

Alan Tregilgas  
Utilities Commission  
GPO Box 915  
DARWIN NT 0801

Dear Alan

**Revised draft electricity ring fencing code - PAWA submission**

I refer to the revised draft code issued by the Commission in December 2000. The purpose of this letter is to provide PAWA's response to the draft code.

PAWA's general view is that the revised code is much more workable and practical than the earlier July 2000 draft. The purpose of this submission is not to dispute any of the fundamental obligations or assumptions made in the revised draft, but rather to raise some issues in relation to:

- (a) the interpretation of the code; and
- (b) its application to PAWA.

PAWA has organised itself along product business lines, as this is the most appropriate structure to achieve the right balance between the focus on particular product delivery as well as simply making good business sense. As a result, many of the formal ring fencing obligations contained in the revised code will not present any additional burden on the Authority. The ring fencing code will often only add another layer of reporting to those required within a multi faceted corporation.

**Timetable for development of accounting and cost allocation procedures**

1. I confirm that, in accordance with your letter of 18 January 2001:
  - (a) PAWA must lodge its draft accounting and cost allocation procedures with the Commission for approval by 30 September 2001; and
  - (b) PAWA must lodge its draft information procedures with the Commission for approval by 31 December 2001.

2. PAWA will be implementing a new financial management system, anticipated to be operational from 1 January 2002. Obviously, the accounting and cost allocation procedures will need to be a part of that system. PAWA is concerned that, prior to the system being implemented and used, PAWA will be unable to be as specific as it might be in the cost allocation and accounting procedures. Nonetheless, PAWA is confident that whatever financial management system is selected, it will accommodate the principles and allow for the desired outcomes of the accounting and cost allocation procedures.
3. Whilst not taking issue with the Commission's proposed timeframe, in order to reflect the introduction of this new system, PAWA proposes that the approval process for these procedures be as follows:
  - (a) PAWA prepares and submits to the Commission by 30 September 2001 broad, "higher level" principles and procedures which will comply with its code obligations and the principles set out in Schedule 2. The higher level procedures will be capable of applying to both PAWA's existing and the new financial management systems. Where PAWA is able to, the procedures will reflect the operation and capability of the new financial management system.
  - (b) If the Commission considers it appropriate to do so, the Commission approves the procedures (in accordance with paragraph 4.5 of the Code) subject to the condition that PAWA submit revised more detailed procedures by 28 February 2002. In PAWA's view, it is likely that, once the new system has been operating for 2 months, PAWA will be able to refine and better define the procedures tailored to the new system.
  - (c) The Commission considers the revised procedures which will apply 30 days from the date of their approval.

### **Approval process for procedures**

4. In respect of the development of all of the accounting, cost allocation and information procedures, PAWA considers that the most practical way of developing them is in consultation with the Commission, thus making it more likely that the final products submitted to the Commission for approval meet the Commission's expectations, and minimising wasted time on both sides.

### **Public benefits test**

5. Paragraph 1 of Schedule 2 to the revised code sets out the common principle to be applied by the Commission when considering whether to approve procedures. The principle is stated as follows:-

*"the Commission will..... have regard to the need to achieve an appropriate balance between the public benefits.... and the administrative costs to the Electricity Entity of complying...."*

This test is repeated at paragraph 38 of Appendix A to the revised code.

6. By contrast, paragraph 44 of Appendix A refers to considering not only the costs incurred by the entity, but also those incurred by the Commission and the public when applying the public benefits test.
7. PAWA suggests that the costs to be considered when applying the public benefits test should be standardised throughout the revised code, and should properly include not only the Electricity Entity's costs of compliance, but also the costs of the Commission and the public. PAWA refers to paragraph 25 of its submission of 29 September 2000.

### **Auditing provision**

8. PAWA asks the Commission to clarify a number of issues in the final code as follows:

- (a) Paragraphs 7.3 to 7.6 of the revised code empower the Commission to appoint an independent reviewer to undertake an audit of compliance with an entity's obligations under the Code.

Paragraph 7.6 provides that the entity will be responsible to pay the costs of the audit if the reviewer discovers any failure to comply with a "material obligation". PAWA is concerned that this phrase is potentially open to a number of interpretations and asks that the Commission clarify what is meant by "material obligation" in the final code.

