



**Guidelines for Preparing Ring-fencing
Compliance Reports Under
Section 4.13 of the National Gas Code
(Version 2.0)**

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1. INTRODUCTION

The Queensland Competition Authority is an independent statutory body established under the *Queensland Competition Authority Act 1997*. As part of its responsibilities, the Authority has particular powers and duties set out in the *Gas Pipelines Access (Queensland) Act 1998* (the Act). The Act encompasses and gives effect to the National Third Party Access Code for Natural Gas Pipeline Systems (the Code).

The Authority is the relevant regulator for the two remaining covered gas distribution networks in Queensland, owned by Allgas Energy Limited (Allgas), and Envestra Limited (Envestra). (Dalby and Roma Town Councils were granted revocation from coverage on 12 December 2000 and 24 May 2002, respectively.)

Section 4 of the Code provides for certain minimum ring-fencing requirements to be met by gas distribution network owners to ensure that their business of providing services using a pipeline covered by the Code is segregated from their other business activities. The Authority is responsible for ensuring compliance with these requirements. The Authority may also require additional ring-fencing requirements to be met; alternatively it may, in appropriate cases, consider waiving the ring-fencing requirements upon application from a service provider.

An initial set of *Guidelines for Preparing Ring-fencing Compliance Reports under Section 4.13 of the National Gas Code* (the Ring-fencing Guidelines) was issued in July 2002, to assist the service providers with the preparation of their ring-fencing compliance reports in a manner which fulfils the service provider's reporting obligations under the Code. The Guidelines also provided an indication of the assessment approach to be used by the Authority when assessing compliance with the Code.

The service providers submitted their 2001-02 ring-fencing compliance reports in October 2002. While the 2001-02 reports varied in the level of detail provided, the Authority found the reports lacked sufficient comment on the mechanisms implemented to assess the effectiveness of internal procedures used to ensure compliance and did not provide sufficiently detailed financial statements.

In May 2003, the Authority issued *General Accounting Guidelines for Gas Distribution Network Service Providers* (the Accounting Guidelines) under section 4.2 of the Code. The Accounting Guidelines apply to the maintenance of regulatory accounts by the service providers, from the 2002-03 financial year.

The Ring-fencing Guidelines have been revised to incorporate the requirements of the Accounting Guidelines and to further clarify the type of information required to fulfil the reporting requirements of the Code.

2. RING-FENCING COMPLIANCE REPORTS

Under the Code, service providers are required to report to the Authority, at reasonable intervals, on the measures taken to ensure compliance with their ring-fencing obligations and to provide an assessment of the effectiveness of those measures. The role for the Authority is to assess whether the service provider has met its obligations with respect to the Code.

2.1 Assessment Framework

For each of the regulatory requirements outlined in section 4 of the Code, the Authority has identified the assessment criteria that will apply when assessing compliance. A list has also been compiled of the minimum information requirements necessary to fulfil each of the regulatory requirements. If additional ring-fencing requirements need to be complied with, these will be outlined separately by the Authority.

These Guidelines identify and discuss each of the Code's obligations separately and detail the information considered necessary to demonstrate compliance. It should be noted that compliance is not assessed in isolation. Compliance with sections 4.1 (f), (g), (h) and (i) will be assessed in conjunction with the steps taken to ensure compliance with sections 4.12 and 4.13, given that, to effectively demonstrate compliance, reference must be made to the internal mechanisms implemented to ensure compliance and assessment procedures used to measure their effectiveness.

Registered Legal Entity (section 4.1(a))

QCA Approach

Compliance will be assessed according to whether the service provider has addressed each of the requirements outlined in the Code. Thus, the compliance report should include:

- a statement whether the service provider is a legal entity;
- the full name of the entity; and
- the law under which it is registered.

Information Requirements

- Certificate of Incorporation.

