSP must not provide distribution network access to a related business on more favourable terms than those it provides to a competing retailer, eg. information regarding load management is to be made equally available to all retailers in the market; and
- the Authority may introduce requirements regarding the security measures employed to control the flow of information between the distributor and the retailer.

Procedures for amending, adding to or waiving ring-fencing obligations

The Authority notes the Gas Code contains detailed provisions in relation to adding to or waiving ring-fencing obligations, but that the ACCC has not included such provisions in its electricity ring-fencing requirements. The Authority notes the specific requirement in the Code for the regulator to consider the inclusion of such provisions, and believes transparency and certainty of the process for altering, adding to or waiving ring-fencing obligations would be enhanced by including detailed procedures in the draft Guidelines. Accordingly, the inclusion of such procedures is supported. In particular:

- the Authority must provide a notice to the distribution entity requiring it to comply with additional or amended ring-fencing provisions;
- the Authority is required to inform all interested parties prior to issuing such a notice, including by publication in a national daily newspaper requesting submissions on the proposed changes;
- the Authority must issue a draft decision within 30 days of the last day for submissions, providing a copy of the draft decision to the distributor and anyone making a submission;
- further submissions must then be requested and considered before a final decision is issued within 30 days of the last day for submissions on the draft decision.

Similar provisions apply for the waiving of ring-fencing obligations.

5.2 Matters required to be considered under the National Electricity Code

As per section 6.20.2d of the Code, the Authority has also considered the following matters in preparing the draft Guidelines.

Consistency with the Gas Code

The Code requires consideration of the need for consistency with Federal and State regulation in each participating jurisdiction of ring-fencing requirements for other utilities. In particular, the Authority has considered the provisions of the Gas Code that relate to ring-fencing.

Submissions received by the Authority were broadly supportive of the concept of consistency between energy markets and across jurisdictions, although expressed doubt that this was possible in practice, at least in the short term.

The Authority is of the view that using the Gas Code ring-fencing arrangements as a template for electricity has several advantages, namely:

- it contains provisions relating to all matters to be considered for inclusion in the Distribution Ring-Fencing Guidelines as outlined in section 6.20.2c of the National Electricity Code, which, as noted in section 5.1, are broadly supported by the Authority;
- it assists in achieving consistency between the electricity and gas sectors, as required under section 6.20.2d of the National Electricity Code;
- it assists in achieving consistency between federal and state regulation, also required under section 6.20.2d of the National Electricity Code, given the ACCC has applied most of the Gas Code ring-fencing provisions; and
- in many respects it simply formalises the current ring-fencing arrangements in place in Queensland while also requiring separate reporting to the Authority, and therefore should not be particularly onerous in terms of compliance.

The Authority has therefore adopted the Gas Code ring-fencing provisions as the basis for the development of draft Distribution Ring-Fencing Guidelines.

Consistency with the ACCC

The Code raises the need for consistency between Transmission and Distribution Ring-Fencing Guidelines. In addressing this issue, the Authority has liaised with the ACCC on the issue of ring-fencing in electricity.

While New South Wales and Victoria have had general ring-fencing provisions in place in terms of accounting and licensing requirements for some time, the ACCC was the first regulator to address the ring-fencing requirements of the National Electricity Code in detail, as outlined in their recently released Draft Statement of Principles for the Regulation of Transmission Revenues. The ring-fencing provisions adopted by the ACCC largely mirror those of the Gas Code, with a number of key differences.

Definition of a related business

Most regulatory approaches to ring-fencing stipulate that the regulated entity cannot take part in a related business. The Gas Code defines a related business as:

“... the business of producing, purchasing or selling natural gas, but does not include purchasing or selling of natural gas to the extent necessary (a) for the safe and reliable operation of the pipeline; or (b) to enable a service provider to provide balancing services in connection with a covered pipeline.”

This effectively prevents the regulated business from entering the retail market, but does not prevent it from engaging in activities which are related to the regulated business, but which are not necessarily regulated activities. For example, metering may still be undertaken by the regulated business, even though it may be defined as a contestable activity.

In contrast, the ACCC defines a related business as being:

“... any activity other than the provision of prescribed services.”

The ACCC’s definition is much narrower, effectively precluding a transmission network service provider from undertaking any activities other than those deemed by the regulator to be uncontestable or regulated, prescribed services.

Ergon Energy’s submission to the Authority noted that it has a large geographic area to cover with a very small population density, and the provision of multiple services (including contestable and non-contestable services) through a single entity was essential in terms of economies of scale.

The Authority is of the view that the ACCC definition is overly prescriptive in preventing the regulated entity from undertaking activities that may be economically efficient for it to provide, even though these may not be monopoly activities. It therefore proposes to adopt a definition of related business more along the lines of the Gas Code, namely “producing, purchasing or selling electricity”. However, the proposed requirements relating to accounting separation will require that contestable activities are reported separately to the regulated aspects of the business which form the basis of the regulated tariff.

