Essential Energy

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[redacted]
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

Dear Ms Jolly

## ESSENTIAL ENERGY: CALL FOR INPUT – REVIEW OF THE RING-FENCING GUIDELINE (ELECTRICITY DISTRIBUTION) AND SHARED ASSET GUIDELINE

Essential Energy welcomes the opportunity to comment on the Australian Energy Regulator's (AER) Call for Input as part of the *Review of the Ring-Fencing Guideline v4 and Shared Asset Guideline v2* (Guidelines review). Essential Energy is the regional distribution network service provider (DNSP) for NSW and manages more than 194,000 km of powerlines, covering 95% of the State serving 900,000 households and businesses across regional, rural and remote communities.

Periodic reviews such as this provide an important opportunity not only to consider whether individual regulatory instruments remain fit for purpose, but also to reassess the broader regulatory framework through which the long-term interests of electricity consumers are promoted. We are pleased to understand that the AER is working with the Australian Energy Market Commission (AEMC) as it undertakes its broad Network Regulation Review, which covers many of the same regulatory framework areas for which the AER is seeking input. Whilst it may have been reasonable to allow the AEMC to exercise its market review function first, we understand the AER sees urgency to change the Guidelines prior to the outcomes of the AEMC's Network Regulation Review are known.

As discussed in the AER's Call for Input paper, the electricity sector continues to evolve rapidly. New technologies, emerging services and increasingly interconnected markets are presenting regulatory questions that often extend beyond the scope of changes to individual guidelines. In this environment, maintaining clear regulatory purpose, proportionality and coherence across the broader framework becomes increasingly important.

### The outcomes of the Guidelines review should seek enduring framework outcomes that puts consumers first

The Guidelines review is an opportunity to reinforce a coherent, durable regulatory framework that remains focused on the long-term interests of electricity consumers as technologies, services and markets evolve. Regulatory change should begin with an assessment of the issue being addressed: what consumer or competition harm has been identified, whether intervention is supported by evidence, and which regulatory mechanism is best to respond.

Essential Energy's customers in regional, rural and remote areas of NSW have the same right to good energy market outcomes as their counterparts in metropolitan networks under the National Electricity Objective.  A one-size-fits-all approach to market regulation consistently leaves these consumers behind, as competition outside of cities and regional centres is thin to non-existent leading to poor service delivery. Essential Energy appreciates the flexibility exercised by the AER in granting Ring-fencing waivers recognising that Essential Energy customers may not have access to services. However, these bespoke and temporary solutions continue a cycle of delays and uncertainty for regional consumers which the framework should seek to resolve in an enduring manner.

### Ring-fencing Guideline review

The review of the Ring-fencing Guideline should seek to provide an enduring framework for protecting competition where genuine competition risk exists. For instance, shared organisational capability within a DNSP is not, by itself, evidence of harm to competition. The framework needs to reflect whether costs, information flow, incentives and decision making are appropriately governed. Increasing transparency on how ring-fencing safeguards function in practice may prove a reasonable response to stakeholder concerns rather than implementing additional structural obligations which may be disproportionate to the harm that may occur should a risk eventuate.

Waivers are an important mechanism for managing emerging circumstances while the appropriate regulatory treatment matures. They allow innovation to proceed without weakening core safeguards. However, repeated waiver applications with similar characteristics, common safeguards and consistently low residual risks should prompt consideration by the AER for class waivers, guideline clarification or more permanent regulatory pathways. Waivers should support regulatory evolution, not become the enduring framework.

Ring-fencing obligations should also not seek to duplicate or override service classification where regulatory obligations should follow the service being provided. Where a service has already been classified and regulated accordingly, additional ring-fencing obligations should only apply where a distinct residual consumer or competition risk remains. Ring-fencing should complement service classification, negotiated service arrangements, cost allocation and non-discrimination obligations.

Further, the most effective is not one that attempts to prescribe outcomes for every future technology or business innovation. The framework should remain technology-neutral by focusing on the service being provided, not the technology or asset through which it is delivered. Batteries, electric vehicle charging infrastructure, microgrids and other emerging assets may support multiple regulated, contestable and resilience-related services over their operating life. If regulation attaches to asset classes or technologies, the framework will require continual amendment and may become a barrier to innovation. A service-based approach is more durable and better aligned with consumer outcomes.

### Shared Asset Principles and Guideline

Whilst the Guideline review is not seeking to address the Shared Asset Principles addressed in the National Electricity Rules (clause 6.4.4) to which the Shared Asset Guideline gives practical effect, it is important that the Guidelines review seek to focus on the intent of asset sharing, which is to allow for value creation in distribution networks that can be meaningfully shared with consumers that have paid for the infrastructure.

The current Review raises important questions regarding the operation of the Shared Asset Guideline, including whether the existing sharing arrangements remain appropriate, whether different classes of shared assets warrant different treatment, and how the Guideline should interact with broader regulatory reforms. However, before considering how revenues should be shared, it is first necessary to identify what clause 6.4.4 is seeking to achieve. This gives rise to a broader regulatory question: should the framework seek to maximise the proportion of value shared, or the total value created and ultimately returned to electricity consumers.

The important question to consider is how the shared asset framework can maximise the lifetime value created and returned from customer-funded infrastructure and increase the utilisation of the infrastructure. A higher sharing percentage may not benefit customers if it discourages efficient investment or prevents shared-use opportunities from being created in the first place. Equally, value creation without an appropriate customer return would not give effect to the Shared Asset Principles.

The Shared Asset Guideline itself should not be considered in isolation with service classification, ring-fencing, cost allocation, and revenue determination settings all influencing investment incentives, asset capability and the value that ultimately can returned to consumers. Different asset classes may warrant different regulatory settings where their economics, risks and value-creation potential differ. The objective should be the best whole-of-framework outcome for electricity consumers, not the optimisation of mechanisms in the Shared Asset Guideline alone.

In addition to Essential Energy's views above, appended to this letter is also Essential Energy's assessment of what needs to be considered in the review and opportunities presented through this review.  If you have any questions in relation to this submission, please contact Mr [redacted], Regulatory Strategy Manager, at [redacted].

Yours sincerely,

[redacted]

# Appendix: Regulatory framework considerations

## Strengthening Regulatory Decision Making

Every periodic review presents two opportunities. The first is to address the issues that have emerged since the previous review. The second—and arguably more significant—is to strengthen the regulatory framework so that it continues to promote the long-term interests of electricity consumers as the electricity sector evolves.

Essential Energy considers that this review presents both opportunities.

The matters identified in the consultation paper are important and warrant careful consideration. Many reflect legitimate questions arising from the operation of the current Ring-fencing Guideline (electricity distribution) and Shared Asset Guideline (Guidelines), while others reflect the emergence of new technologies, services and business models that were not envisaged when those Guidelines were originally developed. These matters should be addressed. Equally, they provide an opportunity to reinforce a regulatory framework capable of responding consistently to future challenges while remaining focused on the customer outcomes it exists to deliver.

As the electricity sector evolves, regulatory questions are becoming increasingly interconnected. Decisions affecting service classification, ring-fencing, cost allocation and shared asset arrangements increasingly influence one another. While this review is necessarily focused on the Guidelines, the effectiveness of those instruments cannot be assessed in isolation from the broader regulatory framework within which they operate. Improving individual regulatory instruments and strengthening the operation of the framework are therefore complementary objectives. When each instrument performs its intended role, the framework is better able to deliver efficient investment, effective competition where appropriate, and better long-term outcomes for electricity consumers.

A regulatory framework founded on enduring statutory principles rather than individual technologies provides greater certainty, reduces the need for continual regulatory amendment, and enables innovation to occur within a stable regulatory environment.

High quality regulatory decision making begins by identifying the long-term outcomes the regulatory framework is intended to deliver for electricity consumers under the National Electricity Objective (NEO). From that foundation, the regulatory concern can be clearly defined, the distinction drawn between issues arising from the regulatory framework and those arising through its implementation, and the regulatory instrument best placed to address the issue identified. Proposed responses can then be assessed according to whether they improve the consumer outcomes the framework is intended to achieve.

This submission proceeds on the basis that the long-term interests of electricity consumers are best served when each regulatory instrument performs the function for which it was designed. Ring-fencing protects competition. Service classification determines regulatory treatment. Cost allocation ensures only attributable regulated costs are recovered from consumers. The Shared Asset Guideline (SAG) determines how consumers participate in the value created through the efficient sharing of regulated infrastructure. Each performs a distinct function. When those functions remain clear and complementary, the regulatory framework operates cohesively, resulting in more consistent regulatory decision making and better long-term outcomes for electricity consumers.

Viewed through this lens, the matters raised in this review become more readily distinguishable. Some support refinement of the Guidelines. Others demonstrate the importance of preserving the distinct role of each regulatory instrument within the broader framework. Equally, some concerns may be more appropriately addressed through improvements to implementation, transparency, reporting or compliance, rather than changes to the regulatory framework itself. Correctly distinguishing between these different categories of issues helps ensure that regulatory responses remain proportionate, that each regulatory instrument continues to perform its intended function, and that the framework evolves in a manner that delivers better long-term outcomes for electricity consumers.