- (b) In relation to the auditing of regulatory financial statements, paragraph 2.15(c) of Schedule 2 to the revised code obliges the directors to ensure that accounting records are kept which *"are capable of allowing an auditor to conveniently and properly form an opinion on the regulatory financial statements in accordance with the requirements of this schedule."*

Paragraph 2.15(c) does not refer to the other sources of the requirements in relation to the preparation of accounting records, namely, the requirements of the code itself and the procedures approved by the Commission under the code.

PAWA asks that the Commission clarify the standards which an auditor should apply when auditing the regulatory financial statements (PAWA suggests that the appropriate standards are those set out above, namely, the requirements of the code, including Schedule 2, and the approved procedures.) PAWA considers this to be an important issue for clarification, given PAWA's potential liability for the costs of the audit.

The clarification of the standards to be applied in conducting such an audit is in line with the approach adopted in other jurisdictions (see attachment).

## **Restriction on use/disclosure of information**

9. PAWA notes and accepts the revised obligations contained in the code in relation to this issue. PAWA considers that the remaining issues in relation to the access/use of information are most appropriately dealt with through:
  - (a) the development of tailored information procedures in consultation with the Commission; and
  - (b) discussions between the Commission and PAWA in relation to the practical effects of the requirement, including likely costs of compliance.
10. PAWA agrees that, as proposed by the Commission, pending the finalisation of the information procedures, the prohibition on the disclosure of information should be suspended. This suspension is not reflected in the body of the draft code. PAWA suggests that this be done in the exemptions contained at Schedule 1 to the code. It should exempt all PAWA's prescribed businesses from compliance with paragraphs 3(c)(ii) and 3(d)(ii) of the code.

## **Separation of marketing staff**

11. PAWA is still considering the costs involved in complying with this obligation. Depending upon the result of that consideration, PAWA may ask the Commission at some later time to consider waiving this obligation or delete it from the Code.
12. One of the results of literally applying the definitions of "prescribed business" and "related business" in the revised code to the obligation not to share marketing staff is that marketing staff, for example, of PAWA Retail dealing with contestable customers, could not also be marketing staff of unregulated or separately regulated parts of PAWA's businesses such as Water Services, consultancy services, or specialist maintenance services.
13. Given that the Commission's role is to regulate conduct in the electricity industry, PAWA assumes that the marketing staff restrictions in the code would not apply and are not intended to apply to activities or businesses outside that industry, such as those referred to above. PAWA has difficulty in accepting that the code is intended to fetter the Authority in such a way as can be interpreted from the revised draft. If PAWA's assumption in this is incorrect, it would be appreciated if the Commission would provide convincing reasons why, in a code regulating activities in the electricity industry, conduct in another industry should be also captured by the regulations.

## **Obligations on directors**

14. Paragraphs 2.14 and 2.15 of Schedule 2 to the revised code purport to place obligations on PAWA's directors. PAWA does not have directors

and therefore suggests that these obligations should either be on PAWA itself or on the relevant business manager within PAWA.

### **Ring fencing of PAWA Generation**

15. As the Commission is aware, PAWA has arranged its corporate structure along business lines, for management, accounting and product definition purposes. Inherent in this structure is a natural ring fencing outcome. While PAWA does not agree that PAWA Generation should be included in the definition of "Prescribed Business" and thus subject to ring fencing obligations, PAWA accepts that the Commission has come to a different conclusion.
16. At Appendix B to the draft code, the Commission:
  - (a) implies that PAWA was being misleading in asserting that CSO arrangements already effectively regulate PAWA Generation regarding cross subsidies (paragraph 40); and
  - (b) states that *"PAWA's denial of the existence of such barriers to entry may be a sufficient case in itself for the imposition of clear ring-fencing obligations"* (paragraph 63).
17. PAWA considers that these statements are unjustified and inflammatory, and does not accept the inferences drawn by the Commission from them.
18. Whilst the Commission may have a view that the CSO process, including the supervision by the Territory, is inadequate to "effectively constrain PAWA's capacity to shift costs between its prescribed and contestable businesses", surely this is a matter that should be rectified by the Territory and does not imply that PAWA engages in such practices. The CSO is only available for franchise sales and the Territory has a very strong interest in minimising the amount, thus ensuring that this CSO does not include an element of cross-subsidisation.
19. PAWA acknowledges that its statement regarding 'no barriers to entry' could have been misleading as to PAWA's position. The statement was merely intended to convey that there are no artificial, contrived or additional barriers to entry into the generation business. PAWA is quite obviously aware of the matters articulated by the Commission as would be any potential generator.