Auditing requirements

In terms of compliance with ring-fencing requirements, the ACCC has an additional clause which may require, upon reasonable notice, a transmission network service provider (TNSP) to appoint an independent auditor approved by the ACCC to report on such matters as specified by the ACCC, and provide a copy of the auditor’s report to the ACCC. If the ACCC nominates auditing standards, the auditor must report in accordance with those standards. For the purposes of this clause, the ACCC may publish auditing guidelines with which a TNSP must comply. Victoria has a similar provision, although the focus of their ring-fencing arrangements is very much on accounting, as legal separation is not required.

While the inclusion of a provision relating to auditing along the lines proposed by the ACCC will invoke additional costs for distribution entities, it would allow the Authority the option of independent auditing expertise should it deem it to be necessary. The Authority has therefore included an additional provision in the draft Electricity Distribution Ring-Fencing Guidelines relating to auditing, to be imposed should the Authority deem it necessary, along the lines of that proposed by the ACCC.

Adding to or waiving ring-fencing obligations

In relation to provisions for including additional ring-fencing requirements, the ACCC has relied solely on the criterion of weighing up the costs of their imposition against the public benefit, rather than the provisions outlined in the Gas Code, which in summary include:

- ensuring the service provider does not have regard to the interests of an Associate in priority to the interests of other customers or prospective customers; and
- ensuring that ring-fencing obligations do not impose unreasonable compliance costs on the service provider or its Associates.

The ACCC's public benefit requirement would appear to encompass the more specific issues raised in the Gas Code, and requires that there be net benefits in imposing additional regulatory requirements. In this regard, the ACCC approach is supported.

Similarly, the ACCC's provisions relating to the waiving of ring-fencing obligations rely on weighing up the costs of their imposition against the public benefit. This differs from the provisions of the Gas Code, which in summary include:

- the requirement not to carry on a related business may be waived where the administrative costs to the service provider and its Associates of complying with the obligation outweigh any public benefit arising from the distribution entity meeting the obligation, taking into account arrangements put in place by the distribution entity (if any) to ensure that confidential information is not disclosed;
- the requirement not to carry on a related business may be waived where an arrangement has been established between the service provider and the relevant regulator which requires the relevant regulator to approve an Associate Contract prior to the service provider entering into such a contract with an Associate; and
- the requirements relating to marketing staff working for both the service provider and an Associate (sections 4.1h and 4.1i in the Gas Code) may be waived where the relevant regulator is satisfied that the administrative costs to the service provider and its Associates of complying with that obligation outweigh any public benefit arising from the service provider meeting the obligation.

In this instance, the Gas Code provisions are more limited than the proposed ACCC approach, as under the Gas Code, only certain provisions (relating to undertaking a related business and the use of marketing staff by the distribution entity and an Associate) can be waived. Again, the ACCC approach is more simple, more clear, and can be applied to any of the ring-fencing provisions provided a net benefit can be demonstrated. For these reasons, the ACCC approach to waiving ring-fencing obligations is supported.

Procedures for adding to or waiving ring-fencing obligations

The ACCC does not have any detailed requirements in its ring-fencing arrangements regarding the actual process of adding to or waiving such obligations. The Gas Code, in contrast, requires the regulator to:

- inform interested parties it is considering additional ring-fencing requirements or considering waiving particular ring-fencing requirements;
- publish newspaper notices requesting submissions on the proposal;

- consider these submissions;
- issue a draft decision and provide copies of this decision to the service provider and those who made submissions;
- request submissions on the draft decision;
- consider these submissions; and
- issue a final decision, to have effect within 14 days.

As noted in the previous section, the Authority supports the inclusion of detailed procedural requirements in the interests of promoting transparency and certainty for market participants. However, the Authority has concerns regarding the timing requirements of the Gas Code, which require a draft decision to be issued within 14 days after the close of submissions and a final decision to be issued 21 days after the last day for submissions on the draft decision. In particular, the Authority considers this timeframe is too short to give such matters appropriate consideration.

The Authority therefore supports the inclusion of detailed procedural requirements for amending, adding to or waiving ring-fencing obligations along the lines of the Gas Code, but proposes to extend the timeframe for issuing draft and final decisions to within 30 days of the close of submissions.

Additional staff

The Gas Code and the ACCC require that there be no common marketing staff between a regulated entity and an Associate. The ACCC further requires that any additional staff that move between a regulated entity and an Associate must be notified to the ACCC. Under the provisions for additional ring-fencing requirements, the ACCC also retains the right to require that any staff may not work for both a regulated entity and an Associate.