For example, the Ring-fencing Guideline (RFG) should continue to protect competition without assuming the role of service classification, while the Shared Asset Guideline (SAG) should continue to give practical effect to the Shared Asset Principles in clause 6.4.4 of the National Electricity Rules. Optimising these Guidelines in a manner that respects the broader regulatory framework strengthens both the individual instruments and the framework as a whole, improving its ability to deliver the long-term interests of electricity consumers.

Ultimately, this submission is not intended simply to advocate particular regulatory outcomes. Rather, it seeks to contribute an approach to regulatory assessment that supports consistent, transparent and evidence-based decision making. By focusing first on the outcomes the regulatory framework is intended to deliver for electricity consumers, and then ensuring each regulatory instrument performs its intended function in support of those outcomes, this review presents an opportunity to strengthen not only the Guidelines, but also the framework they support.

Essential Energy hopes the approach set out in this submission assists the AER not only in addressing the matters raised through this review, but also in reinforcing a regulatory framework capable of responding consistently to future challenges while remaining firmly focused on the long-term interests of electricity consumers.

## The Regulatory Assessment Framework in Practice

The five issues examined in this submission are intentionally arranged to build upon one another. Together they demonstrate how a disciplined regulatory assessment progresses from identifying the appropriate regulatory treatment of services to the broader question of what the regulatory framework should ultimately seek to achieve.

| PROGRESSION | REGULATORY QUESTION | OUTCOME |
|---|---|---|
| **Issue 1** | What is being regulated? | Regulatory obligations should follow the service being provided. |
| **Issue 2** | When is further intervention justified? | Functional separation should respond only to residual regulatory risks. |

| | | |
|---|---|---|
| **Issue 3** | How should regulation accommodate innovation? | Regulation should focus on services, regulatory risks and consumer outcomes – not technologies. |
| **Issue 4** | How should regulation evolve? | Waivers should facilitate regulatory evolution while enduring pathways mature. |
| **Issue 5** | What does good regulation ultimately seek to achieve? | Maximise the lifetime value created and returned to electricity consumers. |

Each issue builds upon the previous one. Collectively, they demonstrate how disciplined regulatory assessment leads to practical regulatory outcomes while preserving the coherence of the broader statutory framework.

## PART I – Foundations for regulatory decision making

Part I establishes the statutory and regulatory foundations for the issues considered throughout this submission. It identifies the governing objective, the distinct functions of the relevant regulatory instruments, the importance of beneficiary alignment and evidence-based intervention, and concludes with a set of regulatory considerations that provide a structured approach to assessing the matters raised in this review.

### THE GOVERNING OBJECTIVE

Every regulatory instrument administered under the National Electricity Law ultimately derives its purpose from the NEO. The NEO is therefore more than the legislative context for this review – it is the governing objective against which regulatory decisions, and the frameworks that support them, should be considered.

Periodic guideline reviews provide an opportunity to consider whether regulatory instruments continue to promote the long-term interests of consumers and remain aligned with the statutory objective they were established to serve.

Accordingly, this review should begin by reaffirming the governing objective before considering whether, and how, the existing framework should evolve.

### THE STATUTORY ARCHITECTURE

The NEO is given practical effect through an integrated statutory framework established under the National Electricity Law and the National Electricity Rules. Within that framework, different regulatory instruments perform different functions, each contributing to the achievement of the same overarching objective.

The Rules establish the substantive regulatory framework. The Guidelines support its consistent administration. Together, they establish the regulatory architecture through which obligations are applied, compliance is monitored, markets operate and consumers are protected.

Periodic reviews of regulatory guidelines therefore play an important role within the broader statutory architecture. Their purpose is to ensure that regulatory instruments continue to operate coherently within the broader statutory framework while promoting the long-term interests of consumers.

While these instruments operate as part of an integrated statutory framework, they do not all serve identical purposes or benefit the same parties in the same way. Some regulatory mechanisms are directed primarily toward protecting electricity consumers, while others facilitate efficient market participation, transparency or commercial arrangements between industry participants.

Accordingly, identifying the intended beneficiary of a proposed regulatory intervention provides an additional means of testing whether the proposed response remains aligned with its statutory purpose. Where the primary benefits accrue outside electricity consumers, the pathway through which those benefits are expected to promote the long-term interests of consumers should be capable of being clearly demonstrated.

## UNDERSTANDING THE REGULATORY CONCERN

Every regulatory review begins with one or more identified regulatory concerns. However, the existence of a concern does not, of itself, determine that the regulatory framework requires amendment. Before considering whether change is necessary, it is first important to understand the nature of the concern being raised.

Similar regulatory concerns may arise from very different causes. They may reflect genuine deficiencies in the regulatory framework. Equally, they may arise from non-compliance with an otherwise appropriate framework, inconsistent application of regulatory requirements, information asymmetries, stakeholder perceptions, or evolving market conditions. While each may warrant regulatory attention, they do not necessarily warrant the same regulatory response.

Accordingly, the first task of a regulatory review is not to determine how the framework should change, but to establish the nature of the concern requiring attention. Properly identifying, and classifying, the issue provides the foundation for determining which regulatory functions, powers and regulatory instruments are most appropriately engaged.

## FROM CLASSIFICATION TO REGULATORY RESPONSE

Once the nature of the regulatory concern has been established, that classification should inform the regulatory response. Different types of concerns engage different statutory functions, powers and regulatory mechanisms. The objective is therefore not simply to determine whether regulatory action is warranted, but to ensure that the response corresponds to the nature of the concern identified.

For example, concerns arising from deficiencies in the regulatory framework may justify amendments to regulatory instruments or, where appropriate, future rule change proposals. By contrast, concerns arising from non-compliance may be more appropriately addressed through monitoring, investigation or enforcement.

Where concerns arise primarily from misunderstanding or stakeholder perception, amendment of the regulatory framework may not be the appropriate response. Greater transparency, regulatory guidance or improved communication may better promote confidence in the framework while preserving regulatory certainty.

Matching the regulatory response to the nature of the concern promotes a proportionate response directed to the issue identified. It also supports confidence in the broader statutory framework by avoiding unnecessary amendment where existing statutory functions are capable of addressing the concern.

### EXERCISING THE APPROPRIATE REGULATORY FUNCTION

Once the appropriate regulatory function has been identified, consideration should turn to the statutory mechanism through which that function is most effectively exercised. While the National Electricity Law and Rules establish an integrated regulatory framework, they also allocate different responsibilities to different regulatory instruments and processes. The effectiveness of that framework depends upon each instrument performing the role for which it was intended.

Accordingly, not every regulatory concern should be addressed through amendment of the RFG or the SAG simply because those instruments are under review. Some concerns are more appropriately addressed through existing compliance and enforcement powers. Others are better addressed through regulatory guidance or improved transparency. Others may ultimately require future consideration through separate regulatory processes or changes to the National Electricity Rules.

Recognising these distinctions assists in preserving the coherence of the broader regulatory framework. It also helps ensure that each regulatory instrument continues to perform its intended role, avoids unnecessary duplication between regulatory processes, and promotes confidence that concerns are being addressed through the most appropriate statutory mechanism.

The statutory framework should therefore continue to evolve around enduring regulatory principles rather than particular technologies or business models. Technologies and business models will continue to evolve, often more rapidly than regulatory instruments can reasonably be amended. A framework founded on services, regulatory risks and consumer outcomes provides greater regulatory certainty, reduces unnecessary regulatory change, enables innovation, and continues to protect consumers and competition.

### A DISCIPLINED APPROACH TO THIS REVIEW

The discussion above establishes the statutory context and regulatory considerations that inform the assessment of the issues raised throughout this review. It provides a structured basis for distinguishing between different types of concerns and ensuring that proposed regulatory responses remain connected to the statutory objective, reflect the nature of the concern identified, and employ the statutory functions and mechanisms most appropriate to the circumstances.