Must not carry on a Related Business (section 4.1(b))

QCA Approach

Structural separation of distribution and retail services aims to make the financial relationships between two operating units of a business more transparent. It also assists with the identification of potential incentives or practices which may result in anti-competitive behaviour. Examples of anti-competitive behaviour include:

- price discrimination between internal and external service providers;
 - disclosure of information which is not available within the market; or
 - cross subsidies between other business activities.
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Full separation of related business units does not guarantee that the service provider and a related business would not use contractual arrangements to engage in anti-competitive activity. According to the Code, a related business is one which is in the business of producing, purchasing or selling natural gas, but does not include purchasing or selling of natural gas to the extent necessary for the safe and reliable operation of a covered pipeline or to enable a service provider to provide balancing services in connection with a covered pipeline.

Compliance will be assessed according to the service provider's ability to identify the activities it offers and the business activities offered by its associates and related entities. From this information the Authority will cross check the services offered by the service provider against the services offered by each of the identified associates and related entities.

In most instances, the service provider's annual report provides a sufficient level of detail to demonstrate compliance with the Code. However, service providers must ensure the compliance report addresses each of the information requirements outlined below.

Information Requirements

- Describe the business activities of the service provider;
- Identify all of the service provider's associates and related entities; and
- Describe the business activities of the associates and related entities identified.

Establish and Maintain Separate and Consolidated Sets of Accounts (sections 4.1 (c) and (d))

QCA Approach

Accounting separation of business units within an entity aims to ensure that there is no inappropriate shifting of costs towards either the business entity or the parent company. The cost allocation methodology, prepared by the service provider, must detail the processes used when costs are allocated between different networks and business units.

Section 4.1(c) of the Code, requires the service provider to prepare and maintain a separate set of accounts for each covered pipeline. Schedule A of the Code details the location, operator, description and regulator for each of the covered pipelines (as at the time of the commencement of the Code). Thus, the service provider is required to establish and maintain a separate set of accounts for each network covered by an access arrangement.

Allgas is required to establish and maintain a separate set of accounts for the covered network, which consists of the following four operating regions:

- Brisbane region (south of the Brisbane river);
- Western region (including Toowoomba and Oakey);
- South Coast region (including Surfers Paradise and Coolangatta); and
- Tweed Heads region in north east New South Wales.

Envestra is required to establish and maintain a separate set of accounts for its covered network, which consists of the following two regions:

- Brisbane region (including Ipswich and suburbs north of the Brisbane river); and
- Northern region (serving Rockhampton and Gladstone).

To demonstrate compliance with section 4.1(d), the service provider must provide evidence to the effect that it maintains a separate set of consolidated accounts for the entire business.

Section 4.2 of the Code states that a service provider must comply with any general Accounting Guidelines published by the Authority, any guidelines prepared by the service provider and approved by the Authority, and any guidelines the Authority advises will apply. These 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 Relevant Regulator of the calculation of the Reference Tariffs for Covered Pipelines'.

In May 2003, the Authority issued a set of Accounting Guidelines which provide for the collection, allocation and recording of accounting data by the service providers.

The ring-fencing compliance report must include a set of accounts which comply with the Accounting Guidelines published by the Authority.

The Authority has also sought the cooperation of the service providers with regard to:

- the regulatory accounting statements being adequately and independently audited; and
- provision of Directors' responsibility statements.

If a service provider does not arrange for its regulatory accounting statements to be audited in a manner considered satisfactory by the Authority, the Authority will arrange for the regulatory accounting statements to be audited once they have been submitted.

Information Requirements

- Accounts, associated supporting schedules and work papers for the covered pipeline prepared in accordance with the Accounting Guidelines;
- Accounts, associated supporting schedules and work papers for the entire business prepared in accordance with the Accounting Guidelines;
- For audits of regulatory accounting statements arranged by the service provider, a signed regulatory audit report and a report to the Authority and the service provider (where appropriate); and
- Directors' responsibility statement (at the service providers discretion).