The Authority supports the inclusion of requirements that prevent any common marketing staff between the distribution network service provider and an Associate (such as a retailer), in accordance with the provisions of the Gas Code. The Authority also supports the additional provisions in the ACCC's ring-fencing arrangements in relation to notification of the movement of additional staff and the right to require staff not work for both a DNSP and an Associate. These provisions give the Authority the flexibility to assess the potential for conflicts to arise when staff work for both a distributor and a retailer, and to require staff to work for only one or the other where such a conflict is perceived to arise. Similarly, where there are rational arguments for doing so, this provision permits the use of common staff while ensuring the Authority is aware of such an arrangement.

Consistency with other jurisdictional regulators

The Code raises the need for consistency in Distribution Ring-Fencing Guidelines between participating jurisdictions. In meeting this requirement, the Authority has held discussions with the Independent Pricing and Regulatory Tribunal in NSW, the Office of the Regulator General in Victoria, the Independent Pricing and Regulatory Commission in the ACT, and the South Australian Electricity Reform and Sales Unit.

IPART, in its June 1999 report on Pricing for Electricity Networks and Retail Supply, notes its support for the work done by the ACCC on ring-fencing guidelines, but believes it requires further refinement. In particular, the Tribunal has stated it would like to see:

- the setting of clear cost allocation rules;
- the inclusion of strong non-discrimination rules to ensure that a distribution entity's dealings with a related retailer are consistent with its dealings with other retailers; and
- the tightening of requirements relating to the disclosure of confidential information.

The Tribunal therefore supports further development of ring-fencing guidelines, including through consultation with stakeholders. Concurrently, the Tribunal proposes to review the current Accounting Separation Code that applies to electricity entities in NSW.

According to ORG's June 1999 Electricity Industry Guideline No. 3: Regulatory Information Requirements:

- clauses in distribution licences require that the licensee must ensure that separate accounts are prepared for each electricity business in accordance with Guidelines set by the Office, and in the manner and form decided by the Office;
- there are broad processes in place for revision of these arrangements;
- there is a strong focus on regulatory accounting statements and their content, including information on issues such as operating and maintenance costs, executive remuneration, depreciation, asset valuation, interest and dividends, customer contributions, and inflation adjustments; and
- there are also requirements for procurement of an audit opinion.

However, the requirements of the Gas Code are largely absent, particularly in terms of any requirement for legal separation and the stipulation that a regulated business cannot carry on a related business.

The Australian Capital Territory Independent Pricing and Regulatory Commission released a final pricing determination in electricity distribution in May 1999. This determination does not address the ring-fencing issues as outlined in section 6.20 of the National Electricity Code.

In South Australia, regulatory arrangements are being amended in light of the recent decision of the South Australian Government to enter into long term leasing arrangements for its electricity entities. Currently, there is legal separation of distribution and retailing functions, with these entities both controlled by a single holding company structure under a "stapling" arrangement. South Australia's *Electricity Act 1996* (as amended) requires the business of the operation of the distribution network to be kept separate from any other business of the entity, but there are no other formal ring-fencing requirements in place (although these are under active consideration as part of the leasing process). Cross ownership restrictions will apply to the long term lease arrangements, although the only arrangements that relate to distribution and retailing entities provide that neither distributors nor retailers are able to hold generation licences.

The above indicates that the position of the other jurisdictional regulators on ring-fencing is still being developed. IPART is broadly supportive of the ACCC approach but favours further refinement of these arrangements, while ORG proposes a stringent accounting separation only approach. Other jurisdictions have not yet released any firm position on ring-fencing.

The Authority's proposed approach, as noted earlier, is broadly consistent with that put forward by the ACCC and that likely to be adopted by IPART. The ORG approach is fundamentally different, relying almost exclusively on accounting requirements to ensure there is adequate ring-fencing. A number of submissions to the Authority argued that a focus on accounting separation only would lead to onerous and detailed compliance requirements which would be significantly more costly than an approach which focuses on legal or structural separation with commensurately less onerous accounting provisions.

The Authority is therefore of the view that its approach meets the requirement for consistency across jurisdictions as much as possible given the current position of other jurisdictional regulators. The Authority also supports ongoing liaison between regulatory bodies with a view to ensuring greater consistency over the medium term.

Consistency with retailer of last resort arrangements

The Code requires consideration of the need for Distribution Ring-Fencing Guidelines to be consistent with arrangements for the retailer of last resort for any given jurisdiction. There are no current arrangements of this nature in Queensland, although provisions exist under the *Electricity Act 1994* for a regulation to be made establishing a retailer of last resort.

5.3 Consultation requirements

The Authority has consulted with participating jurisdictions, Code participants and other interested parties in preparing the draft Guidelines, as required under 6.20.2e of the Code. In particular, the Authority has:

- met with representatives from a number of participating jurisdictions;
- prepared an Issues Paper on ring-fencing in July 1999 which was advertised widely and sent to all Code participants as well as a number of other interested parties;
- called for submissions on the issues raised in the Issues Paper;
- met with a number of stakeholders regarding their submissions to the Authority; and
- released these draft Electricity Distribution Ring-Fencing Guidelines for comment, which have been advertised widely and sent to all Code participants and interested parties.