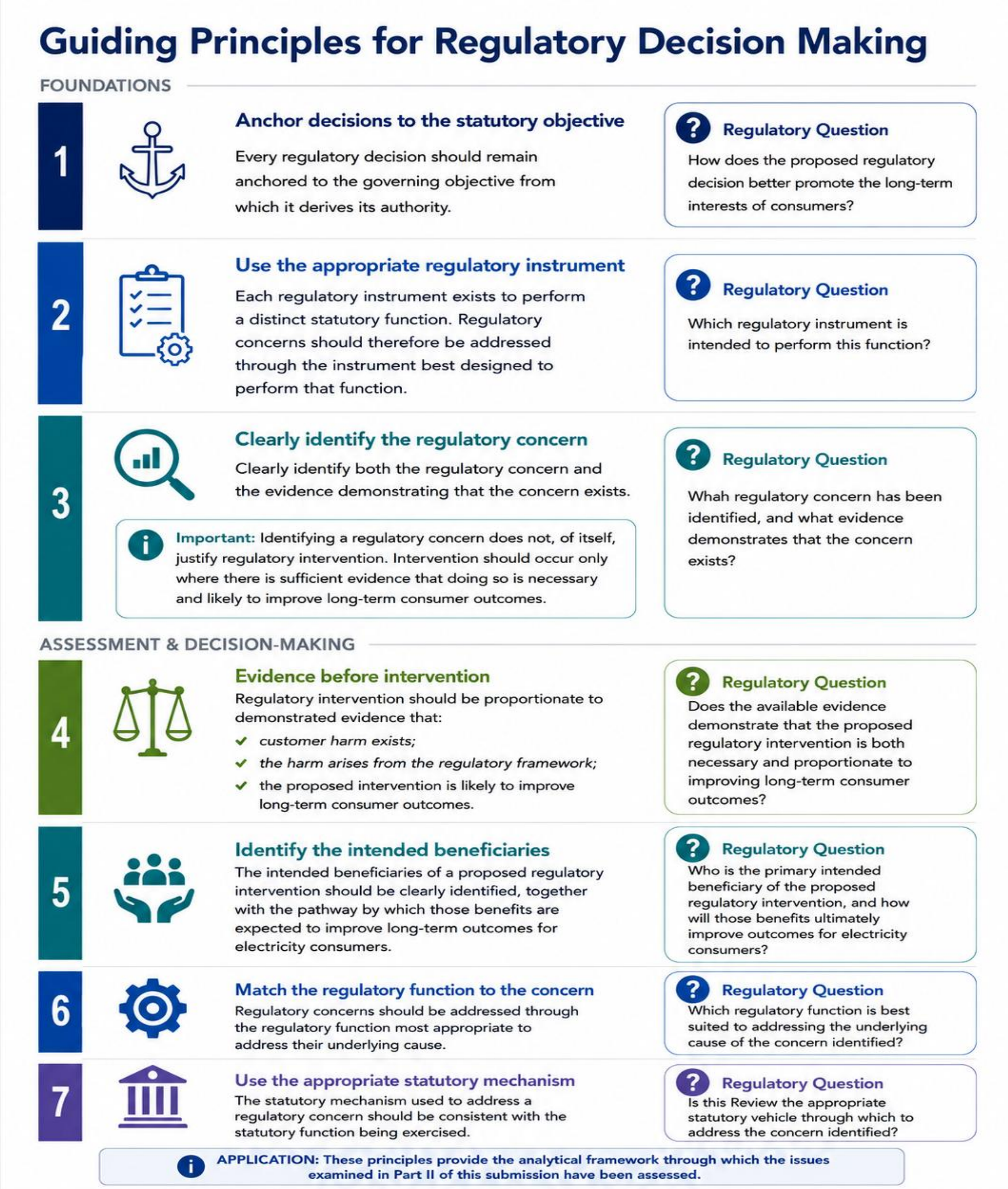
Part II applies these principles to the principal issues raised during the consultation process. In each case, the objective is not simply to consider whether change is desirable, but whether the proposed regulatory response promotes the long-term interests of consumers through the most appropriate exercise of the AER's statutory functions.

This approach seeks to support robust regulatory decision making by distinguishing between concerns that warrant amendment of the regulatory framework and those more appropriately addressed through the existing regulatory architecture. In doing so, it aims to promote both effective regulation and confidence in the regulatory framework over time.

## Decision Principles for this Review

The decision principles outlined in Part I establish a structured approach to regulatory decision making. From those considerations arise a series of guiding principles intended to assist the AER in assessing the issues raised throughout this review. Collectively, these principles maintain a clear connection between the governing objective, the regulatory concern identified, the evidence supporting intervention, the statutory function being exercised and the regulatory mechanism through which that function is performed. Each principle is accompanied by a regulatory question intended to promote disciplined, transparent and consistent regulatory decision making.

**Figure 1: Guiding principles in regulatory decision making**



# PART II – Application of the regulatory considerations

Part II applies the regulatory considerations and decision principles set out in Part I to the principal issues raised in this review. The purpose is not to revisit the foundations established above, but to demonstrate how their consistent application supports decisions that promote the long-term interests of electricity consumers.

The issues considered in this Part have been identified by applying the regulatory considerations established in Part I. While the consultation process has raised a broad range of concerns, not all require amendment of the Guidelines. Some are more appropriately addressed through existing compliance and enforcement powers, regulatory guidance, improved transparency or other regulatory processes. The issues that follow therefore focus on those aspects of the current framework that, in Essential Energy's view, warrant further consideration through this review because targeted refinement has the potential to improve the coherence of the framework and better promote the long-term interests of electricity consumers.

## Issue 1 — Regulatory obligations should follow service classification

**Service classification determines the primary regulatory treatment of a service. Ring-fencing obligations should only supplement that treatment where a distinct regulatory risk remains.**

### REGULATORY CONCERN

The review raises questions about how the RFG should apply where Distribution Network Service Providers (DNSPs) undertake negotiated services, emerging services and activities that do not fit neatly within traditional service classifications. Stakeholders have expressed differing views on whether the current framework appropriately distinguishes between regulated services, contestable activities and other organisational functions. This section considers how those questions should be assessed within the broader statutory framework. Essential Energy notes that the purpose of regulation is not to eliminate every regulatory risk, but to identify those risks that may result in material harm to consumers or competition and apply proportionate regulatory responses.

The regulatory treatment applied to a service should therefore follow from the legal classification of that service, rather than being determined independently through overlapping regulatory instruments. Under the National Electricity Rules, service classification establishes how a service is recognised, regulated and recovered. Additional regulatory obligations – such as functional separation, information sharing restrictions, reporting obligations or other operational requirements – should address a distinct regulatory concern and complement, rather than duplicate or override the primary regulatory framework.

This sequencing is important to maintaining a coherent regulatory framework. Where a service has already been assessed and classified under Chapter 6 of the National Electricity Rules, any additional obligations imposed through the RFG should be supported by clear evidence that the existing regulatory framework does not adequately address the identified concern. In the absence of such evidence, layering additional structural obligations risks creating regulatory inconsistency, increasing compliance costs and reducing regulatory certainty without delivering corresponding consumer benefits.

Accordingly, regulatory obligations should be viewed as a consequence of service classification, not as a parallel mechanism for determining how a service should be regulated. This preserves the integrity of the statutory framework and ensures each regulatory instrument performs its intended function within the broader regulatory architecture.

### WHY THIS IS A FRAMEWORK ISSUE

This concern does not arise from non-compliance with the existing RFG. A DNSP could comply fully with the Guideline, and the underlying tension would remain.

The issue arises from the interaction between:

- the AER's service-classification decision;
- the negotiated-services regime established by Chapter 6 of the Rules;
- the DNSP's AER-approved negotiating framework; and
- the functional-separation requirements imposed by the RFG.

It is therefore appropriate to consider through this review whether those instruments are performing distinct and complementary regulatory functions or whether, in some circumstances, the RFG imposes an additional structural response without a clearly identified corresponding harm.

Accordingly, the issue is not whether greater visibility may be desirable, but whether the identified concern is more appropriately addressed through refinement of the RFG or through other existing regulatory mechanisms.

### ASSESSMENT

#### Distribution and transmission ring-fencing obligation alignment on negotiated services

As identified in the consultation paper, there is a stakeholder identified misalignment between the treatment of negotiated services between the transmission and distribution ring-fencing frameworks where DNSPs may only provide negotiated services where functionally separated from the regulated activities of the DNSP or seek a waiver.

As a regional network with substantial sub transmission network, capable of supporting renewable generation and battery energy storage systems, and large loads which may traditionally connect at the transmission level of the grid, Essential Energy views the inconsistency of the application of ring-fencing to transmission networks and distribution networks as needing remedy.  The AER, through its review of transmission ring-fencing already recognises that there is low risk of harm through a network business negotiating with generation and large load proponents as such proponents have capability and capacity to negotiation on equal terms.

In order to increase the utilisation of sub transmission assets that consumers have paid for, it is logical that Essential Energy should be able to negotiate with large businesses seeking to connect at the sub transmission level on an even playing field to transmission without the need for each connection project to be functionally separated from the DNSP or the DNSP needing to seek an individual waiver.

Currently, negotiated services already operate within a regulated pathway. The classification of a service as negotiated reflects a decision that direct price control is not warranted, but that the DNSP's market position requires regulatory protections governing access, price and other terms and conditions.

The Rules already provide those protections through the negotiate-arbitrate regime. The Victorian distribution determinations illustrate how that framework can be applied to access to DNSP assets for EV charging infrastructure, bringing those services within an established regulatory pathway rather than leaving access entirely to commercial negotiation.

That classification addresses a recognisable regulatory concern: the DNSP controls access to infrastructure that a third party may require, and the negotiate-arbitrate regime provides protections against unreasonable refusal, pricing or access terms. It is less evident what further harm is addressed by requiring the same service to be delivered through a functionally separated part of the DNSP.