Cost Allocation (section 4.1(e))

QCA Approach

In accordance with the Code, a service provider is required to demonstrate that an appropriate method has been used to allocate all costs between the covered pipeline and any other business activity. It is the Authority's responsibility to determine whether the cost allocation method is consistent with the principles outlined in section 8.1 of the Code, and is otherwise fair and reasonable.

The Accounting Guidelines require costs to be assigned on the basis that items that are directly attributable are directly assigned and items that are not directly attributable are indirectly assigned (or allocated) on a causation basis. Section 3.4 of the Accounting Guidelines, requires service providers to submit their cost allocation manuals to the Authority for approval.

A cost allocation manual must be a stand alone document which addresses the following areas:

- Purpose: a general statement advising that the cost allocation manual is intended to ensure compliance with the Code, assist with the preparation of the regulatory accounting statements and ensure the correct allocation of revenue and costs between the covered pipeline and other business units;
- Principles of Allocation: an overview on how costs and revenue are allocated from the business unit incurring the cost to those business units being allocated a portion of the cost. A graphical depiction of this relationship is useful;
- Allocation Method: the general principles used to allocate revenue, depreciation, costs, assets and liabilities to the regulated and non-regulated business units; and
- Glossary of Terms: given that the cost allocation manual will be used by external parties, it is essential that all of the terms used within the cost allocation manual are defined.

Information Requirements

- An approved cost allocation manual;
- Work papers identifying the amounts allocated on a causation basis, the amounts that have not been so allocated and the numeric quantity of each cost allocation base;
- Description of the items allocated on a non-causation basis, stating the defensible basis of allocation, the reason for choosing that basis and an explanation why no causal relationship could be established; and
- Confirmation by the auditor that the regulatory accounts have been prepared in accordance with the Accounting Guidelines, in particular, that the allocation of costs is in accordance with the cost allocation manual.

Confidential Information (sections 4.1(f) and (g))

QCA Approach

With the progressive introduction of retail contestability and the existence of multi utilities, it is important that information flows are consistent with the requirements of the Code. In a rapidly growing and complex environment, there are increased incentives for market participants to use customer information for purposes such as marketing.

The Code requires a service provider to ensure that confidential information:

- provided by a user, is only used for the purpose for which it was originally provided;
- obtained during the course of business with the user, is not disclosed if it would materially affect the user; and
- is not disclosed to any other person without the approval of the user or prospective user to whom the information pertains.

Compliance with each of these obligations is dependent upon a compliance framework being established internally by the service provider. For example, the Code does not prescribe how approval is to be sought from the user. Thus, it is the service provider's responsibility to establish an approval process which meets its obligations under the Code and reflects current industry standards.

The process of approval refers to the process of obtaining a user's or potential user's consent for disclosing confidential information or using confidential information for a use other than that for which it was originally provided. There are two key issues to be considered with respect to consent. It must be made on an informed basis and be able to be verified. Given the nature of the information in question, it is important that the user or end user is accurately informed of the information which will be used, and for what purpose, prior to granting their consent. Consent should not be sought on a broad range of uses or without a timeframe specified for the use of this information. If the user so wishes, they should have the opportunity to revoke their consent at any time.

The Authority prefers the use of explicit (verifiable) consent rather than implied consent. Given that written consent is the most verifiable form of consent, the Authority would prefer the use of a written approval process compared to one based on verbal consent which is harder to prove after the fact.

As noted earlier, the Code requires a service provider to 'ensure' confidential information is treated appropriately, thus the compliance report must provide sufficient information to demonstrate this has been achieved.

Information Requirements

- Description of the internal procedures established to ensure confidential information is used only for the purposes for which it was provided;
- Description of the internal procedures established to ensure confidential information is not inappropriately disclosed if it would materially affect the user;
- Description of the internal procedures established to ensure confidential information is not disclosed to any other person without the approval of the user or prospective user to whom the information pertains;
- Details of the approval process;
- Details of how these internal procedures are implemented/maintained; and
- Details of how the effectiveness of the internal procedures is measured and the regularity of these assessments.