5.4 Definition of prescribed services

The Code requires ring-fencing of prescribed distribution services from the provision of other services by the Distribution Network Service Provider. In their recent publications on electricity, neither the ACCC or IPART has defined exactly what constitutes prescribed or regulated services.

The issue of defining prescribed services is a difficult and complex one, requiring some understanding of technical matters relating to the operation of distribution networks as well as judgement as to which distribution activities might be contestable. Submissions to the Authority noted that any definitions adopted now are likely to be wrong or inappropriate within a relatively short timeframe, given the rapid development of the national electricity market. In addition, submissions to the Authority from distribution entities have argued for the development of definitions in conjunction with industry. The Authority supports this view, and believes this task is probably best undertaken as part of the broader pricing review, to be completed in 2000.

As a consequence, the Distribution Ring-Fencing Guidelines will become effective from the date of commencement of the Authority's regulatory role in pricing, ie. 19 December 2000.

5.5 Issues raised in submissions

Ownership separation

The Gas Code does not cover a number of other issues raised in submissions received to date by the Authority. One such issue is whether complete ownership separation would be an appropriate option for Queensland.

Complete ownership separation has been compulsorily introduced in New Zealand through legislation, broadly in response to perceived anti-competitive behaviour by jointly owned distribution entities and retail entities. In the UK, a number of regional electricity companies have voluntarily separated their distribution and retail businesses. This change has been supported by the electricity regulator, which has expressed the view that complete business separation between retailing and distribution is necessary in order that customers gain maximum benefits in both competitive and non-competitive areas. Legislation is to be introduced shortly requiring legal and management separation of distribution and retailing businesses. However, the legislation will not require ownership separation.

Complete ownership separation is supported by a number of the submissions received by the Authority, primarily as this absolutely eliminates the financial incentive to act in a manner that can distort competition. This provides all retailers in the Queensland market with equal opportunity to build commercial relationships with distribution entities.

The Authority notes that ownership separation is a major issue that would involve significant legislative changes and that other states to date have not invoked separation even in legal terms.

In addition, most retailers operating in the national market are affiliated with, or are part of, a distribution business. In competitive terms, Queensland retailers competing in southern markets are therefore on an equal footing relative to those retailers competing in Queensland.

Such affiliation also provides retailers with sufficient assets in terms of the distribution entity's balance sheet to enable them to gain finance to operate their businesses and to meet the prudential requirements outlined under the Code. This finance might not otherwise be available given that retailers are service oriented entities with little asset backing. Currently, backing is provided by way of a guarantee that is recognised as a contingent liability in the books of the distribution entity.

One possible alternative to ownership separation in Queensland, canvassed in several submissions received by the Authority, is to establish the retailers as subsidiaries of generation entities rather than distribution entities. This proposal would remove the potential for distribution entities to provide a competitive advantage to retailers, while still providing the latter with asset backing.

In addition, a number of market participants have argued that a retail customer base is a natural counterparty to generation, creating an effective hedge to assist in risk management. This has been evidenced in New Zealand, where the requirement for ownership separation between distribution and retailing has driven amalgamations between generators and retailers. The Government may wish to give further consideration to these structural issues, which fall outside the ambit of the Authority in determining ring-fencing arrangements.

The Authority therefore notes there is support for ownership separation from some market participants, but that there are also arguments against such separation, particularly in light of the absence of legal separation to date in other jurisdictions. The Authority also notes general comments made in some submissions in support of a more fulsome consideration of the current industry structure, given the convergence between energy markets and the evolution of the National Electricity Market.

In summary, the Authority believes consideration of such structural options, along with alternatives such as transferring retail subsidiaries to generating entities, should appropriately be further considered by Government. This is consistent with the Authority's view that at the present time, it will regard industry structure as a given and to develop its ring-fencing guidelines accordingly. However, as noted earlier, the Authority expects that over time, evidence will emerge as to the benefits and costs of different industry structures, and that the effectiveness of the current structure of the electricity industry will then be able to be more clearly determined.

Branding

The Gas Code ring-fencing provisions are also silent on the issue of common branding. Branding relates to the use of a common name for both the distribution and retailing businesses. Common identities between distributors and retailers may create unfounded fears that quality of service will be reduced if an alternative retailer is preferred.

Several submissions received by the Authority raised this as a potential barrier to retail competition, in particular as it carries the perception of greater security and creates greater potential for cost sharing eg. with respect to advertising.

The Authority notes that other jurisdictions allow retail and distribution functions to co-exist within a single legal entity. Given this, the Authority is of the view that the issue of separate branding of retail and distribution entities in Queensland should not be actively pursued at this time.