The relevant comparison is not between regulation and no regulation. It is between:

1. delivery as a negotiated distribution service, subject to the protections established by the Rules; and
2. delivery of that same regulated service through an additionally separated internal organisational structure.

The second response should not follow automatically from the first. It should depend upon an identified harm that the negotiated-services regime and the generally applicable non-discrimination, cost-allocation and information-protection obligations do not already address.

### "Internal RESP" describes an organisational response, not the regulatory harm

The AER's workshop material identifies concerns about the visibility of services undertaken by a part of a DNSP that is treated as a RESP. It also raises practical questions concerning shared staff, systems, incentives, information flows and decision making. These are legitimate matters for examination. However, they represent potential regulatory risks rather than, in themselves, evidence of consumer or competitive harm.

The starting point is not whether an internal RESP requires stronger functional separation. It is first to identify the service or activity being undertaken, determine whether it is regulated, unregulated or not yet a service, identify the relevant regulatory risk, determine whether that risk gives rise to potential consumer or competition harm, consider which existing regulatory obligation already addresses that risk, and only then determine whether any additional obligation is necessary and proportionate.

For a negotiated distribution service that can only be provided by the DNSP because it depends upon access to, or operation of, that DNSP's network assets, there may be no competing provider of the underlying service to protect through functional separation. The relevant regulatory concern may instead be whether access is available on fair and reasonable terms. That concern is directly addressed through service classification and the negotiate-arbitrate arrangements.

Where there is a separate contestable downstream market – for example, competition between charge-point operators using access to DNSP poles – the important protection is that the DNSP provides access without discrimination and does not use information or its control of the network to favour itself or an affiliate. Those risks should be addressed directly. Requiring organisational separation of the team providing the regulated access service may add cost and complexity without improving access or competition in the downstream market.

The regulatory response should be proportionate to the identified regulatory risk and the potential harm it presents. The existence of an "internal RESP" should not become the harm to which the Guideline responds.

## Planning and development activities should not be presumed to be services

Not every activity undertaken by a DNSP constitutes the provision of a service. Planning, development and project preparation activities may involve expenditure, dedicated resources and internal governance arrangements without giving rise to a regulated or unregulated service.

Renewable Energy Zone (REZ) planning illustrates why this distinction matters. During planning and development, activities may be governed principally by the Cost Allocation Methodology (CAM) because no customer service is yet being provided. As services emerge during delivery or operation, the appropriate regulatory treatment should then follow the nature of the service, using existing mechanisms such as service classification, negotiated-service arrangements or waivers where appropriate.

The Central-West Orana class waiver demonstrates the flexibility of the existing RFG to respond to emerging service models where the regulatory treatment is not yet settled. Faced with a novel service model, the AER exercised its discretion to provide regulatory certainty by granting a class waiver while the REZ framework was being established.[1]

The existence of that waiver should not be taken to mean that all preparatory or planning activities constitute services requiring ring-fencing treatment. Rather, it illustrates the AER's ability to respond pragmatically where the regulatory treatment of an emerging service model remains uncertain.

**Once a REZ becomes operational, the appropriate regulatory treatment should continue to follow the nature of the service being provided rather than the organisational structure through which it is delivered.**

The AER's 2025 decision granting Ausgrid a waiver for the Hunter Central Coast REZ demonstrates this principle in practice.[2] Although the services were treated as "other services" under the RFG because they were regulated under the NSW Electricity Infrastructure Investment framework rather than the National Electricity Law, the AER concluded that the relevant competition and discrimination risks were unlikely to arise because, once the Network Operator had been selected, there was no competition for the provision of those services. It therefore granted a waiver from staff, office and branding separation after concluding that the costs of compliance outweighed any corresponding consumer benefit.

The significance of these decisions is not that waivers were granted. It is that, in each case, the AER first identified the nature of the service, assessed the relevant consumer and competition harms, and then selected the regulatory mechanism that was proportionate to those harms.

The existing waiver framework therefore already provides flexibility where new service models do not fit neatly within the standard requirements of the RFG, allowing the AER to respond proportionately while the appropriate long-term regulatory treatment is established.

The emergence of new service models therefore does not necessarily demonstrate a deficiency in the RFG. It may instead require careful identification of the relevant service, the consumer or competition

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[1] AER Decision, Distribution ring-fencing class waiver for the Central-West Orana Renewable Energy Zone, March 2022.

[2] Decision | Australian Energy Regulator (AER)

harm requiring management, and application of the most appropriate existing regulatory mechanism, including service classification, the CAM, negotiated-service arrangements or waivers.

This illustrates that the appropriate regulatory response should follow identification of the relevant service and the consumer or competition harm requiring management, rather than the organisational structure through which an activity is undertaken.

### PATH FORWARD

Essential Energy considers that the review should clarify the treatment of negotiated distribution services and the circumstances in which a part of a DNSP providing those services is required to comply with functional-separation obligations.

That consideration should begin by identifying the relevant activity, determining whether it constitutes a service, identifying the applicable regulatory framework, and then identifying the particular consumer or competition harm to be addressed, rather than beginning with the organisational structure through which the activity is undertaken. In particular, the AER should consider whether:

1. activities should first be characterised by their regulatory substance – including whether they constitute a service at all – before the RFG is applied;
2. the current treatment of negotiated distribution services continues to serve the purpose for which it was introduced, and whether its current treatment remains consistent with the mature service-classification framework established under Chapter 6 of the National Electricity Rules;
3. targeted obligations would be more proportionate, including non-discrimination, information protection, cost allocation and transparent identification of the services undertaken, where a residual consumer or competition harm remains after application of the existing regulatory framework;
4. visibility concerns should be addressed through proportionate reporting or accounting measures, rather than being treated as evidence that legal or functional separation is required.

The objective should not be to create a special exemption for a particular organisational model. It should be to ensure that service classification, negotiated-services regulation, cost allocation, non-discrimination obligations and ring-fencing each perform their intended function without unnecessary duplication. The review also provides an opportunity to consider whether aspects of the current Guideline that were developed during the initial implementation of ring-fencing continue to perform the function for which they were introduced in light of the now mature service-classification framework.

Doing so will allow each regulatory instrument to address the consumer or competition harm it was designed to manage, while avoiding unnecessary overlap between complementary regulatory mechanisms.

Where an identifiable risk remains after those mechanisms have been applied, additional functional separation may be justified. A regulatory framework that classifies services consistently, identifies the harm requiring management and applies the appropriate regulatory instrument before imposing additional structural obligations is more likely to promote the long-term interests of electricity consumers. Waivers should remain available to address genuinely exceptional or transitional circumstances, rather than circumstances that may be more appropriately resolved through refinement of the underlying regulatory architecture.

Essential Energy

## ISSUE 2 — Functional separation should respond to residual regulatory risk

**Functional separation is a regulatory mechanism for managing identifiable competition risks. It should be directed towards residual regulatory risks that remain after the application of complementary regulatory safeguards, rather than applied as a default response to shared organisational capability.**

### REGULATORY CONCERN

Stakeholders have presented two competing propositions regarding the functional separation provisions of the RFG. Some argue that the existing obligations do not adequately protect competition, while others contend that they have become unnecessarily restrictive as new technologies and business models emerge. The question for this review is therefore not simply whether functional separation should be strengthened or relaxed, but whether it remains appropriately calibrated to the competition risks it is intended to address.

The RFG employs functional separation to protect competition by preventing regulated monopoly services from conferring inappropriate advantages on contestable activities. However, functional separation is only one component of a broader regulatory framework that also includes non-discrimination obligations, confidential information protections, cost allocation requirements, governance arrangements, compliance reporting and independent audit. Together, these mechanisms operate to address different dimensions of competition risk.

The question for this review is therefore not whether functional separation remains an appropriate regulatory mechanism. It clearly does. Rather, the relevant question is whether additional structural obligations are supported by evidence of residual competition or consumer harms that are not already addressed through those complementary safeguards.

### WHY THIS IS A FRAMEWORK ISSUE

This issue concerns the calibration of an existing regulatory mechanism rather than whether that mechanism should exist. Functional separation remains an important element of the RFG. The question is whether the Guideline continues to apply that mechanism proportionately to the residual competition risks that remain after other regulatory safeguards have been taken into account.

Issue 1 considers circumstances where the underlying service is already subject to an established regulatory pathway under Chapter 6 of the National Electricity Rules. In those circumstances, the principal question was whether additional ring-fencing obligations were required once the service had already been classified and regulated. This issue addresses a different question. It considers activities undertaken within genuinely contestable markets, where functional separation performs an important role in protecting competition.

Resolving that question requires distinguishing between two different concerns. The first is whether existing obligations are sufficient to prevent regulated monopoly resources conferring inappropriate competitive advantages. The second is whether expanding those obligations would address identifiable competition risks that are not already managed through the Guideline's broader suite of safeguards.