Marketing Staff (sections 4.1(h) and (i))

QCA Approach

The requirement to prevent the sharing of marketing staff is closely related to the need to prevent the flow of information between related businesses.

The depth of analysis required in the compliance report with respect to marketing staff is dependent, in part, on the business structure of the service provider. It is therefore important that the annual compliance report details how marketing is undertaken, that is, whether it is carried out using internal or external resources.

If conducted internally, the service provider should identify whether any of its marketing staff are also servants, consultants, independent contractors or agents of an associate that takes part in a related business. If conducted externally, the service provider should identify whether the external servants, consultants, independent contractors or agents also undertake marketing for an associate that takes part in a related business.

In assessing compliance, the Authority will be applying the broadest possible meaning to 'servant, consultants, independent contractors or agents'.

The Authority also wants to ensure that staff of the service provider are aware of the service provider's obligations under the Code, as this serves to reinforce ongoing compliance with section 4.

As noted earlier, the Code requires a service provider to 'ensure' the sharing of marketing staff is prevented, thus the compliance report must provide sufficient information to demonstrate this has been achieved.

Information Requirements

- Identification of any marketing staff who are also servants, consultants, independent contractors or agents of an associate that takes part in a related business, and detail the duties performed by such employees;
- Identification of any employees, consultants, independent contractors or agents of the service provider who are also marketing staff of an associate that takes part in a related business, and describe the employment circumstances;
- Details of the internal procedures implemented to ensure compliance;
- Details of how the internal procedures are implemented/maintained; and
- Details of how the effectiveness of the internal procedures is measured and the regularity of these assessments.

Disclosure of End User Information (section 4.1A)

QCA Approach

In contrast to sections 4.1(f) and 4.1(g) which relate to actions initiated by the service provider, section 4.1A provides for the end user to access and release information relating to that end user. Given that the request for release of information must be in writing, it is important that internal procedures reflect this requirement.

The process implemented by the service provider should be described in detail and any supporting material should be attached to the compliance report as evidence.

Information Requirements

- Describe measures put in place to ensure that, when an end user requests in writing the disclosure of confidential information, it is conducted without contravening sections 4.1(f) and 4.1(g) of the Code.

Procedures Established to Ensure Compliance (section 4.12)

QCA Approach

Throughout this document, reference has been made to the use of internal procedures by service providers to ensure compliance with their obligations under the Code. Given that the Code requires such procedures to be established and maintained, the service provider's compliance report should detail how this has been achieved.

Information Requirements

- Details of the internal procedures established to ensure compliance;
- A copy of the documented procedures;
- Description of how the effectiveness of procedures is assessed, including the frequency of assessments and who conducts the assessments; and
- Details of the mechanisms implemented to address deficiencies identified in assessments.

Breach of Ring-fencing Obligations (section 4.14)

QCA Approach

It is the Authority's view that, for effective ring-fencing compliance, the service provider's staff and management should be aware of the service provider's obligations under the Code. Such an awareness may be developed via education programs and making manuals available to management and staff.

To effectively demonstrate compliance, the service provider should show how staff are equipped to identify actual or potential breaches. Also, the internal procedures in place for reporting a breach, remedying a breach and reporting the breach to the Authority should be discussed in detail.

Information Requirements

- Description of the measures implemented to inform management and staff of the service provider's ring-fencing obligations; and
- Details of the procedures for reporting and remedying a breach.

2.2 Information Previously Submitted

If during a previous review, information relevant to the current ring-fencing compliance report was provided to the Authority, there may be no need to submit the information again. Rather, the service provider should provide details in the compliance report concerning when it was originally submitted to the Authority and any changes that have been made to the information since that time.