However, the Authority intends to pay particular attention to issues of cost sharing and cost allocation between retailers and distributors in ensuring compliance with its draft Distribution Ring-Fencing Guidelines. The Authority is of the view that marketing costs, for example, should be fully allocated to the retail side of the business, as there appears little justification for a distribution entity to advertise its services. The Authority also intends to revisit the issue of branding in the future should current arrangements prove a significant barrier to competition.

In addition, the Authority has the capacity to introduce conduct rules to address concerns at the retail level such as ensuring the advice given to customers to induce them to change retailer is accurate. In determining the need for such rules, the Authority will address a range of issues related to matters such as information requirements necessary to ensure that customers are not misled regarding quality of supply being maintained irrespective of the retailer selected.

6. THE AUTHORITY'S APPROACH

In developing its approach to ring-fencing in electricity, the Authority has taken into account:

- existing ring-fencing arrangements in the Queensland electricity industry, which involve legal separation between distributors and retailers and consequent mandatory reporting requirements under the *Government Owned Corporations Act 1993* and Corporations Law;
- the requirements imposed on the Authority under the National Electricity Code;
- the Authority's stated objectives and principles of ring-fencing; and
- issues arising from the Code's requirements, in particular as raised in submissions to the Authority, and including:
 - consistency with the Gas Code;
 - consistency with the ACCC's approach to ring-fencing in electricity, particularly on issues such as the definition of a related business, auditing requirements, and adding to and waiving ring-fencing obligations;
 - consistency with other jurisdictions;
 - the definition of prescribed services;
 - ownership separation and
 - separate branding.

In summary, the Authority's approach:

- encompasses the major aspects of ring-fencing as identified in section 6.20.2c of the National Electricity Code, in particular legal separation between distribution and retailing functions (which is already in place in Queensland, as noted above), separate accounting requirements, and cost allocation;
- uses the Gas Code as a template for ring-fencing in electricity, thereby ensuring consistency across energy markets;
- is largely consistent with the ACCC's approach to ring-fencing in electricity, in particular in terms of additional provisions for auditing of accounts, although differs in terms of the definition of a related business and in terms of detailed provisions for adding to or waiving ring-fencing obligations;
- is likely to be consistent with the approach to be adopted by IPART, pending further details of the Tribunal's proposed ring-fencing arrangements, although differs from that currently proposed by ORG, as ORG does not require legal separation or that the entity not carry on a related business;
- notes that a detailed definition of prescribed services is to be undertaken as part of the Authority's forthcoming distribution pricing review;

- notes there is support for complete ownership separation from some market participants, but that there are also arguments against such separation, and that the effectiveness of structural options will be further considered over time;
- notes that there is support for further managerial separation from some market participants, but that the need for this will be assessed over time in terms of the effectiveness of the currently proposed arrangements; and
- recognises common branding can create a competitive advantage, but does not support separate branding of retail and distribution entities at this time.

The Authority believes there is currently insufficient evidence regarding the costs and benefits of various approaches to industry structure in terms of engendering competition. Accordingly, the Authority proposes at the present time to regard industry structure as a given and to adopt an approach to ring-fencing which would vary depending on the industry structure chosen.

However, the Authority expects that over time, evidence will emerge as to these benefits and costs, and that the effectiveness of the current structure of the electricity industry will be able to be more clearly determined. In the interim, the Authority notes that the costs of ring-fencing are likely to be significantly higher where an integrated structure is adopted, relative to those that would be incurred under a structure which had greater structural separation. It is also the Authority's view that these costs should be borne by the entities being regulated.

The Authority believes that, given the current structure of the Queensland electricity industry, the approach adopted provides the best balance in ensuring effective separation between distribution and retailing businesses in order to encourage competition, while minimising the regulatory compliance burden on distribution entities.

In preparing the draft Guidelines, the Authority has been mindful of the fact that Queensland's legal separation requirements have been in place for several years, while some other jurisdictions are only now moving to support legal separation. The Authority expects that, in the near future, legal separation will be introduced at the national level in transmission, as well as in New South Wales at the distribution level.

Once this occurs, the costs to distribution entities of additional ring-fencing requirements, in terms of the loss of consistency with other jurisdictions, may be considerably less. In these circumstances, there may be net benefits from additional separation requirements. In addition, the Authority intends to monitor the Distribution Ring-Fencing Guidelines with a view to assessing their effectiveness and amending the Guidelines where necessary. As a consequence, and in accordance with good regulatory practice, the Authority intends to review its Distribution Ring-Fencing Guidelines at the conclusion of each regulatory period to ensure they are effective in achieving the Authority's objectives.