The RFG does not rely on functional separation in isolation. It combines targeted structural requirements with complementary obligations relating to non-discrimination, confidential information, cost allocation, governance, compliance reporting and independent audit. These mechanisms operate together to address different dimensions of competition risk. Accordingly, any proposal to expand functional separation should demonstrate why those existing safeguards are insufficient to address the identified concern.

Accordingly, the principal task for this review is to distinguish between concerns that reveal shortcomings in the Guideline itself and concerns that arise from its implementation, compliance or transparency. Only the former necessarily requires amendment of the Guideline.

## ASSESSMENT

### The Guideline manages residual competition risk through complementary safeguards

The RFG has never relied upon functional separation as its sole mechanism for protecting competition. Rather, it deliberately combines targeted structural separation with complementary regulatory safeguards that collectively manage different dimensions of competition risk. Those safeguards include non-discrimination obligations, confidential information protections, cost allocation requirements, governance arrangements, compliance reporting and independent audit. Assessing whether additional structural obligations are warranted therefore requires consideration of how these mechanisms operate together rather than evaluating functional separation in isolation.

The workshop scenarios illustrate this integrated approach. Staff may undertake both regulated and contestable activities, but only subject to clearly defined conditions governing time recording, cost allocation, access to confidential information, governance oversight and ongoing compliance. These safeguards are not incidental to the framework – they are fundamental components of how the Guideline manages competition risks in practice.

Accordingly, the relevant regulatory question is not whether functional separation is effective in isolation, but whether the existing suite of regulatory safeguards leaves any residual competition or consumer harm requiring additional structural intervention.

### Shared organisational capability is not, of itself, evidence of regulatory harm

This consideration is particularly relevant for geographically dispersed DNSPs. Specialist capability may be limited and required across a large service area, including in regional, rural and remote locations. Requirements that result in the duplication of specialist staff, systems or facilities should therefore be supported by a material residual risk and a demonstrated consumer benefit, having regard to the additional cost ultimately borne through the provision of network and related services.

The consultation process highlights concerns regarding the sharing of staff and organisational capability between regulated and contestable activities. These concerns warrant careful examination. However, the existence of shared capability is not, of itself, evidence that regulated customers are subsidising contestable activities or that competition has been distorted.

The relevant regulatory question is not whether staff are shared, but whether the costs of those shared resources are appropriately borne by the activities receiving the benefit.

Properly applied, the Cost Allocation Method changes the question from *"Are staff shared?"* to *"Who bears the cost of the shared resource?"* Where labour, vehicles, equipment, training, corporate overheads and other shared costs are allocated in accordance with an approved Cost Allocation Method, together with associated governance and compliance costs, the existence of shared organisational capability does not, without more, establish cross-subsidisation.

Indeed, the opposite commercial outcome may arise. Where contestable services bear the full economic cost of specialist staff, associated overheads and governance obligations, those services may ultimately be supplied at prices above those available elsewhere in the market. In those circumstances, any competitive distinction arises not because regulated customers have subsidised the activity, but because customers choose to purchase specialist expertise at its full commercial cost.

### Residual competition risks are activity-specific

This does not suggest that functional separation should be relaxed. On the contrary, functional separation remains an essential mechanism where genuine residual competition risks exist.

Those risks, however, are not uniform across all activities. Personnel involved in commercial decision making, procurement, customer engagement, access to confidential information, network investment decisions or other functions capable of influencing competitive outcomes may present materially different risks from operational personnel whose activities are governed principally through transparent cost allocation and established operational procedures.

Functional separation is therefore most effective when directed towards those activities capable of creating identifiable competition risks rather than being applied uniformly across all shared organisational capability. A risk-based approach better aligns structural obligations with the consumer and competition harms they are intended to prevent while avoiding unnecessary organisational separation where complementary safeguards already provide effective protection.

### Visibility concerns do not necessarily indicate framework deficiencies

The consultation process also highlights another important consideration. Even where the Guideline is appropriately designed and compliance is robust, stakeholder concerns may continue if the operation of the existing safeguards is not readily visible or well understood.

This does not necessarily indicate a deficiency in the Guideline itself. It may instead suggest that additional transparency, reporting or regulatory guidance could assist stakeholders to better understand how the existing framework manages the risks that the Guideline is intended to address.

Consultation plays an essential role in identifying stakeholder concerns. The subsequent task of the review, however, is to determine whether those concerns arise from deficiencies in the Guideline, failures of compliance, limited visibility of existing safeguards, or uncertainty regarding how those safeguards operate in practice. Although each may present in a similar way, they engage different regulatory functions and therefore require materially different regulatory responses.

Accordingly, proposals to expand functional separation should be supported by evidence that existing safeguards are insufficient to address an identifiable residual competition or consumer harm. Where the principal concern instead relates to stakeholder confidence or visibility of the existing framework, more proportionate responses – such as enhanced reporting, improved transparency or additional regulatory guidance – may better promote the long-term interests of electricity consumers while preserving the coherence of the broader regulatory framework.

## PATH FORWARD

In considering potential refinements to the RFG, the AER should continue to recognise that functional separation is one component of a broader regulatory framework. Additional structural obligations should therefore be introduced only where the existing suite of complementary safeguards – including non-discrimination obligations, confidential information protections, cost allocation requirements, governance arrangements, compliance reporting and independent audit – do not adequately address the relevant competition or consumer risk.

Accordingly, the review provides an opportunity to further strengthen the proportionality of the Guideline by considering whether:

1. identified stakeholder concerns arise from deficiencies in the Guideline itself, or from compliance, transparency or understanding of the existing framework;
2. existing complementary safeguards already manage the relevant competition or consumer risks before additional structural separation obligations are introduced;
3. functional separation obligations remain focused on those activities presenting identifiable residual competition risks, particularly those involving commercially sensitive information, discriminatory decision making or other functions capable of influencing competitive outcomes;
4. improvements to transparency, reporting or regulatory guidance may, in some circumstances, provide a more proportionate response than additional structural separation where stakeholder concerns primarily relate to confidence in, or visibility of, the existing framework.

The objective should be to ensure that functional separation continues to perform the specific role for which it was established – protecting competition where identifiable residual risks remain after the framework has been applied.

Such an approach preserves the complementary operation of the RFG, the Cost Allocation Method, governance arrangements and associated compliance obligations, while ensuring that structural intervention remains proportionate, evidence-based and directed towards promoting the long-term interests of electricity consumers.

# Issue 3 - Applying regulatory obligations according to the nature of the service

**The regulatory framework should regulate the service being provided, rather than the technology, ownership model or physical asset through which that service is delivered. This enables the framework to evolve with changing technologies while preserving consistent regulatory treatment.**

### REGULATORY CONCERN

Australia's electricity system is undergoing a fundamental transition. The growth of consumer energy resources, batteries, electric vehicles and more active distribution system operation is changing not only the technologies connected to the network, but the range of services those technologies are capable of providing. As a consequence, the review raises broader questions about how the Guidelines should apply as new services emerge and traditional distinctions between regulated and contestable activities become increasingly blurred.

The increasing deployment of emerging energy technologies is creating new combinations of regulated and contestable activities within individual assets. Batteries, EV charging infrastructure, islandable microgrids and other distributed energy resources are capable of providing multiple services over their operating life, some of which are regulated distribution services while others may be delivered through competitive markets.

This increasing functional diversity raises an important regulatory question. Should regulatory obligations be determined primarily by the physical characteristics or ownership of the asset, or by the particular service being provided at a given time?

Where regulation follows the asset itself, there is a risk that fundamentally different services become subject to identical regulatory treatment despite presenting different consumer benefits, competitive characteristics and regulatory risks. Conversely, where regulation follows the service being provided, each activity can be assessed against the statutory framework and regulatory instruments designed for that purpose.

As new technologies continue to evolve, maintaining this distinction will become increasingly important to ensuring that regulation remains proportionate, technology-neutral and consistent with the National Electricity Objective.

### WHY THIS IS A FRAMEWORK ISSUE

The consultation paper identifies a rapidly changing operating environment characterised by new technologies, new market participants and an expanding range of distribution system functions. It also notes the emerging role of DNSPs as distribution system operators, the growth of flexibility services, batteries, EV charging infrastructure and other hybrid service models. These developments raise legitimate questions about whether the existing Guidelines remain capable of accommodating emerging services while maintaining effective competition safeguards. This is not simply a question of how particular technologies should be regulated.

This is not fundamentally a question about batteries, EV charging infrastructure or any other individual technology. It is a question about the object of regulation.

If regulatory obligations attach to technologies or physical assets, each technological advance risks requiring new regulatory rules. If, however, regulatory obligations continue to follow the services being provided, existing regulatory principles can evolve alongside changing technologies without requiring continual redesign of the framework.

### ASSESSMENT

The SAG already recognises that individual assets may be used to provide multiple services and establishes principles for attributing costs between regulated and unregulated activities. Similarly, the RFG recognises that different services may require different regulatory treatment depending upon the competition risks they present. The challenge is therefore not the absence of regulatory mechanisms, but ensuring those mechanisms continue to be applied consistently as technologies evolve.

