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COMMENTS ON ERA DISCUSSION PAPER ON RINGFENCING RULES

Thank you for the invitation to comment on the discussion paper regarding possible ringfencing rules which may be applied to the Networks Strengthened Business Unit (NSBU) of Western Power Corporation (WPC).

I would take this opportunity to commend the Authority for what appears to be a well-written paper, which includes a fair discussion on the various possibilities. WPC is committed to ensure that the Western Australian community has complete faith in the effective and unbiased management of the Network business and is eager to support that goal by working cooperatively with the ERA on any matters regarding ringfencing.

Of course, since the paper was prepared, the Minister has announced his intention to introduce legislation to facilitate the disaggregation of WPC. Once disaggregation occurs (and a challenging timetable from the Minister is anticipated), many of the issues dealt with in your paper will become less significant and some will become redundant. The ERA may wish to delay further consideration of the ringfencing arrangements in light of the legislative timetable.

For the most part, WPC believes that the issues raised are already adequately addressed, either by the existing ringfencing requirements of the Access Code or through disaggregation. Even now, WPC has separate management teams for each of its business units, and procedures in place for such things as the management of confidential information. We trust that the existing ringfencing arrangements required of NSBU and its associated entities are equally required of all other regulated businesses and their respective associates. We offer the following comments in addition to our general conclusion that further ringfencing rules would be unnecessary.

Cross-subsidisation

The costs of operating NSBU and System Management are joint in nature and must be allocated across the various Rule participants and ultimately electricity consumers. Implicitly, there will always be the potential for cross-subsidisation. However, the use of independently verified published tariffs removes the possibility of discretion from NSBU, effectively managing the cross-subsidisation risks raised. By separately identifying the costs associated with System Management to the ERA, the opportunity for cross-subsidisation between NSBU and System Management is being effectively managed.

Additionally, as part of the implementation of the new business model, WPC is implementing financial and policy changes directed at ensuring all services provided between the Strengthened Business Units are undertaken on a commercial (arms-length) basis.

Discriminatory Access to Services

The disaggregation of WPC will ensure non-discriminatory access to network services. Additionally NSBU already maintains the secure separation of those parts of the business that deal with confidential information. This includes electronic security and confidentiality assurances. The appropriateness of these measures has been confirmed by independent audits on several occasions.

The use of the term “ancillary services” in the first paragraph of section 5.3.2 requires clarification. Ancillary Services are referred to in the Access Code (see definition of “Covered Service” and “Excluded Service”) but are primarily covered by the Market Rules (clause 3.9). The Market Rules require Ancillary Services to be procured by System Management, but they are provided to/charged to users by the Independent Market Operator, rather than the electricity network business. WPC supports System Management procuring ancillary services on a non-discriminatory basis under the guidance of the ERA.

Costs of Ringfencing

What are the costs of ringfencing that the Authority should consider in developing ringfencing rules?

Ongoing costs for demonstration of compliance with the existing Code ringfencing requirements should not be significant. However, set-up costs for new requirements may well be substantial. The benefits obviously need to be weighed against the costs - it is possible for some reporting items, which may be of little material benefit to be very expensive to implement. Consequently, we would encourage a consultative approach, which would facilitate detailed analysis and costing before any final decisions are made.

Application of Ringfencing Arrangements

Should the Authority require ringfencing between Western Power’s transmission and distribution activities?

An effective and efficient cost allocation framework exists within NSBU, which ensures an appropriate allocation of both capital and operating costs between Transmission and Distribution. This ensures that these costs are passed on appropriately to users via published access prices. The cost allocation methodologies, which are described in current publications and have been validated in the past by the Office of Energy, will be reviewed again in the forthcoming Access Arrangement to be approved by the ERA.

It is important to understand that the network business has no incentive to inaccurately allocate costs between transmission and distribution activities and it is relatively straightforward to audit and verify that the methodologies allocate the costs appropriately. The relevance of the cost allocation methodology is to ensure that prices are as cost reflective as possible for all customers and any cross subsidisation between large and small users is minimised.

Should ringfencing rules be drafted to be general in scope but to have the provision for specific rules?

WPC supports the approach of “... drafted to be as general in scope as possible so that they can accommodate any future structural arrangements with as little modification as possible.”

This approach will hopefully enable NSBU to tune/enhance existing processes as needed, rather than developing new procedures and supporting systems, thus minimising effort and cost. In any event, the Code empowers the Authority to vary ringfencing rules as it deems necessary, at any time, enabling the future introduction of specific rules if required.

Should Western Power or another integrated service provider be required to have separate offices for its monopoly network business and its other businesses?

Separation can be effectively maintained within the same location.

Are ringfencing rules necessary to provide for the separate branding and marketing of an integrated service provider's businesses?

Separate branding will be a costly exercise. Clearly this will be necessary as part of disaggregation but without this driver, the benefits would seem to be difficult to justify, particularly when there is only one legal entity.

Are ringfencing rules necessary to provide for the separation of an integrated service provider's information systems for its different businesses?

Ringfencing rules should only specify the required functionality or separation of data (eg. by effective partitioning and access controls etc.) and not the physical systems. Physical separation of systems is expensive and may be practically unnecessary to meet ringfencing requirements.

Non-discrimination in the Provision of Goods and Services

Are the ringfencing rules and principles specified above appropriate to provide for non-discrimination in the provision of goods and services by an integrated service provider?

