



Endeavour
Energy



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Mr Mark Feather
General Manager
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Dear Mr Feather

Ring-fencing Guideline Electricity Transmission: Issues Paper

Ausgrid, Endeavour Energy and Essential Energy (**the NSW Distribution Network Service Providers (DNSPs)**) welcome this opportunity to provide a joint submission in response to the Australian Energy Regulator's (**AER**) electricity transmission ring-fencing guideline review.

1 Context for this review

Much has changed since ring-fencing rules were first developed for transmission businesses around twenty years ago. The energy sector is now undergoing a major transformation, driven by changes in technology, decarbonisation objectives and broader market developments.

Several features of the sector's transformation potentially have implications for the design of ring-fencing arrangements, including:

- 1 New services and business models are continuing to emerge, with varying degrees of contestability. Many of these emerging services and business models are potentially key to facilitating the delivery of reliable and affordable energy with reduced (or zero) carbon emissions.
- 2 The need to augment the grid to accommodate new sources of generation is driving significant transmission investment. This includes major projects being undertaken by incumbent Transmission Network Service Providers (**TNSPs**), as well as a range of potentially contestable projects.
- 3 Various changes have been made to the transmission connection and access framework in recent years, intended to improve the process for new generation connecting to the grid. These have included changes aimed at introducing contestability into aspects of the transmission connection process. The Australian Energy Market Commission (**AEMC**) has recently issued

an Options Paper identifying options to further broaden the scope for contestability around transmission planning and investment.¹

Evidently, network businesses have a crucial role to play in facilitating the delivery of new energy services and supporting the market transition. In addition to connecting new sources of generation, networks can play a role in orchestrating distributed energy resources and providing valuable additional services using smart network assets (e.g. storage capacity from batteries within the network).

Given these and other developments, it is important that regulatory settings are appropriately tuned to promote innovation and investment in new services and technologies, while maintaining appropriate competition safeguards. The NSW DNSPs therefore support this review of the Transmission Ring-fencing Guideline (**Transmission Guideline**).

2 Approach to ring-fencing arrangements for transmission

The NSW DNSPs agree that ring-fencing arrangements for distribution are an appropriate reference point for this review. Indeed, in some areas, it may be appropriate to align ring-fencing arrangements for DNSPs and TNSPs. However, this does not necessarily mean that the Transmission Guideline should simply mirror the current Distribution Ring-fencing Guideline (**Distribution Guideline**).

While the NSW DNSPs acknowledge that the AER has given detailed consideration to these settings as part of the distribution guideline review, we consider it would be prudent for the AER, as part of this review, to conduct a fresh review of these settings given the rapid pace of the market transition and the market dynamics outlined above.

Once the appropriate policy position has been identified, this should then be applied in a consistent manner in the Transmission and Distribution Guidelines. If, during this review, the AER updates or revises any of its policy positions, this may mean that corresponding adjustments need to be made to the Distribution Guideline.

This is particularly relevant to the issue of the ownership and use of batteries by network service providers. Network service providers can play an important role in socialising and maximising the market and customer benefits of emerging network technologies such as batteries. Where a battery is deployed to provide services in addition to network support it is appropriate for regulatory controls to be in place to mitigate the potential for harm to customers such as non-discrimination, cost-allocation and/or revenue sharing provisions. However, we remain of the view that a ring-fencing waiver-based approach to implementing these controls is sub-optimal and a more tailored and uniform guideline (or the like) should be considered as a matter of urgency.

3 Legal separation rules

Legal separation is one area where there is currently a disconnect between the ring-fencing rules for transmission and distribution businesses.

One area where symmetry between the distribution and transmission guidelines is clearly important is in the scope of network services that can be provided by DNSPs and TNSPs. Appropriately, under the Distribution Guideline a DNSP is allowed to provide distribution services *and* transmission services. However, under the current Transmission Guideline a TNSP that provides ring-fenced services cannot provide distribution services.² This potentially creates problems for DNSPs that may wish to provide transmission services (as they are allowed to do under the distribution guideline)

¹ AEMC, Options Paper: Transmission Planning and Investment – Contestability, 7 July 2022.