Recent developments illustrate this evolution. Battery energy storage systems may provide regulated network support during periods of network constraint, participate in wholesale or ancillary service markets, support islandable microgrids during outages, or provide flexibility services as market arrangements continue to evolve. The physical asset remains unchanged, while the services provided – and the regulatory considerations they engage – vary considerably.

A similar distinction arises in relation to public EV charging infrastructure. The charging equipment itself does not determine the appropriate regulatory treatment. Rather, the relevant question is whether the activity involves provision of a regulated distribution service, participation in a contestable charging market, or some combination of both. The same physical infrastructure may therefore engage different regulatory instruments depending upon the service being delivered.

This distinction becomes increasingly important for hybrid assets capable of performing multiple regulated and contestable functions simultaneously. Applying regulatory obligations solely by reference to the ownership or physical characteristics of the asset risks either over-regulating contestable activities or constraining efficient provision of regulated services. Conversely, assessing each service according to its economic characteristics and associated consumer or competition risks allows the existing regulatory instruments to perform their intended functions while remaining adaptable to future technological developments.

Viewed in this way, technology neutrality is not an objective in itself. It is the natural consequence of regulating services according to their function rather than the assets through which they are delivered.

### PATH FORWARD

The review provides an opportunity to reinforce the principle that regulatory obligations should attach to the services being provided rather than the technologies or assets through which those services are delivered.

In considering potential refinements to the Guidelines, the AER may wish to continue applying a service-based approach that recognises the increasingly multi-functional nature of modern network assets.

Accordingly, the review provides an opportunity to consider whether:

1. regulatory obligations remain aligned with the particular service being provided, rather than the technology or physical asset through which that service is delivered;
2. hybrid assets providing multiple regulated and contestable services continue to be assessed according to the distinct economic characteristics and competition risks associated with each service;
3. existing regulatory instruments collectively provide sufficient flexibility to accommodate emerging technologies without requiring technology-specific regulatory treatment; and
4. future amendments continue to preserve technology neutrality by focusing on services, consumer outcomes and identified regulatory risks rather than particular asset classes.

The objective should not be to develop regulatory rules for individual technologies. Rather, it should be to reinforce a durable regulatory framework capable of accommodating future technologies by consistently regulating risks and consumer outcomes.

## Issue 4 – Waivers should support regulatory evolution, not replace it

**Waivers are a mechanism for managing regulatory uncertainty while preserving the integrity of the broader regulatory framework. They should bridge emerging circumstances – not replace enduring regulatory architecture.**

**Where repeated individual waivers address materially similar activities and are subject to common safeguards, the AER should consider whether a class waiver or enduring guideline clarification will provide greater certainty without weakening consumer or competition protections.**

### REGULATORY CONCERN

The consultation process raises important questions regarding the operation of the waiver framework, including whether waivers are being applied consistently, whether class waivers remain appropriate in some circumstances, and whether the framework continues to strike an appropriate balance between encouraging innovation and protecting competition.

As new technologies and service models continue to emerge, the relevant question is not whether waivers should become more or less available. Rather, it is whether the waiver framework continues to provide an appropriate mechanism for accommodating transitional circumstances while maintaining the consumer protections established by the RFG.

### WHY THIS IS A FRAMEWORK ISSUE

The preceding issues establish three important principles:

1. Regulatory obligations should follow service classification.
2. Functional separation should respond to identifiable residual competition risks.

3. Regulatory obligations should attach to the services being provided rather than the technologies or assets through which those services are delivered.

The waiver framework performs a complementary function within that broader regulatory architecture.

Emerging service models will inevitably arise before permanent service classifications, guideline amendments or other enduring regulatory pathways can be developed. The waiver framework exists to manage those transitional circumstances while preserving the coherence of the framework.

This is therefore not principally a question about the administration of waivers. It is a question about how regulatory frameworks evolve while maintaining consistency, proportionality and confidence over time.

## ASSESSMENT

### Waivers preserve flexibility without undermining the framework

The RFG has always recognised that a generally applicable regulatory instrument cannot anticipate every future service model or market development. The waiver framework was therefore deliberately incorporated to enable the AER to respond to circumstances where strict application of particular structural obligations would not promote the long-term interests of electricity consumers.

Importantly, waivers do not remove the Guideline's core protections relating to non-discrimination, cost allocation or cross-subsidisation. Rather, they provide flexibility in the application of particular structural obligations where the relevant consumer and competition risks can be effectively managed through alternative means.

Accordingly, waivers should be viewed as an integral component of the regulatory framework rather than an exception to it.

### The framework has evolved towards evidence-based proportionality

The evolution of the RFG demonstrates a consistent movement towards a more mature, risk-based approach to waiver assessment.

Earlier refinements recognised that emerging technologies, particularly battery energy storage systems, could simultaneously provide regulated network services and contestable services. Rather than applying identical procedural requirements to every proposal, the AER progressively aligned assessment pathways with the level of demonstrated regulatory risk. Lower-risk proposals became eligible for streamlined assessment, while proposals presenting more complex competition or consumer issues continued to require full assessment.

The subsequent introduction of class waivers for community batteries and the removal of general limits on waiver duration continued this evolution. These changes did not reduce the substantive assessment of competition or consumer impacts. Rather, they reflected increasing confidence that procedural requirements could be calibrated according to objectively identifiable risk characteristics while preserving the underlying protections of the Guideline.

Collectively, these developments demonstrate a consistent regulatory philosophy. The waiver framework has evolved not by weakening the Guideline, but by progressively aligning procedural requirements with demonstrated regulatory risk.

### Waiver experience supports regulatory maturity

The waiver framework performs a second, less obvious but equally important function.

Repeated waiver decisions provide an important source of regulatory learning. Where similar applications consistently demonstrate common characteristics, common safeguards and consistently low residual risks, the experience gained through individual waiver decisions may indicate that more permanent, technology-neutral regulatory pathways have become appropriate.

In this way, the waiver framework performs two complementary functions. It enables innovation to proceed while regulatory settings remain uncertain, and it generates the practical experience necessary to determine whether enduring amendments to the broader regulatory framework are warranted.

The waiver framework is therefore not simply an administrative mechanism. It forms part of the regulatory learning cycle through which the regulatory framework adapts to changing technologies, market structures and service models while preserving confidence in the integrity of the broader regulatory architecture.

## PATH FORWARD

Rather than viewing waivers solely as exceptions to the RFG, the review provides an opportunity to reaffirm their role as a disciplined mechanism for managing transitional regulatory uncertainty while preserving the integrity of the regulatory framework.

As the electricity sector continues to evolve, emerging service models will inevitably precede permanent service classifications, guideline amendments or other enduring regulatory pathways. The waiver framework should continue to provide the flexibility necessary to accommodate those circumstances without compromising the substantive consumer and competition protections established by the Guideline.

Accordingly, the AER may wish to consider whether:

1. waivers continue to operate as a transitional mechanism where permanent regulatory pathways have not yet matured;
2. procedural requirements remain proportionate to the residual consumer and competition risks presented by individual proposals, allowing regulatory effort to be directed towards higher-risk activities while reducing unnecessary administrative burden for lower-risk proposals;
3. experience gained through repeated waiver decisions should inform the development of more permanent, technology-neutral regulatory pathways where common characteristics and consistently low residual risks become well understood; and
4. the waiver framework continues to preserve sufficient flexibility to support innovation while maintaining the substantive consumer and competition protections established by the RFG.

The objective should not be to increase or reduce the use of waivers as an end in themselves. Rather, it should be to ensure that the waiver framework continues to provide a disciplined mechanism for managing transitional regulatory uncertainty while supporting the orderly evolution of the broader regulatory framework in the long-term interests of electricity consumers.

# ISSUE 5 – Optimising Long-term Customer Value Through Shared Assets

**The Shared Asset Guideline should not be assessed in isolation. Together with the broader regulatory framework, it should give practical effect to the Shared Asset Principles in clause 6.4.4 by encouraging the efficient creation, utilisation and sharing of customer value from the infrastructure electricity consumers have funded.**

## REGULATORY CONCERN

Clause 6.4.4 of the National Electricity Rules establishes an important policy objective. It encourages DNSPs to make efficient use of regulated assets to provide other services, provided those services do not materially prejudice the provision of standard control services. The SAG gives practical effect to that objective by determining how electricity customers share in the value created through those arrangements.

The SAG operates as one element of a broader regulatory framework. Together with service classification, ring-fencing, cost allocation, revenue determination and other regulatory mechanisms, it gives practical effect to the Shared Asset Principles in clause 6.4.4 of the National Electricity Rules. The objective is not simply to determine how existing revenue is shared, but to encourage the efficient creation, utilisation and sharing of customer value from infrastructure funded by electricity consumers.

The current review raises important questions regarding the operation of the Guideline, including whether the existing sharing arrangements remain appropriate, whether different classes of shared assets warrant different treatment, and how the Guideline should interact with broader regulatory reforms.