The Authority's draft Distribution Ring-Fencing Guidelines are at Attachment A. As per the consultation requirements of the National Electricity Code, the Authority has made this report, which contains its conclusions on ring-fencing and the reasons for reaching such conclusions, available to all Code Participants and interested parties. A list of submissions received to date is contained at Attachment B. The Authority now invites comments on the draft Guidelines, including the analysis upon which they are based, to be forwarded to the Authority by Friday 25 February 2000.

ATTACHMENT A**DRAFT DISTRIBUTION RING-FENCING GUIDELINES**

These Distribution Ring-Fencing Guidelines (Guidelines) will apply to all Distribution Network Service Providers (DNSPs) located in Queensland.

The Guidelines have been prepared on the basis that legal separation is already in place between Queensland distribution and retail entities, and that this requirement is material in defining the structure of the electricity industry. In the event that a change in the structure of the industry in terms of these separation requirements is contemplated, the Authority will revisit the Guidelines to ensure that they remain appropriate to the circumstances.

Ring-fencing minimum obligations

1. A distribution network service provider (DNSP) that provides prescribed distribution services in Queensland must:
 - (a) be a legal entity incorporated pursuant to the Corporations Law, or a statutory corporation, or a government or an entity established by royal charter; (Gas Code)
 - (b) not carry on a related business; (Gas Code)
 - (c) establish and maintain a separate set of accounts in respect of the prescribed distribution services; (adapted from the Gas Code)
 - (d) establish and maintain a separate consolidated set of accounts in respect of the entire business of the DNSP, including establishing and maintaining a separate set of accounts in respect of excluded services provided by the DNSP; (adapted from the Gas Code)
 - (e) allocate any costs that are shared between an activity that is covered by a set of accounts described in (c) and any other activity, including any activity performed by another entity, in a manner that ensures there is no cross subsidy, and according to a methodology for allocating costs that is approved by the QCA, is generally consistent with the objectives of the National Electricity Code and is otherwise fair and reasonable; (adapted from the Gas Code)
 - (f) 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 person without the approval of the customer or prospective customer who provided it, except:
 - (i) if the confidential information comes into the public domain otherwise than by disclosure by the DNSP; or
 - (ii) to comply with any law, any legally binding order of a court, government, government or semi-government authority or administrative body or the listing rules of any relevant recognised stock exchange; (Gas Code)
 - (g) ensure that all confidential information obtained by the DNSP or by its employees, consultants, independent contractors or agents in the course of conducting its business and which might reasonably be expected to affect materially the commercial interests of a customer or prospective customer is not disclosed to any other person without the approval of the customer or prospective customer to whom that information pertains, except:

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- (i) if the confidential information comes into the public domain otherwise than by disclosure by the DNSP; or
 - (ii) to comply with any law, any legally binding order of a court, government, government or semi-government authority or administrative body or the listing rules of any relevant recognised stock exchange; (Gas Code)
- (h) not provide distribution network access to a related business on more favourable terms than those it provides to any other customer or Code participant; and
- (i) ensure that its marketing staff are not also staff of an Associate that takes part in a related business and, in the event that they become or are found to be involved in a related business contrary to this section, must procure their immediate removal from its marketing staff. (Gas Code)
2. In complying with 1 (c), (d) and (e), a DNSP must:
- (a) if the QCA has published general accounting guidelines for DNSPs which apply to the accounts being prepared, comply with those guidelines (Gas Code); or
 - (b) if the QCA has not published such guidelines, comply with guidelines prepared by the DNSP and approved by the QCA or, if there are no such guidelines, comply with such guidelines (if any) as the QCA advises the DNSP apply to that DNSP from time to time. (Gas Code and similar provisions in ACCC)

Such guidelines may, amongst other things, require the accounts to contain sufficient information, and to be presented in such a manner, as would enable the verification by the QCA of the calculation of distribution use of system charges. (adapted from the Gas Code)

3. An entity that provides prescribed distribution services must notify the QCA if:
- (a) any of its employees, consultants, independent contractors or agents are, or will be, employees, consultants, independent contractors or agents of an Associate that takes part in a related business; or
 - (b) any employees, consultants, independent contractors or agents of an Associate that takes part in a related business will be employees, consultants, independent contractors or agents of it. (ACCC)
4. A notification under section 3 must be provided to the QCA five business days prior to the date on which:
- (a) the employee, consultant, independent contractor or agent of the entity that provides prescribed distribution services will be a employee, consultant, independent contractor or agent of the Associate that takes part in a related business; or
 - (b) the employee, consultant, independent contractor or agent of the Associate that takes part in a related business will be a employee, consultant, independent contractor or agent of the entity that provides prescribed distribution services. (ACCC)
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Adding to or amending ring-fencing obligations

5. The QCA may by notice to a DNSP require the DNSP to comply with obligations in addition to the minimum obligations outlined in section 1 above (including temporary obligations), or add to or amend these Distribution Ring-Fencing Guidelines. The QCA may add to or amend the Distribution Ring-Fencing Guidelines provided that it is satisfied the DNSP cannot demonstrate that the administrative cost to the DNSP and its Associates of complying with the additional or altered obligations is, or is likely to, outweigh the benefit to the public. The DNSP must comply with any additional obligations imposed under this section 5. (adapted from ACCC)
6. Without limiting the additional obligations that may be imposed under section 5, the QCA may require that:
 - (a) the DNSP ensure its additional staff are not employees, consultants, independent contractors or agents of an Associate that carries on a related business and, in the event that they become or are found to be involved in a related business, ensure their immediate removal from the additional staff; and
 - (b) the electronic, physical and procedural security measures employed in respect of the offices of the DNSP and of all offices of its Associates are satisfactory to the QCA.

