



17 September 2021

Kirsten Wren  
Economic Regulation Authority

Transmission via: <https://www.erawa.com.au/consultation>

Dear Kirsten

## **PILBARA NETWORKS ACCESS CODE – PROPOSED RINGFENCING RULES FOR COVERED PILBARA NETWORKS**

Alinta Energy appreciates the opportunity to comment on the proposed ringfencing rules for the covered Pilbara Networks:

- the **Horizon Power coastal network**, covered under the Minister for Energy's "final coverage decision" of 2 February 2018<sup>1</sup> which demonstrated that all three criteria were met under the Electricity Networks Access Code coverage test (ENAC)<sup>2</sup>; and
- the **Alinta DEWAP Port Hedland network**, covered by prescription<sup>3</sup> and therefore not subject to any assessment against the ENAC coverage criteria<sup>4</sup>.

Ring-fencing arrangements are typically implemented to address the harms that can emerge from vertically integrated suppliers owning and operating network infrastructure. The two broad categories of harms that can emerge are:

- **Cost shifting from the contestable market to the regulated network** where the effect in the regulated market is that network prices are higher than reasonable, thus leading to higher final prices to customers, and the effect in the contestable market is that the NSP's related business can get an unfair cost advantage; and
- **Anti-competitive actions** whereby the NSP is able to use its control of the network infrastructure to raise the profits of its related party in the related market, which may include such actions as using technical matters to suppress access (and hence competition in the contestable market), imposing unnecessary costs on competitors

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<sup>1</sup> [Electricity Networks Access Code – Coverage Application \(www.wa.gov.au\)](http://www.wa.gov.au)

<sup>2</sup> Under the ENAC, there are three criteria which must be satisfied before coverage of a network is granted. These are:

- Promotion of competition, that is would coverage result in a material increase in competition in at least one market?
- Would it be uneconomic for another party to develop another network to provide the covered services provided?
- Would access be contrary to the public interest?

<sup>3</sup> Section 3.3.2, Detailed Design Consultation Paper (DDCP) – light handed access regime. Available here: [Pilbara electricity reforms \(www.wa.gov.au\)](http://www.wa.gov.au)

<sup>4</sup> Refer to Alinta Energy's assessment of its network against the three coverage criteria contained in section 3.2.1 of its DDCP submission, available here: [Design Consultation Paper – Regulatory Framework for the Pilbara electricity networks \(www.wa.gov.au\)](http://www.wa.gov.au)

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or misusing in the related market confidential information received from other competitors in the course of access discussions.

During the detailed design process for the Pilbara Electricity Reforms, ringfencing arrangements for the NWIS were considered necessary to achieve the following:

- deliver confidence that the major harms that can arise from leveraging the regulated monopoly in a competitive market will be addressed; and
- provide a fit-for-purpose approach that recognises the costs and benefits of some measures may differ between covered networks.

Section 127 of the Pilbara Networks Access Code (PNAC) sets out the ringfencing policy objectives to achieve this.

The primary objective is to ensure that the vertical integration of an NSP with another business does not lead to a reduction of competition in a related market. The PNAC also incorporates secondary objectives which recognise the guiding principles of the NWIS market reforms, being fit-for-purpose regulation, which recognises the substantial differences in the scale, scope and size of the individual NWIS networks, and the balancing of this in relation to the cost and disruption imposed by NSP ringfencing rules.

When assessing the proposed ringfencing rules submitted by Alinta Energy and Horizon Power it is important that the ringfencing policy objectives are at the forefront of the Economic Regulation Authority's mind. The reason for this is threefold:

- There are material differences in the covered networks which give rise to a fit for purpose approach to ring fencing<sup>5</sup>;
- The newly contestable customer base is all supplied off the Horizon Power network; and
- The Alinta DEWAP network is fully contracted on a firm basis with no additional capacity being available for new loads on a firm (n-1 basis) unless significant transmission infrastructure investment is made.