These are important questions.

However, before considering how revenues should be shared, it is first necessary to identify what clause 6.4.4 is actually seeking to achieve. This gives rise to a broader regulatory question: should the framework seek to maximise the proportion of value shared, or the total value created and ultimately returned to electricity consumers.

### Central Proposition

The long-term interests of electricity consumers are unlikely to be maximised by optimising the sharing percentage in isolation. They are more likely to be maximised by encouraging the greatest lifetime value to be created from customer-funded infrastructure and returning an appropriate share of that value to electricity consumers. Why this is a framework issue

This issue extends beyond the operation of the SAG itself. It is fundamentally concerned with the purpose of the broader regulatory framework and the role that clause 6.4.4 of the National Electricity Rules is intended to perform.

While the SAG determines how electricity customers participate in the value created through the sharing of regulated infrastructure, the efficient creation of that value is influenced collectively by service classification, ring-fencing, cost allocation, revenue determination and the broader statutory framework.

The effectiveness of the SAG therefore depends not only on its own operation, but also on these complementary regulatory instruments performing their intended functions.

Accordingly, this SAG review presents an opportunity to consider not only whether the Guideline remains fit for purpose, but whether the broader regulatory framework continues to work cohesively to give practical effect to the Shared Asset Principles in clause 6.4.4.

Clause 6.4.4 does not simply contemplate sharing revenues once they have been earned. It seeks to encourage the efficient utilisation of customer-funded infrastructure to create additional value, while preserving their primary network function and providing a mechanism for electricity customers to share in that value.

This distinction **fundamentally changes the question before the review.**

If the objective of the Shared Asset principles were simply to maximise the proportion of revenue returned to electricity customers, the assessment would focus primarily on sharing ratios and materiality thresholds – and other mechanisms for distributing additional revenue.

However, clause 6.4.4 is directed toward a broader objective. It encourages businesses to identify efficient opportunities to create additional value from customer-funded infrastructure while providing for electricity customers to share in that value.

The SAG should therefore be assessed against two complementary objectives.

1. Does it encourage efficient investment and efficient utilisation of customer-funded assets?
2. Does it return an appropriate share of the resulting value to the electricity customers who funded those assets?

Neither objective, in isolation, is sufficient.

A framework that maximises the proportion of revenue shared while discouraging businesses from creating that revenue may ultimately leave electricity customers worse off than a framework that encourages substantially greater customer value creation while sharing a smaller proportion of that value. Equally, a framework that encourages value creation but returns little of that value to customers would fail to give practical effect to the Shared Asset Principles or promote the long-term interests of electricity consumers.

The objective is therefore neither to maximise DNSP returns nor to maximise the customer sharing percentage in isolation. **It is to maximise the lifetime value created and returned to electricity customers from the infrastructure they have funded.**

## ASSESSMENT

### Investment Decisions Create Customer Value

Once viewed through this lens, the greatest opportunity presented by clause 6.4.4 lies not in the sharing of revenues after investment has occurred, but in influencing investment decisions before those assets are constructed. Revenue can only be shared if value is first created.

Every investment in regulated infrastructure involves choices about the technology selected, the capabilities incorporated within that asset, and the opportunities it may create throughout its operational life. Those decisions determine whether customer-funded infrastructure is capable of supporting additional services that generate enduring customer value alongside its primary network function.

This changes the nature of the regulatory question.

It is no longer simply:

*"What proportion of revenue should customers receive?"*

It becomes:

*"**How should the regulatory framework encourage the greatest amount of efficient value to be created and returned to electricity customers over the life of customer-funded infrastructure?"***

That is fundamentally an investment optimisation problem rather than simply a revenue allocation problem.

### Better Investment Decisions Produce Better Customer Outcomes

This has an important practical implication. Where two prudent and efficient investment options are capable of meeting an identified network need at broadly comparable cost, the regulatory framework should encourage consideration of the option capable of generating greater long-term value for electricity customers over the life of the asset.

This is not an argument for speculative investment, nor does it diminish the primacy of the regulated network function. Rather, it recognises that where different technologies satisfy the same network requirement, electricity customers are likely to be better served by selecting the asset capable of supporting efficient additional uses over time. Clause 6.4.4 is directed precisely toward encouraging those opportunities.

### Investment Requires More Than Opportunity

Recognising commercial opportunities alone does not create customer value. Those opportunities must also be capable of attracting efficient investment.

A regulatory framework may permit shared use in principle while discouraging investment in the infrastructure capable of supporting that shared use. For example, where additional capability must be funded almost entirely through uncertain future commercial revenues, while only a limited proportion of those revenues may ultimately be retained, the commercially rational decision may be not to make the additional investment at all.

Where that happens, the opportunity exists in principle but not in practice, where:

- No investment occurs
- No additional value is created
- No additional return becomes available to electricity customers.

The effectiveness of the SAG should not be assessed solely by reference to the revenues ultimately shared. It should also be assessed by whether the broader regulatory framework encourages efficient investment capable of creating those revenues in the first place.

## Different Assets Optimise Customer Value Differently

This also explains why a single optimisation setting is unlikely to produce efficient outcomes across every class of shared asset, noting that different assets exhibit different economic characteristics. They involve different investment risks, financing requirements, commercial opportunities and operational flexibility.

Where some assets may create relatively little additional value regardless of the sharing ratio adopted, others may generate substantial customer value over several decades through multiple complementary uses. The economically efficient outcome is therefore unlikely to be achieved through identical regulatory settings for fundamentally different asset classes.

Instead, the framework should be capable of recognising those differences where doing so better promotes the efficient creation of customer value while remaining consistent with clause 6.4.4 and the National Electricity Objective.

## Financeability Matters

Emerging technologies illustrate why this issue is becoming increasingly important with network batteries providing a useful example.

A battery may simultaneously provide regulated network services while supporting resilience, system support, orchestration, the capacity to deliver ancillary services and other commercial opportunities throughout its operational life.

Under current arrangements, only the portion justified by regulated network benefits may generally be attributed to the regulated asset base, with the remaining investment relying upon grants, shareholder capital or future commercial revenues. This creates a financing constraint.

Projects capable of producing substantial long-term customer value may not proceed because the commercial component cannot be financed on efficient terms, even where the combined regulated and commercial benefits would justify the investment.

The question is therefore not simply how future revenues should be shared. It is whether the framework provides an efficient pathway for those investments to occur.

This also raises a broader optimisation question.

For some classes of assets, a greater regulated contribution combined with stronger customer sharing of resulting commercial revenues may ultimately produce superior long-term customer outcomes than a framework relying upon lower regulated investment and more limited opportunities for value creation.

Whether particular combinations represent the optimal outcome is ultimately an empirical question rather than a predetermined conclusion.  The important point is that the framework should be capable of identifying and encouraging those outcomes where they exist.

## APPLYING AN INTEGRATED REGULATORY FRAMEWORK

None of these outcomes are determined by the SAG in isolation. Investment decisions are influenced collectively by service classification, ring-fencing, cost allocation, revenue determination and the SAG itself.

Each instrument performs a different regulatory function.  Together they influence capital allocation, investment incentives, asset capability and ultimately the lifetime value generated for electricity customers. The relevant optimisation task is therefore not the performance of any individual regulatory instrument but the performance of the regulatory framework as a whole.

Viewed through this integrated framework, the issues raised by the review can be assessed more consistently against the policy objective expressed in clause 6.4.4. That requires more than considering how existing revenues should be classified or shared. It requires consideration of how alternative regulatory settings influence the creation of customer value over the life of customer-funded infrastructure.

Accordingly, where changes to service classification, ring-fencing or the SAG are proposed, the relevant sequence of questions may be:

- Does the proposed change preserve the primary network function of the asset?
- Does it continue to encourage efficient shared use consistent with clause 6.4.4?
- Does it strengthen or weaken incentives to invest in infrastructure capable of supporting future shared use?
- Who is the primary beneficiary of the proposed regulatory change?
- Does the framework, taken as a whole, improve the long-term interests of electricity consumers?

The interaction between service classification and the SAG provides a useful illustration of why the broader regulatory framework must be assessed as an integrated system. Where an activity currently generating shared asset revenue is brought within regulated service classification, the immediate consequences may appear beneficial, where:

- Third-party users may receive regulated prices or additional regulatory protections
- The AER may obtain greater regulatory oversight
- Administrative transparency may improve.

These are all legitimate regulatory objectives. However, they do not necessarily demonstrate that electricity consumers are better off.

The relevant comparison is not between regulated and unregulated treatment in the abstract. It is between the long-term customer outcomes produced by alternative regulatory frameworks.

For example, classification as an Alternative Control Service may reduce prices paid by third-party users while simultaneously reducing the financial incentives to develop new shared-use opportunities where regulated prices do not adequately support the additional investment, capability or commercial risk required to create those opportunities.