The examples given in this section 6 shall not be construed as limiting the types of action a DNSP may have to take in order to comply with section 1. (Gas Code and ACCC)

Procedures for adding to or amending ring-fencing obligations

7. The QCA must, before issuing a notice under the provisions for adding to or amending ring-fencing obligations, inform each person known to the QCA who the QCA believes has a sufficient interest in the matter that it is considering issuing a notice under section 5 with respect to a particular DNSP, by publishing a notice in a national daily newspaper which at least:
 - (a) states who the DNSP concerned is and the obligations the QCA is considering adding; and
 - (b) requests submissions by a date specified in the notice (not being a date earlier than 14 days after the date of the notice). (Gas Code)

The QCA will also give a copy of any notice published in a national daily newspaper in accordance with this section 7 to the DNSP to which the notice relates.

8. The QCA must consider any submissions received by the date specified in the notice published under 7(b) and may (but is not obliged to) consider any submissions received after that date. (Gas Code)
9. Within 30 days after the last day for submissions specified in the notice published under 7(b), the QCA must issue a draft decision stating whether or not it intends to issue a notice under section 5. (Gas Code amended for timing)

10. The QCA must:
 - (a) provide a copy of its draft decision to the DNSP, 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 14 days after the date the draft decision was issued). (Gas Code)
11. The QCA must consider any submissions it receives by the date specified by the QCA under section 10 and it may (but is not obliged to) consider any submissions received after that date. (Gas Code)
12. Within 30 days after the last day for submissions on the draft decision specified by the QCA, the QCA must issue a final decision stating whether or not it will issue a notice under section 5. (Gas Code amended for timing)
13. A notice under the provisions for additional ring-fencing obligations has effect 14 days after the notice is given to the DNSP or such later date as the QCA specifies in the notice. (Gas Code)

Compliance procedures and compliance reporting

14. A DNSP must establish and maintain appropriate internal procedures to ensure it complies with its obligations under the Distribution Ring-Fencing Guidelines. The QCA may require the DNSP to demonstrate the adequacy of these procedures upon reasonable notice. However, any statement made or assurance given by the QCA concerning the adequacy of the DNSP's compliance procedures does not affect the DNSP's obligations under these Guidelines. (Gas Code)
15. A DNSP must provide a report to the QCA, at reasonable intervals determined by the QCA, describing the measures taken by the DNSP to ensure compliance with its obligations under these Guidelines. This report, along with the QCA's assessment of compliance, will be made publicly available by the QCA. Confidential information will be removed from the public report where the DNSP can demonstrate that its public release would harm the commercial interests of the DNSP. (Gas Code)
16. The QCA may, upon reasonable notice, require a DNSP to:
 - (a) appoint an independent auditor approved by the QCA to report on such matters as are specified by the QCA; and
 - (b) provide a copy of the auditor's report to the QCA by a date specified by the QCA. (ACCC)
17. If the QCA nominates auditing standards to apply to an audit under section 16, the auditor must report in accordance with those auditing standards. To avoid doubt, the QCA may nominate one or more auditing standards. (ACCC)
18. For the purpose of section 17, the QCA may publish auditing guidelines with which a DNSP must comply. (ACCC)

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19. A DNSP must provide a report of any breach of any of its obligations under these guidelines to the QCA immediately upon becoming aware that the breach has occurred. (Gas Code and ACCC) Any breach of these requirements may be reported to NECA, with potential civil penalties where a breach is determined to have occurred.