Alinta Energy's submission on Horizon Power's ringfencing rules is set out as follows:

- Appendix 2: Alinta Energy comments on "Overview of HP's network and customers in the Pilbara region";
- Appendix 3: Alinta Energy comments on Horizon Power's Cost Allocation Methodology; and
- Appendix 4: Alinta Energy comments on Horizon Power's Competition Protection measures.

Please contact me on [jacinda.papps@alintaenergy.com.au](mailto:jacinda.papps@alintaenergy.com.au) or if you would like to discuss this submission in further detail.

Yours sincerely

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<sup>5</sup> Refer to appendix 1.

## Appendix 1: Material differences between the two covered networks

The Alinta Energy DEWAP network consists of three 66kV feeders comprising of about 22.5km of 75MVA conductor, of which:

- two feeders connect Port Hedland Power Station to the Horizon Power network substations of Wedgefield and Murdoch; and
- a single line runs between and connects the Port Hedland Power Station's two sites of generation (at Port Hedland and Boodarie).

There are three contracted users of the ADEWAP Network who all have firm and as available contracted network usage rights under long term agreements. The combination of the ADEWAP Network users' current contracted firm plus non-firm network usage rights see no availability of firm network capacity capable of being contracted by new prospective users of the ADEWAP Network.

In contrast, the Horizon Power interconnected network is a meshed network which extends from Dampier to Goldsworthy, via Karratha and Port Hedland. A lattice tower 220KV transmission line interconnects Cape Lambert Terminal, South Hedland Terminal and Hedland Terminal. A 132KV network interconnects Cape Lambert Terminal, Karratha Terminal, Bulgarra Substation, Pegs Creek Substation and Dampier Substation. A 66KV network interconnects Hedland Terminal, Wedgefield Substation, Anderson Street Substation, Murdoch Drive Substation and the Goldsworthy supply point.

Horizon Power is a vertically integrated business providing electricity to 45,829 customers in regional and remote areas of Western Australia, including residential, commercial and major industry loads<sup>6</sup>. We believe approximately 15,000 of these retail accounts are within the NWIS.

It is the significant size and scale of Horizon Power's interconnected network (coupled with the constestable customer base supplied primarily off the Horizon Power network) that facilitates the need for efficient separation (via appropriate ringfencing) of its network operations from the retail and third-party power generation arms of its NWIS business.

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<sup>6</sup> This includes residential, business and prepayment customers. Refer: [Microsoft Word - FINAL FOR PUBLICATION - Annual data report - Energy retailers 2019-20 \(erawa.com.au\)](#)

## **Appendix 2: Alinta Energy comments on “Overview of HP’s network and customers in the Pilbara region”**

### 1. Comparison of Horizon Power’s network

Horizon Power has stated that this document provides an overview of Horizon Power’s network and customers in the Pilbara region, including a range of metrics that illustrate that:

*“Horizon Power’s network and customer base in the Pilbara region are small relative to other electricity network service providers”.<sup>7</sup>*

Alinta Energy notes that Horizon Power has compared itself to several other network service providers in Australia and not to the network service provider in the region in which it operates.

While Horizon Power is small relative to Western Power and eastern seaboard Network Service Providers, its scale, scope and size is materially larger than that of Alinta DEWAP (as demonstrated in appendix 1). The ringfencing policy objectives address this point. Specifically, section 127(2)(a) recognises the fact that the structure and nature of NSPs businesses differ substantially.

### 2. Reference to Wholesale Electricity market

Section 3 states that “The wholesale electricity market supplied by this subset of lightly regulated networks within the NWIS is subject to administered arrangements by the Independent System Operator”.

To be clear, there is no wholesale electricity market in the NWIS. The NWIS is a bilaterally contracted market. Further, the Pilbara Networks Rules establish rules for the operation, management, security and reliability of Pilbara networks and the functions of the Pilbara independent system operator.