### **Definition of "Prescribed Business" - PAWA Generation**

20. The definition of "Prescribed Business" as it applies to PAWA Generation at paragraph 10.2 of the draft Code refers to PAWA Generation being a Prescribed Business *"until such time as the Commission is satisfied that [PAWA] no longer has a substantial degree of market power in the market for the generation of electricity to Customers."*

21. PAWA asks that the Commission clarify the following issues in the final code:
  - (a) the basis on which the Commission will assess whether PAWA still has a substantial degree of market power (eg 40% as referred to at paragraph 54 of Appendix B to the revised Code); and
  - (b) whether PAWA will have the right to request the Commission to reassess PAWA's market power, and whether the Commission intends to review the issue on a regular basis (and, if so, how often that review will take place).
22. Further, the definition makes specific reference to the *"market for the generation of electricity for sale to Customers"*. "Customer" is defined as *"a person who engages (or proposes to engage) in the activity of purchasing goods or services from a Prescribed Business"*.
23. Accordingly, importing that definition into the definition of "Prescribed Business" as it relates to PAWA Generation, the market in which PAWA's dominance is to be assessed is the market PAWA has at any time for generation of electricity. This is because electricity entities other than PAWA which generate electricity are not prescribed businesses and therefore will never be part of the "market for the generation of electricity for sale to customers".
24. PAWA suggests that the market in which PAWA Generation's dominance is to be assessed be redefined in the final code. In reconsidering the definition of the relevant market, the Commission should also clarify whether the relevant market includes those entities which generate their own electricity (such as pastoralists , mining operations and major industries likely to establish when Timor Sea gas is available onshore).

**Definition of "Prescribed Business "- inclusion of other non-contestable goods or services**

25. PAWA asks the Commission to delete sub-paragraph (a)(iv) of the definition of "Prescribed Business" in paragraph 10.2 of the revised code. For the sake of clarity and regulatory openness, it is essential that more than a "determination" by the Commission should be required before other businesses are included in the definition of "Prescribed Business".
26. PAWA suggests that, if the Commission did consider that a further business should be included in the definition of "Prescribed Business", the appropriate way to implement that would be through the mechanisms in the Code for its amendment and for adding ring fencing obligations, allowing parties that will be affected by the change to make submissions, and for the Commission to consider them.

We believe we are now at a point where we can see finality on these issues and look forward to giving effect to the ring fencing code and working with the Commission to achieve the desired outcomes at a cost that provides benefits to the Northern Territory community.

I am happy to discuss the matters raised above and any other issues at any time.

Yours sincerely

BARRY CHAMBERS  
CHIEF EXECUTIVE OFFICER

February 2001

## Attachment

### Approach of regulators in other jurisdictions to the scope of regulatory audits

Regulators in other jurisdictions have clearly set out in their guidelines that regulatory financial statements *"shall be subject to an auditor's opinion in accordance with the requirements of this Guideline"*<sup>1</sup>. The guidelines include principles of preparation and information requirements which make clear the basis of which the audit will be undertaken.

These regulators also clearly state the scope of audit opinion that may be required. For example, the ORG and SAIIR set out their requirements for regulatory audit reports in one of the following forms<sup>2</sup>:-

- an audit report on a special purpose financial report;
- a review report;
- an agreed upon procedures report; or
- a combination of a review report and an agreed upon procedures report.

Each of these is clearly defined in the guidelines.

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<sup>1</sup> ORG, Victoria "Electricity Guideline No. 8 - Electricity Transmission Regulatory Information Requirements", August 1997, paragraph 3.13.1.

<sup>2</sup> Office of the SAIIR, "Electricity Information Guideline - Transmission and System Control", October 2000.