Waiver of ring-fencing obligations

20. The QCA may, by notice to a DNSP, waive any of a DNSP's obligations under section 1 provided that the QCA is satisfied that the DNSP can demonstrate that the administrative cost to the DNSP and its Associates of complying with the obligation outweighs the benefit, or any likely benefit, to the public. (ACCC)

Procedures for waiving ring-fencing obligations

21. A DNSP may apply to the QCA requesting the QCA to issue a notice under section 20. (Gas Code)
22. When the QCA receives an application under section 21 the QCA 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 QCA who the QCA believes has a sufficient interest in the matter that it has received the application by publishing a notice in a national daily newspaper which at least:
 - (i) states who the DNSP concerned is and the obligations that the application seeks to have waived;
 - (ii) states how copies of the application can be obtained;
 - (iii) requests submissions by a date specified in the notice (not being a date earlier than 14 days after the date of the notice). (Gas Code)
23. The QCA 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 QCA. (Gas Code)
24. The QCA must consider any submissions received by the date specified in the notice published under section 22 and it may (but is not obliged to) consider any submissions received after that date. (Gas Code)
25. Within 30 days after the last day for submissions specified in the notice published under section 22 the QCA must issue a draft decision stating whether or not it intends to issue a notice under section 20. (Gas Code amended for timing)
26. The QCA must:
- (a) provide a copy of its draft decision to the DNSP, 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 14 days after the date the draft decision was issued). (Gas Code)

27. The QCA must consider any submissions it receives by the date specified by the QCA under section 26 and it may (but is not obliged to) consider any submissions received after that date. (Gas Code)
28. Within 30 days after the last day for submissions on the draft decision specified by the QCA, the QCA must issue a final decision stating whether or not it will issue a notice under section 20. (Gas Code amended for timing)
29. A notice under section 20 has effect 14 days after the notice is given to the DNSP or such later date as the QCA specifies in the notice. (adapted from the Gas Code)

Glossary of terms

For the purposes of these Guidelines, the following definitions apply:

additional staff means employees, consultants, independent consultants and agents of a DNSP who are not marketing staff. (adapted from the Gas Code)

Associate has the meaning given to it under the Corporations Law. (indirectly in Gas Code, ACCC defines as Div 2 of Part 1.2 of the Corporations Law if various identified sections were repealed)

auditor means a person registered as an auditor, or taken to be registered as an auditor, under Part 9.2 of the Corporations Law. (ACCC)

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). (ACCC)

Code or National Electricity Code means the code of conduct called the National Electricity Code approved by Ministers of the participating jurisdictions. (shortened from NEC)

Code Participant means NEMMCO or a person who is registered with NEMMCO under Chapter 2 of the National Electricity Code. (shortened from the NEC)

confidential information means in relation to a Code Participant, information which is or has been provided to that Code Participant under or in connection with the National Electricity Code and which is stated under the Code or by NEMMCO or NECA to be confidential information or otherwise confidential or commercially sensitive or information which is derived from any such information. (NEC. Gas Code has a different definition)

cross subsidy occurs where for any costs that are jointly incurred in providing prescribed distribution services and excluded services, the costs allocated to one service are less than the long run avoidable cost of their supply.

customer means a person who engages in the activity of purchasing electricity supplied through a distribution system and registers with NEMMCO as a customer in accordance with the National Electricity Code. (NEC)

distribution means the conveyance of electricity through a distribution system. (NEC)

distribution network service provider (DNSP) means a person who engages in the activity of owning, controlling, or operating a distribution system. (NEC)

distribution service means the services provided by a distribution system which are associated with the conveyance of electricity through the distribution system.

distribution system means a distribution network, together with the connection assets associated with the distribution network, which is connected to another transmission or distribution system. (NEC)

excluded services means distribution services which are not prescribed distribution services and are therefore excluded from the revenue or price cap which applies to prescribed distribution services. (NEC)

long run avoidable cost means that part of the cost of any output that could be saved over the long term by not producing it.

marketing staff means employees, 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 employees, 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. (ACCC and Gas Code)

NECA means the National Electricity Code Administrator Limited ACN 073 942 775, the company responsible for administering the National Electricity Code. (NEC)

NEMMCO means the National Electricity Market Management Company Limited ACN 072 010 327, the company which operates and administers the market in accordance with the National Electricity Code. (NEC)

person includes an individual or a body politic or body corporate. (ACCC)

prescribed distribution services means distribution services which are determined by the QCA as those which should be subject to economic regulation under clause 6.10.4(a) of the National Electricity Code. Such services are deemed to be those currently being performed by any Queensland DNSP, although this definition will be subject to review under the Authority's forthcoming distribution pricing review. (adapted from the NEC)

QCA means the Queensland Competition Authority as established under the *Queensland Competition Authority Act 1997*. (NEC)

related business means the business of producing, purchasing or selling electricity. (adapted from Gas Code)

ATTACHMENT B

SUBMISSIONS RECEIVED BY THE AUTHORITY

The Authority received submissions from the following entities in response to its Issues Paper on Ring-Fencing for Electricity Distribution Entities, which was released on Friday 23 July 1999. All non-confidential copies are available on the Authority's website at www.qca.org.au or may be obtained by contacting the Authority on 07-3222 0555.

CS Energy

Energex Ltd and Energex Retail Pty Ltd (joint submission)

EnergyAustralia

Ergon Energy Corporation Ltd and Ergon Energy Pty Ltd (joint submission)

Gadens Lawyers

Stanwell Corporation Limited (confidential submission)