### 3. Customer numbers

Section 2 states that Horizon Power supplies “electricity to more than 100,000 households and more than 10,000 businesses in regional towns and remote communities across Western Australia”. This doesn’t align with the customer numbers reported by the Economic Regulation Authority in its “Annual data report 2019/20 Energy Retailers”<sup>8</sup> whereby 45,829 customers are reported.

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<sup>7</sup> Refer section 1: [Horizon-Power---background-on-network-and-customers-for-ringfencing-for-publication-.PDF \(erawa.com.au\)](#)

<sup>8</sup> This includes residential, business and prepayment customers. Refer: [Microsoft Word - FINAL FOR PUBLICATION - Annual data report - Energy retailers 2019-20 \(erawa.com.au\)](#)

### **Appendix 3: Alinta Energy comments on Horizon Power's Cost Allocation Methodology**

#### 1. Section 2 – Purpose of the Methodology

Horizon Power notes that:

*"This document provides assurance to the communities served by Horizon Power that the costs it incurs are appropriately allocated between Horizon Power's network business and its other businesses to mitigate the risk that costs are shifted from Horizon Power's contestable and/or unregulated business segments (other businesses) to the network business.*

*For the purposes of this document, the Pilbara region refers only to the community served by the interconnected network that supplies that region."*

[Alinta Emphasis added]

Alinta Energy is concerned that this seems to limit the cost allocation methodology to the interconnected network. We consider there is a risk of cost shifting from the non-regulated (remote and regional networks) to the regulated network which should be addressed.

Further, Horizon Power's document doesn't define its "other businesses" anywhere. We assume this assume this is covered by the "business segments" in section 8. However, this should be clarified.

#### 2. Section 5 – Regulatory Requirements

Horizon Power notes that the cost allocation methodology will be applied to "develop annual regulatory accounts... and financial information...for the Horizon Power Pilbara Network Business". Alinta Energy considers that this should be expanded so that the cost allocation methodology will be used to prepare its regulatory accounts and financial information for its "other businesses" as well.

#### 3. Section 8.1 Cost Pools

The document notes that:

"To enable the reference tariffs to be calculated for each of the reference services, the costs that are attributed or allocated to the distribution and transmission services (function) in the Pilbara region (location) are attributed or allocated to the following cost pools:

- transmission – East Pilbara and West Pilbara
- sub-transmission – East Pilbara and West Pilbara
- distribution HV – East Pilbara and West Pilbara
- distribution LV
- streetlighting
- metering
- ISO
- non-target revenue services"

Alinta Energy considers that Horizon Power should not be recovering any ISO function costs in its target revenue or reference tariffs as these recoverable via other means (refer rule 125 of the PNR).

#### 4. Section 8.2 – ISO Functions

Horizon Power notes that “The ISO functions will be provided by Horizon Power’s system control centre”.

Alinta Energy notes that the Horizon Power’s system control centre will not be undertaking all of the ISO functions beyond that which is delegates (i.e. the real-time functions). The legislative framework allows for Horizon to undertake some aspects of the real-time ISO role on a delegated basis. However, it needs to be made clear that Horizon Power will not be undertaking any additional functions (purposefully or unintentionally) outside of what was intended by the regulatory framework (and included in the instrument of delegation).

#### 5. Section 8.3 – Our other services

The document notes that “Horizon Power may provide unregulated network services to customers in the Pilbara region. If these services are provided, they are subject to natural competition and so the commercial terms and conditions for these services are not lightly regulated. The commercial terms and conditions (e.g. fees) for these services are negotiated between the parties. Horizon Power’s business objectives require these negotiations to be reasonable and in good faith”.

It is not clear what other unregulated network services would be captured here. Alinta Energy requests clarification.

#### 6. Section 9.1 Cost and revenue allocation principles

This section outlines a number of principles Horizon Power is committing to. However, there is no indication as to how this will be monitored for compliance.