The framework has not prohibited shared use, it has simply made some shared-use opportunities less attractive to pursue. Over time, that may result in fewer commercial arrangements, lower shared-asset revenues and ultimately less value being returned to electricity consumers through the SAG – if it is operational at all under regulated service delivery.

This illustrates why the identity of the primary beneficiary remains an important consideration. Applying the Beneficiary Alignment principle established earlier, the immediate beneficiary of lower regulated prices is generally the commercial user purchasing the service. Whether those benefits are subsequently passed through to electricity consumers depends upon the competitive conditions within downstream markets and should not simply be assumed. By contrast, customer returns delivered through the SAG are intended to flow directly and transparently to electricity consumers through the regulatory determination.

The relevant regulatory question is therefore not simply whether a proposed regulatory change benefits someone. It is whether the principal beneficiaries remain aligned with the governing objective or whether there is persuasive evidence that benefits initially accruing to another party will ultimately produce superior long-term outcomes for electricity consumers.

Viewed in this way, each regulatory instrument performs a distinct function within the broader framework. Their individual roles can be summarised as follows:

| REGULATORY INSTRUMENT | PRIMARY FUNCTION |
|---|---|
| Service Classification | Determines regulatory treatment |
| Ring-fencing | Protects competition |
| Cost Allocation | Protects consumers from inappropriate cost recovery |
| Shared Asset Guideline | Determines how consumers participate in value created through efficient shared use |

Each instrument performs a distinct function. None should be optimised in isolation.

The relevant question is whether their combined operation continues to encourage efficient investment, efficient shared use and the creation of long-term customer value consistent with clause 6.4.4 and the National Electricity Objective.

Viewed collectively, the review is not simply an opportunity to refine how existing revenues are shared. It is an opportunity to ensure the broader regulatory framework continues to encourage the efficient creation, utilisation and sharing of customer value in the manner contemplated by clause 6.4.4.

## PATH FORWARD

The discussion throughout this section begins with a simple proposition. Clause 6.4.4 is directed toward encouraging the efficient use of customer-funded infrastructure to create additional value for electricity consumers while preserving the primary network purpose of those assets. The SAG gives practical effect to that objective, but only as one element of the framework.

The review presents an opportunity to consider the SAG as more than a mechanism for determining how existing shared-asset revenues should be allocated.

It presents an opportunity to consider how the framework gives practical effect to the policy objective expressed in clause 6.4.4 by encouraging the efficient creation, utilisation and sharing of customer value from infrastructure funded by electricity consumers.

Essential Energy is not suggesting that the review should adopt any particular sharing ratio, materiality threshold or predetermined regulatory setting. Those matters are properly matters for the AER, informed by evidence, stakeholder consultation and the empirical assessment of how different regulatory settings influence long-term customer outcomes.

The broader opportunity presented by this review is to ensure that those settings are considered within the context of the overall regulatory objective they are intended to achieve. Viewed in this way, the relevant question is not simply whether existing sharing arrangements should be increased, reduced or otherwise modified.

It is whether the interaction between service classification, ring-fencing, cost allocation and the SAG encourages the efficient creation of customer value and returns an appropriate share of that value to electricity consumers in the manner contemplated by clause 6.4.4.

This broader perspective may ultimately support the existing arrangements.

It may equally support different sharing ratios, materiality thresholds or alternative regulatory settings for different classes of shared assets. The important point is that these should emerge from an assessment of the overall performance of the regulatory framework rather than from consideration of individual mechanisms in isolation.

Accordingly, the AER may wish to consider:

1. Whether the current framework, taken as a whole, continues to give effective practical effect to the policy objective expressed in clause 6.4.4 of the National Electricity Rules.
2. Whether the interaction between service classification, ring-fencing, cost allocation and the SAG encourages efficient investment, efficient shared use and the creation of long-term customer value.
3. Whether different classes of shared assets exhibit sufficiently different economic characteristics to warrant different optimisation settings, informed by empirical evidence rather than the application of uniform regulatory parameters.
4. Whether future refinements should assess proposed regulatory changes according to their effect on whole-of-system customer outcomes, rather than the performance of individual regulatory instruments considered in isolation.
5. Whether the framework, taken as a whole, maximises the lifetime value created and returned to electricity consumers from customer-funded infrastructure, consistent with the National Electricity Objective and the policy intent of clause 6.4.4.

Ultimately, the objective of the review is not to optimise the operation of the SAG in isolation. It is to ensure that the broader regulatory framework continues to encourage the efficient creation, utilisation and sharing of customer value from customer-funded infrastructure in a manner that promotes the long-term interests of electricity consumers.

## Supporting Consistent Regulatory Decision Making

This review extends beyond resolving the specific issues identified in the consultation paper. As the electricity sector continues to evolve, new technologies, business models and forms of asset utilisation will continue to emerge. While the circumstances may change, the regulatory challenge remains the same: ensuring that decisions continue to promote the long-term interests of electricity consumers in accordance with the NEO.

The purpose of this submission has therefore been not only to address the individual matters raised in this review, but also to demonstrate a structured approach to regulatory assessment that can be applied consistently as new issues arise. By anchoring regulatory decisions to statutory objectives, clearly defined regulatory functions and evidence-based assessment, the AER can maintain a framework that remains both adaptable and durable over time.

### PRINCIPLES FOR FUTURE REGULATORY DECISIONS

The pace of technological and market change means it is neither practical nor desirable for regulatory instruments to anticipate every future circumstance. Attempts to prescribe detailed regulatory outcomes for every emerging technology or business model are unlikely to remain effective over time and risk creating unnecessary complexity, regulatory inconsistency and unintended consequences.

Instead, future reviews should continue to be guided by enduring statutory principles rather than the characteristics of any particular technology or commercial arrangement. The NEO already provides the overarching purpose for regulatory decision making. The role of the regulatory framework is to ensure that each regulatory instrument continues to perform its intended function in support of that objective.

Throughout this submission, Essential Energy has sought to demonstrate that the most robust regulatory outcomes are achieved when regulatory responses are proportionate to the problem being addressed, evidence supports intervention, and each regulatory instrument is used for the purpose for which it was designed.

### QUESTIONS THAT SUPPORT CONSISTENT DECISION MAKING

As new issues emerge, a consistent assessment process is likely to produce more predictable and transparent regulatory outcomes than one driven by the characteristics of individual technologies or stakeholder interests. In practical terms, future reviews may be assisted by considering questions such as:

- Is the proposed regulatory response consistent with the NEO?
- What customer outcome is the proposed intervention intended to protect or promote?
- Has a genuine regulatory concern been identified and supported by evidence?
- Which regulatory instrument is best placed to address that concern?
- Is the proposed regulatory response proportionate to the identified risk?
- Does the proposed approach preserve efficient investment, efficient competition and opportunities to create and share customer value?

These questions do not predetermine regulatory outcomes. Rather, they provide a consistent framework through which different issues can be assessed while remaining aligned with the statutory objectives established by the National Electricity Law and National Electricity Rules.

### BENEFITS OF A CONSISTENT REGULATORY APPROACH

Applying a consistent assessment approach across future reviews would provide benefits for both regulators and industry participants. It would improve regulatory certainty, reduce unnecessary complexity, encourage efficient investment and innovation, and strengthen confidence that regulatory decisions remain focused on consumer outcomes rather than the optimisation of individual regulatory instruments.

Importantly, such an approach also reinforces the complementary nature of the regulatory framework. Ring-fencing, service classification, cost allocation and shared asset arrangements each perform distinct regulatory functions. Their effectiveness is maximised when each instrument addresses the issue for which it was intended, rather than being used to compensate for perceived limitations elsewhere in the framework.

A disciplined approach to regulatory assessment also supports better regulatory adaptation over time. As technologies and market structures evolve, individual regulatory responses may change, but the underlying principles guiding those decisions should remain consistent. This promotes greater confidence that future reforms will continue to be assessed objectively, proportionately and in accordance with the long-term interests of electricity consumers.

### CONCLUDING REMARKS

The objective of this review should be to reinforce a regulatory framework capable of responding consistently to future technologies, business models and market developments while remaining firmly anchored to its statutory purpose. Such a framework should not attempt to prescribe the regulatory outcome for every future circumstance.

As this submission has sought to demonstrate, the long-term interests of electricity consumers are best served when each regulatory instrument performs the function for which it was designed, and when regulatory intervention is directed to the source of the concern rather than its symptoms. A framework built on those principles provides the greatest opportunity to support efficient investment, effective competition where appropriate, and the continued creation and sharing of customer value.

Ultimately, the most effective regulatory framework is not one that attempts to anticipate every future question. It is one that asks the right questions, applies the right regulatory tools, and consistently delivers outcomes that advance the long-term interests of electricity consumers.

Ultimately, the most effective regulatory framework is not one that attempts to anticipate every future question. It is one that asks the right questions, applies the right regulatory tools, and consistently advances the long-term interests of electricity consumers. Technologies and business models will continue to evolve. The enduring strength of the regulatory framework will depend not on predicting those changes, but on applying consistent statutory principles whenever they arise.