



**Guidelines for Preparing Ring-Fencing
Compliance Reports Under
Section 4.13 of the National Gas Code**

July 2002

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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 two gas distribution networks in Queensland, owned by Allgas Energy Limited (Allgas) and Envestra Limited (Envestra). Networks owned by 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.

These guidelines aim to assist service providers in 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 provide an indication of the assessment approach to be used by the Authority when assessing compliance with the Code.

2. RING-FENCING COMPLIANCE REPORTS

Service providers are required under the Gas Code to report at reasonable intervals to the Authority, on the measures taken to ensure compliance with their ring-fencing obligations, and to provide an assessment of the effect 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 it 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.

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 as to 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 in the market;
- cross subsidies between other business activities; or
- discriminatory queuing practices.

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.

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), 4.1(d) and 4.2))

QCA Approach

Accounting separation of business units within an entity aims to ensure that there is no inappropriate shifting of costs between the service provider and other business units or the parent company. The cost allocation methodology, prepared by the service provider, details 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 its 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 also provide evidence to the effect that it maintains a set of consolidated accounts for the entire business.

The compliance report should provide full details of the cost allocation methodology used to allocate costs between covered pipelines (if the service provider operates in more than one jurisdiction) and business entities (regulated or not regulated) and the accounting guidelines used during the preparation of the accounts for both the covered pipelines and the entire business.

As outlined in section 4.2 of the Code, the 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.’

Information Requirements

- Accounts for the covered pipeline;
- Accounts for the entire business;
- The cost allocation methodology; and
- The accounting guidelines used.

Cost Allocation (section 4.1(e))

QCA Approach

The attribution of costs which are directly incurred by the business unit is a straight forward task. This is not the case for joint or common costs, which require costs to be apportioned between business units.

In accordance with the Code, a service provider is required to demonstrate that an appropriate methodology 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.

Costs for gas distribution can be allocated to operating and maintenance, administration or unaccounted for gas. From these broad categories, joint or common costs must be allocated according to some predetermined approach, for example, the costs incurred to provide the service, a proportionate share of the resources used or a contractual agreement on the split of costs. The allocation manual should provide employees with the necessary detail to allocate costs down to the level of reference tariffs. That is, the cost can be allocated to the relevant network, service group, geographic region and customer class.

As outlined in section 4.2 of the Code, the Authority may issue general accounting guidelines to assist with the verification of reference tariffs. To achieve this objective, the Authority requires the accounts of the service provider to be disaggregated to the level of reference service rather than to the level of the covered pipeline.

The Authority will appoint an auditor at its discretion to conduct an assessment of the cost allocation process. During those reporting periods when an independent audit is not conducted, it is the service provider’s responsibility to provide evidence on the effectiveness of the cost allocation methodology and the joint or common costs incurred during that reporting period. Such evidence could be sourced from internal audits conducted by the service provider during the reporting period.

Information Requirements

- The cost allocation methodology detailed to the level of reference tariffs; and

- Evidence of the effectiveness of the cost allocation methodology.

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

The Authority, in determining compliance, will be assessing the adequacy of the supporting procedures established by the service provider. Thus, the compliance report should describe in detail the processes established by the service provider to ensure compliance with each of its obligations regarding confidential information.

Information Requirements

- Describe internal procedures established to ensure confidential information is used only for the purposes for which it was provided;
- Provide details of the approval process; and

- Describe internal processes used to ensure confidential information obtained in the course of conducting business is not inappropriately disclosed to any other person.

Marketing Staff (sections 4.1(h) and 4.1(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 will also want 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.

Information Requirements

- Identify any marketing staff who are also servants, consultants, independent contractors or agents of an associate, whether that associate takes part in a related business and detail the duties performed by such employees; and
- Identify any employees, consultants, independent contractors or agents of the service provider who are also marketing staff of an associate, whether that associate takes part in a related business, and describe the nature of the employment relationship.

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 include details of:

- the internal procedure/s;
- the processes used to maintain the procedure/s; and
- how the procedure/s ensure compliance.

By the service provider adequately addressing each of these areas, the Authority will be able to assess the service provider's compliance with section 4 of the Code.

Information Requirements

- Detail the internal procedures established to ensure compliance;
- Provide a copy of the documented procedures; and
- Describe the measures used to monitor the effectiveness of the procedures.

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

- Describe measures implemented to inform management and staff of the service provider's ring-fencing obligations; and
- Detail 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	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
Associate Contract	<p>a contract, arrangement or understanding between:</p> <p>(a) the Service Provider and an Associate in connection with the provision of a Service; or</p> <p>(b) the Service Provider and any person in connection with the provision of a Service which provides a direct or indirect benefit to an Associate and which is not an arm's length transaction</p>
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	<p>information that is by its nature confidential or is known by the other party to be confidential and includes;</p> <p>(a) 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;</p> <p>(b) information relating to the internal management and structure of the party or the personnel, policies and strategies of the party;</p> <p>(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</p> <p>(d) information in the party's possession relating to the other party's clients or suppliers and like information</p>
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.
End User	<p>Means a person who:</p> <p>(a) acquires or proposes to acquire Natural Gas from a User; or</p> <p>(b) proposes to acquire Natural Gas from a Prospective User</p>

Marketing Staff	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: <ul style="list-style-type: none"> (a) strategic decision making, including the executive officer or officers to whom Marketing Staff report either directly or indirectly; (b) technical, administrative, accounting or service functions
Multi utility	a business that is licensed to distribute both electricity and gas. A multi utility is essentially a combination of single-sector distributors
Prospective User	Means a person who seeks or is reasonable likely to seek to enter into a contract for a Service and includes a User who seeks or may seek to enter into a contract for an additional Service.
Reference Tariff	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
Service	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): <ul style="list-style-type: none"> (a) haulage services (such as firm haulage, interruptible haulage, spot haulage and backhaul); (b) the right to interconnect with the Covered Pipeline; and (c) services ancillary to the provisions of such services, but does not include the production, sale or purchasing of Natural Gas
Service Provider	has the meaning given in the Gas Pipelines Access Law (that is, the person who is, or is to be, the owner or operator or the whole or any part of the pipeline or proposed pipeline – Schedule 1 of the South Australian Act, Part 1, clause 2)
User	a person who has a current contract for a Service, or an entitlement to a Service as a result of an arbitration