#### 7. Section 9.5.2 System control and dispatch shared costs (causal correlation)

In relation to System Control and dispatch shared costs, Horizon Power’s Cost Allocation Methodology states:

*A detailed activity-based costing exercise was undertaken in March 2019 to determine the most appropriate allocation of costs to each of these functions.*

The delegated ISO functions were not detailed in March 2019 and were only finalised in early 2021 and are still to be confirmed via an instrument of delegation. Given this, an activity-based costing exercise to determine allocation of costs to the ISO functions from 2019 does not seem to be appropriate.

Alinta Energy recommends Horizon power undertake a more detailed and contemporaneous activity-based costing exercise now that the delegated ISO function has been detailed.

#### 8. Section 9.5.3 Corporate shared costs

Section 134(1)(b) of the Code requires Horizon Power to allocate or attribute costs relating to its network business in a way that provides a true and fair view of (among other things) the percentage of any corporate overhead cost applied to the network business for services that provide the network business with necessary resources;

However, Horizon Power has simply stated that it allocates corporate shared costs to the business segments using the method that most appropriately reflects the causal correlation of

the underlying transaction.

#### 9. Asset Value allocation

The "asset value" allocation is "allocation on an asset value basis is applied when the underlying transaction has a causal correlation to Horizon Power's principal service of building, maintaining and operating assets, e.g. health and safety. Asset value is determined by the ratios of the asset value in the business segment to the total value of assets".

This allocation methodology is fine in principle, but the table in Appendix 1 provides no details regarding the quantum of the ratios being applied when the methodology is being used. For example, Engineering Services are allocated using "Asset value, excluding retail and corporate assets", but then does not provide any quantum of what that means in practice. At a minimum Alinta Energy would have expected an estimate of the first year applied % of engineering services cost.

#### 10. Corporate three factor method

The allocation using the corporate three factor method is applied when there is no causal correlation between the underlying transaction and the consumption of staff/labour or the service of building, maintaining and operating assets, e.g. health and safety. The corporate three factor method for allocating costs and revenue to a location is an equal weighting of asset value, revenue and FTEs, and then allocating costs and revenue to a function is an equal weighting of asset value, a fixed component and FTEs.

This method is very convoluted. A worked example would be helpful, particularly as there are a lot of cost categories proposed to use this method. It is also not clear what the difference between locational corporate three factor and functional three factor is.

#### 11. Proportion of expenditure that cannot be directly attributed or capitalised

There is no visibility of what proportion of Horizon Power's expenditure cannot be directly attributed or capitalised – Alinta Energy considers that this should sit no higher than 30%.

## Appendix 4: Alinta Energy comments on Horizon Power's Competition Protection measures

### 1. Definitions and treatment of commercially sensitive information

In relation to information, Horizon power has departed from the PNAC definitions (as demonstrated below:

#### PNAC Definitions

**Confidential Information**, information that—

- (i) by its nature is confidential; or
- (ii) is specified to be confidential by the discloser.

**Commercially sensitive information** - means information in relation to:

- (a) an applicant or customer developed by or in the possession of an NSP (includes a network business's present and future dealings with the applicant, or customer, but excludes aggregated information); or
- (b) an NSP which comes into the possession of another NSP for the purposes of performing a function under the Pilbara networks rules; or
- (c) an NSP which is developed by or in the possession of an applicant or customer (excludes information required by the PNAC to be published or aggregated information that does not relate to the identifiable NSP).

*Note – HP does not use this definition, other than in relation to sections directly referencing the PNAC*

#### Horizon Power Definitions

**Electricity information** - information about electricity networks, electricity customers or electricity services that relates to an identifiable customer or class of customer with fewer than three customers

**Confidential Information** –confidential information includes electricity information, acquired or generated by the Horizon Power Pilbara Network Business in connection with its provision of covered network services, that is not already publicly available, and includes electricity information that:

- the Horizon Power Pilbara Network Business derives from that information, or
- is provided to the Horizon Power Pilbara Network Business by or in relation to a customer or prospective customer of covered network services

**Confidential electricity information** (refer clause 9.3.1 of the document), includes non-public:

- network quality information – frequency stability, voltage stability, power factor and harmonic levels
- network asset loadings downstream of a substation
- customer consumption profiles (individuals or aggregated for a customer class with fewer than three customers)
- customers' tariff assignments (unless the information being sought is personal information).