3. GLOSSARY

Access Arrangement	an arrangement for access to a Covered Pipeline that has been approved by the Relevant Regulator
Associate	in relation to a person, has the meaning it would have under Division 2 of Part 1.2 of the Corporations Law if sections 13, 14, 16(2) and 17 of the Law were repealed, except that a person will not be considered to be an Associate of a Service Provider solely because that person proposes to enter, or has entered, into a contract, arrangement or understanding with the Service Provider for the provision of a Service
Causation Basis	Means, in relation to a basis of allocation, that the allocation basis is the most significant trigger of consumption or utilisation of the resources or services represented by the costs or other account item that is being allocated.
Code	National Third Party Access Code for Natural Gas Pipeline Systems as changed from time to time in accordance with the Gas Pipelines Access Law
Confidential Information	information that is by its nature confidential or is known by the other party to be confidential and includes; <ul style="list-style-type: none"> (a) any information relating to the financial position of the party and in particular includes information relating to the assets or liabilities of the party and any other matter that affects or may affect the financial position or reputation of the party; (b) information relating to the internal management and structure of the party or the personnel, policies and strategies of the party; (c) information of the party to which the other party has access, other than information referred to in paragraphs (a) and (b), that has any actual or potential commercial value to the first party or to the person or corporation which supplied that information; and (d) any information in the party's possession relating to the other party's clients or suppliers and like information
Covered Pipeline	subject to sections 2.3 and 2.4 of the Code, the whole or a particular part of a Pipeline which is Covered and any extension to, or expansion of the Capacity of, that Covered Pipeline which is to be treated as part of the Covered Pipeline in accordance with the Extensions/Expansions Policy contained in the Access Arrangement for that Covered Pipeline and any expansion of that Covered Pipeline required to be installed under section 6.22 of the Code.
General Accounting Guidelines	means the General Accounting Guidelines, as published by the Authority under section 4.2 of the Code

Gas Pipelines Access Law	<p>In relation to Queensland, means:</p> <p>(a) the provisions referred to in paragraph (a) of the definitions of “Gas Pipelines Access Law” in section 3(1) of the South Australian Act, as applying as a law of that Scheme Participant, and</p> <p>(b) regulations in force under Part 3 of the South Australian Act, as applying as a law of that Scheme Participant.</p>
General Regulatory Accounts	<p>financial records derived from the Statutory Accounts of the Service Provider and the Statutory Accounts of Associates of the Service Provider that are involved in the activities of a covered pipeline.</p>
Marketing Staff	<p>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:</p> <p>(a) strategic decision making, including the executive officer or officers to whom Marketing Staff report either directly or indirectly;</p> <p>(b) technical, administrative, accounting or service functions</p>
Multi utility	<p>a business that is licensed to distribute both electricity and gas. A multi utility is essentially a combination of single-sector distributors</p>
Reference Tariff	<p>a Tariff specified in an Access Arrangement as corresponding to a Reference Service and which has the operation that is described in sections 6.13 and 6.18 of the Code</p>
Regulatory Accounting Statements	<p>Financial reports revealing the performance and financial situation of the Service Provider. They show the originating Statutory Account amount, its translation into a General Regulatory Account amounts and its disaggregation to the Covered Pipeline level.</p>
Service	<p>a service provided by means of a Covered Pipeline (or when used in section 1 a service provided by means of a Pipeline) including (without limitation):</p> <p>(a) haulage services (such as firm haulage, interruptible haulage, spot haulage and backhaul);</p> <p>(b) the right to interconnect with the Covered Pipeline; and</p> <p>(c) services ancillary to the provisions of such services,</p> <p>but does not include the production, sale or purchasing of Natural Gas</p>
Service Provider	<p>has the meaning given in the Gas Pipelines Access Law (that is, the person who is, or is to be, the owner or operator of the whole or any part of the pipeline or proposed pipeline)</p>

Statutory Accounts	The audited set of accounts, prepared in accordance with the Australian Securities & Investment Commission (ASIC) requirements, submitted to ASIC by statutory entities.
User	a person who has a current contract for a Service, or an entitlement to a Service as a result of an arbitration.