The ringfencing rules referred to appear to be reasonable, but do not appear to add materially to the existing obligations under the Code. For example the first dot point on page 38 is covered by section 13.6 of the Code, the second dot point is covered by section 13.8, the third dot point is covered by section 13.4 and 13.5 etc.)

Accounting and Cost Allocation

Is this approach for developing regulatory accounting and cost allocation procedures appropriate?

WPC would support the suggested approach whereby the Authority specifies accounting and cost allocation principles, provided these are consistent with accounting standards (IFRS). NSBU would develop associated detailed procedures.

Do the accounting principles above provide an appropriate basis for developing the accounting procedures?

WPC considers the suggested principles to be reasonable (to the extent that they are consistent with accounting standards).

Do the cost allocation principles above provide an appropriate basis for developing the cost allocation procedures?

WPC considers the suggested principles are reasonable.

Information Management

Is this approach for developing information procedures appropriate?

WPC supports the suggested approach whereby the Authority develops information management principles and NSBU develops associated detailed procedures. (Note: NSBU has already implemented QA procedures of this nature.)

The following specific comments are made with reference to page 46 of the draft guidelines:

- (a) 1st dot point:
“Marketing Staff” is too narrow a definition, as acknowledged in the wording of 13.11 in the Code. For the purposes of a network business, the information must also be accessible to staff that work in other functional areas such as metering, billing and settlement, load forecasting and system planning, and financial management. Any information principles should ensure that accessibility is provided for these functions and that the purposes for which they need the information are accommodated.

- (b) 3rd dot point:
In addition to “good corporate governance”, this should also accommodate principles related to Good Electricity Industry Practice and the Access Code Objectives. This would provide further support and practical effect to the matter in (a) above.

- (c) 4th dot point
This is agreed in principle, but limiting accessibility in aggregate form is problematic for the reasons given in (a).

A more precise definition of “commercially sensitive information” may be necessary to support this principle. We have interpreted the definition in the Access Code to mean that information provided in aggregate form, by its very nature, is not commercially sensitive because it does not relate to any particular party. However, for practical purposes, the need for such definitions to interpret the principles should be avoided where possible.

- (d) 7th dot point
This is agreed in principle, but should be qualified with a reasonableness test – refer section 3.9 of the Customer Transfer Code.

- (e) 9th dot point
This is inappropriate. Director’s liability should be no greater than the statutory duties that currently apply under operation of the Electricity Corporation Act 1994.

- (f) Last paragraph
This should not be necessary as section 2.2(1) is already subject to 2.2(2)(a), the ring fencing rules, which will be modulated by the information principles developed through this current exercise. As per (a) above, any principles aimed at extending the “arms

length” operations within WPC does not prevent it from performing the functions referred to in (a).

The following specific comments are made with reference to page 46 of the draft guidelines:

Do the information principles above provide an appropriate basis for developing the information management procedures?

Yes, they are considered reasonable. The seventh dot point should not only be limited to obligations, but should also include protection of rights.

Should these information principles be extended to Western Power, in light of sections 2.2(1) and (2) of the Electricity Industry Customer Transfer Code 2004?

Refer to comments above.

Compliance Monitoring and Reporting

Do the compliance monitoring and reporting principles above provide an appropriate basis for developing the compliance monitoring and reporting procedures?

WPC appreciates the absolute necessity to ensure effective compliance with all ringfencing objectives and rules, and compliance should be ensured by each of the specific procedures already in place and/or subsequently developed (eg accounting procedures, cost allocation procedures, information management procedures etc.). However, WPC would strive to avoid unnecessary or overly bureaucratic processes and ensure that compliance procedures are as efficient as possible. The clauses in the Code dealing with compliance appear to offer a simple, yet effective framework.

Breaches

Are the principles above necessary to ensure that breaches of the ringfencing arrangements are appropriately managed?

No. Sections 13.42 to 13.44 of the Code effectively deal with breaches of the ringfencing objectives and ringfencing rules. If the Authority considered that the breach of any matter, which is outside the ringfencing objectives, is serious enough to require immediate notification to the Authority, it may simply address this matter in a ringfencing rule.

Time Frame

What matters should the Authority consider in deciding whether particular rules should commence immediately, within 3 months of being placed on the public register or at some other specified date?

As discussed above, implementation of any new ringfencing requirements will vary considerably in complexity and cost. All ringfencing costs will ultimately be borne by electricity users and, in order to minimise (and avoid unnecessary) costs, WPC would prefer a consultative approach to decisions on implementation, particularly in view of imminent disaggregation.

General Comments

Apart from the brief reference at the bottom of page 11, the discussion paper has not addressed ringfencing requirements within either the existing NSBU or the future standalone network business (expected to be implemented prior to the Access Arrangement being finalized). In any event, the network business effectively comprises:

- Regulated Services associated with the Covered Network; and
- System Management associated with obligations under the Market Rules.

These separate functions will need to be considered if/when the Authority decides to proceed with developing ringfencing rules. It should be noted that the System Management function also has special liability provisions under section 126 of the Electricity Industry Act 2004 and special financial provisions under section 2.23 of the Market Rules.

I would like to thank you once again for the opportunity to comment on your discussion paper and assure you that WPC will continue to work constructively with the Authority on this matter. This paper is a coordinated response from all groups with WPC, although NSBU is the primary source of much of the content. Should you wish to further discuss any matters raised herein please contact either myself (on 9326 6403), or Mr Peter Mattner, Network Pricing and Regulation Manager (9326 4556) for matters specific to NSBU.

Yours sincerely,

GREG DENTON
EXECUTIVE MANAGER
STRATEGY & REFORM