² We note the definition of 'ring-fenced services' has recently been amended in the AER's final interim transmission guideline to exclude a service provided by means of, or in connection with, a dual function asset. See: <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/ring-fencing-guideline-electricity-transmission-interim#:~:text=On%2014%20April%202022%20the,been%20issued%20to%20address%20this.>

because they would no longer be allowed to provide distribution services if they become a TNSP and start providing 'ring-fenced services' (within the meaning of the Transmission Guideline).

Consistent with the policy position reflected in the Distribution Guideline, the Transmission Guideline should be amended to allow transmission and distribution services to be provided by a single legal entity.

The NSW DNSPs also consider that the revenue threshold in cl 7.1(b) of the Transmission Guideline needs to be reviewed and updated. This is much higher than the equivalent threshold in the Distribution Guideline and allows a TNSP to carry on significant related business activities. The extent of related business activities that would be permitted under this threshold will only grow as more transmission investment is undertaken and TNSP revenue requirements grow. Provided that the scope of prohibited 'related businesses' is appropriate, the NSW DNSPs see no reason why the revenue threshold should differ between the Distribution and Transmission Guidelines.

4 Functional separation rules

The NSW DNSPs consider that similar functional separation rules are likely to be appropriate for transmission and distribution businesses.

In particular, it would seem necessary and appropriate for similar information security and non-discrimination rules to apply to TNSPs and DNSPs. These rules are likely to be particularly important in the context of contestable grid connections, contestable transmission investment projects and delivery of new energy services.

It may be that some functional separation rules, such as those in relation to branding, could apply differently to TNSPs. The NSW DNSPs acknowledge that there may be relevant differences between the types of customers served by TNSPs and DNSPs which might warrant a more light-handed approach to branding restrictions. In addition to branding, less onerous physical co-location and staff separation rules may be efficient in instances where a single legal entity is providing both transmission and distribution services given the highly specialised but overlapping set of technical, financial and legal resources required to provide these services. As noted above, this is an area of potential symmetry between the Transmission and Distribution Guidelines and the position taken in this review may warrant amendments to the Distribution Guideline.

However, any asymmetry in the functional separation rules should be clearly explained by reference to differences in networks' operating environments, customer characteristics or other relevant factors.

5 Transitional arrangements

The NSW DNSPs understand that there may need to be some form of transition to new ring-fencing arrangements for transmission businesses. DNSPs have been required to transition to new ring-fencing arrangements over the past 5 years, since the AER published Version 1 of its Distribution Guideline in November 2016.

The NSW DNSPs consider that the appropriate approach to this transition is that adopted for distribution businesses – that is, the AER should be able to grant interim waivers for a limited period, to allow TNSPs time to implement appropriate ring-fencing measures. The NSW DNSPs would not support permanent grandfathering of outdated ring-fencing rules for existing projects or business activities.

6 NSW Renewable Energy Zones (REZ)

As noted above, the backdrop to this review is an increasingly rapid and large-scale energy market transition. This is particularly the case in NSW with the significant Electricity Infrastructure Roadmap reforms which will see the establishment of several REZs across the State. A Network Operator (**NO**)

for each REZ will be appointed via a competitive process (or direct appointment failing that) which may include, inter alia, both the NSW transmission and distribution network service providers.

For the Central-West-Orana (**CWO**) REZ the AER granted a ring-fencing class waiver to the distribution ring-fencing guideline to enable DNSPs to apply for, and be appointed to, the NO role.

As part of this review, or separately, we recommend the AER consider its approach to the NSW REZs and how the Transmission and Distribution Guidelines apply to these projects. It may be appropriate that a separate instrument apply to these projects, or at least separate treatment under the transmission and distribution ring-fencing guidelines, given the unique nature of these projects. Each REZ project will be subject to a competitive process and regulatory determination and oversight with highly sophisticated and large commercial entities involved.

The NO is likely to be a single legal entity that provides both transmission and distribution services. We recommend the AER clarify how the transmission (interim and final) and distribution ring-fencing guidelines apply to a DNSP and TNSP respectively who may act as an NO. In doing so, a bespoke guideline for the NSW REZs may be required and/or the existing guidelines clarified in a manner that standardises the treatment of REZ projects and avoids the need for NSPs to lodge a ring-fencing waiver for every REZ process they participate in. Our comments with respect to the functional separation requirements are particularly applicable to these unique projects and the AER's consideration of the appropriate regulatory settings.

We would be happy to discuss any aspect of this submission. If you have any questions in relation to this letter, please contact:

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Yours sincerely,



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