Pursuant to section 134(1)(a) of the PNAC, Horizon Power is required to ensure that Commercially Sensitive Information any information received by the NSP is in respect of a function under the Pilbara Network Rules is kept confidential and is only used within the network business and for the purposes for which it was acquired or developed.

Horizon Power appears to have treated "Commercially Sensitive Information" and a subset of "Confidential Information" and so only describes in section 9.3 "Information access and disclosure" how it will ensure that Confidential Information will be kept secure. The PNAC treats confidential information as distinct from commercially sensitive information (see section 167 of the PNAC "...disclosure or use of confidential or commercially sensitive information" [emphasis added]). Horizon Power has therefore failed to identify how it will specifically keep "Commercially Sensitive Information" secure in these circumstances.

We recommend clause 9.3.1 be clarified that for the purposes of the clause confidential information includes electricity information and commercially sensitive information.

In respect of clause 9.3.3 Alinta has concerns regarding the sharing of electricity information which is both confidential and commercially sensitive to other legal entities. This clause should make clear that disclosure to other legal entities (including competitors) is subject to the strict pre-disclosure process set out in clause 9.3.2. Similarly, Horizon Power should amend the clause to make clear that it will only be providing electricity information to Horizon Power staff that are responsible for the provision of services in the Pilbara Network and not other parts of its business unless permitted under clause 9.3.2.

### 2. Compliance

Section 6 outlines that:



"All Horizon Power staff are individually accountable to ensure that they comply with the ringfencing rules set out in this document.

The Manager, Network Regulation and Open Access is responsible for ensuring that the procedures required to ensure and monitor compliance with these ringfencing rules have been established, maintained and implemented, and all Horizon Power staff comply with these ringfencing rules."

It is not clear what form Horizon Power's compliance monitoring will take and whether or not it is sufficient to meet the requirements of section 141 of the PNAC.

### 3. Ringfencing declarations and training

Horizon Power is proposing to implement:

- A "Ringfencing Declaration that will be signed by all staff that are involved with the provision of services in the Pilbara region, either prior to 1 July 2021 or on commencement of employment with Horizon Power, whichever is the latter"; and
- Initial, induction and (not defined) periodic refresher training.

Alinta Energy does not consider that this is sufficient. By contrast, Alinta Energy has proposed annual declarations (which are audited) and annual training.

There seems to be a high reliance on training staff and then trusting them to do the right thing. It would be more appropriate if staff sign a declaration annually (currently proposed to be signed only once), and that there is a register for breaches (or potential breaches) that can then be audited. This would then demonstrate that the training has been effective.

### 4. Obligation to not discriminate

As a general observation this section lists a series of statements in relation to Horizon Power's obligation to not discriminate (which appear to have been largely taken from the AER Ringfencing Guideline (Electricity distribution)). However, it is not clear how this will be managed, enforced and monitored.

Further, while Alinta Energy supports the anti-discrimination obligations and competition measures Horizon Power has set and recognises that they largely align with the AER's guidelines; Alinta notes that there is no explicit requirement and mechanism to record and investigate any suspected breaches raised internally or by external stakeholders.

We therefore recommend that Horizon Power include requirements for:

- A register to record issues or suspected non-compliances raised by internal and external stakeholders.
- A Horizon Power staff member to be allocated responsibility for investigating and documenting any issues raised.

There is also no discussion of record keeping for meetings that may involve people with conflict of interest (as identified by their register), nor is there any mention of specifically how those conflicts would be managed.

### 5. Separate offices

Alinta Energy notes that Horizon Power is not physically separating the staff in the Karratha and

Port Hedland offices between those dealing with network and those dealing with everything else, which based on their comments is understandable. However, there is no articulation of how Horizon Power is going to ensure the appropriate treatment of network access information and customer /retail information.

The harm associated with sharing of commercially sensitive information (inadvertent or otherwise) between regulated network staff and staff of an associate or other business due to physical co-location or office sharing needs to be explicitly addressed.

Of interest, the AER's Electricity Distribution ringfencing guidelines require that the DNSP must use offices that are separate from a related electricity service provider, subject to certain exemptions<sup>9</sup>. Offices that are shared due to an exemption in the guideline must be declared in a public register.<sup>10</sup>

#### 6. Separate staff

Alinta Energy notes that Horizon Power has stated that does not have the economies of scale or scope to separate a small number of functions that are shared between the provision or marketing of covered network services in the Pilbara region and the provision or marketing of contestable generation or retail electricity services in the Pilbara region.

Alinta Energy recognises that the costs and disruption associated with separating these functions are likely to outweigh the potential benefits for a small number of contestable customers. However, there needs to be measures put in place to address the harm of sharing of commercially sensitive information (inadvertent or otherwise) between regulated network staff and staff of the associate or other business due to sharing of staff between the regulated network business and an associate or other business.

Similarly, to the above, the AER's Electricity Distribution ringfencing guidelines requires that the DNSP ensure that its staff involved in the provision or marketing of direct control services are not also involved in the provision or marketing of contestable electricity services by a related service provider, excepting where those staff, subject to certain exemptions<sup>11</sup>. Staff that are shared due to an exemption in the guideline must be declared in a public register<sup>12</sup>.

#### 7. HP Systems Operations

The table in section 9.2.1 notes that Horizon Power Systems Operations staff will continue to be shared, with the additional safeguards of:

- the operations of the HPCC are undertaken in a physically discrete room, separate from the rest of the business. Information and data shown on monitors in that separate room and visible to the HPCC will not be visible to anyone else within the business by virtue of frosting all transparent and glass surfaces previously allowing visual access into the HPCC's separate room.
- ...
- confidential information is protected and quarantined from employees providing contestable services.

Like comments above, Alinta Energy is concerned that this doesn't adequately cover Horizon Power's obligations in relation to commercially sensitive information under the PNAC.

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<sup>9</sup> AER, Ring-fencing Guideline Electricity Distribution, Version 2, October 2017, cl. 4.2.1.

<sup>10</sup> AER, Ring-fencing Guideline Electricity Distribution, Version 2, October 2017, cl. 4.2.4.

<sup>11</sup> AER, Ring-fencing Guideline Electricity Distribution, Version 2, October 2017, cl. 4.2.2.

<sup>12</sup> AER, Ring-fencing Guideline Electricity Distribution, Version 2, October 2017, cl. 4.2.4.

Particularly the information in relation to part (b) of the definition of commercially sensitive information regarding “an NSP which comes into the possession of another NSP for the purposes of performing a function under the Pilbara networks rules”.

We recommend it be clarified that confidential information includes electricity information and commercially sensitive information. Further, Alinta Energy requests information about how this information is “is protected and quarantined from employees providing contestable services”, beyond frosting all transparent and glass surfaces into the HPCC.

8. Arrangements recorded in writing

The PNAC's Sections 130 and 131 require that an NSP must record the full terms and conditions of any associate arrangement in writing. Further, if the network business of an NSP provides one or more covered services to an other business of the NSP (deemed associate arrangement) then the network business and the other business must record in writing the full terms and conditions of this deemed associate arrangement. This must occur to the same standard as would occur if the businesses were arms-length separate entities.

As outlined above, Horizon Power doesn't refer to or define its “other businesses” nor set out how it complies with sections 130 and 131 or the PNAC.