

Consultation Paper

Options to address gaps in transmission ring-fencing framework

May 2023

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AER reference: 15088458

Shortened forms

Shortened Form	Extended Form
ACCC	Australian Competition and Consumer Commission
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AEC	Australian Energy Council
AEO	Australian Energy Operations
AER	Australian Energy Regulator
AusNet	AusNet Transmission Group Pty Ltd
CitiPower	CitiPower, Powercor and United Energy (joint submissions)
DCA	Dedicated Connection Asset
DNA	Designated Network Asset
DNSP	Distribution Network Service Provider
ENA	Energy Networks Australia
guideline	Ring-fencing guideline – Electricity Transmission (Version 4), March 2023
IUSA	Identified User Shared Asset
NEM	National Electricity Market
NEO	National Electricity Objective
NER or the rules	National Electricity Rules
NSW DNSPs	Ausgrid, Endeavour Energy, Essential Energy (joint submissions)
RESP	related electricity service provider
REZ	Renewable Energy Zone(s)
TNSP	Transmission Network Service Provider

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Request for submissions

Interested parties are invited to make written submissions to the Australian Energy Regulator (AER) regarding this consultation paper by close of business, **9 June 2023**.

Submissions should be sent electronically to AERringfencing@ aer.gov.au.

Alternatively, submissions can be mailed to:

General Manager, Strategic Policy and Energy Systems Innovation
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

The AER prefers that all submissions be publicly available to facilitate an informed and transparent consultative process. Submissions will be treated as public documents unless otherwise requested.

Parties wishing to submit confidential information are requested to:

- Clearly identify the information that is the subject of the confidentiality claim; and
- Provide a non-confidential version of the submission in a form suitable for publication.

All non-confidential submissions will be placed on the AER's website at www.aer.gov.au.

For further information regarding the AER's use and disclosure of information provided to it, see the ACCC/AER Information Policy, June 2014 available on the AER's website.

Enquiries about this paper, our transmission ring-fencing guideline, or about lodging submissions, should be directed to the Strategic Policy and Energy Systems Innovation branch of the AER on 1300 585 165 or AERringfencing@ aer.gov.au.

Survey

The AER is also conducting a survey of market participants (those who have connected or in the process of connecting to the transmission network) to identify any actual or potential discrimination by TNSPs during the connections process. The survey will help the AER's assessment of the materiality of the problem and inform next steps.

Survey respondents have the option to remain anonymous, but the AER may use de-identified aggregated information from the survey to inform any possible rule change request.

The survey can be accessed [here](#) and closes on **9 June 2023**. Alternatively, connecting parties can discuss their survey responses with AER staff by emailing AERringfencing@ aer.gov.au to set up a meeting.

Executive summary

On 1 March 2023, the Australian Energy Regulator (AER) published its [Electricity Transmission Ring-fencing Guideline \(Version 4\)](#) (guideline) following a substantive review of the transmission ring-fencing arrangements. During the course of the review, some stakeholders raised concerns about the ability of electricity transmission network service providers (TNSPs) to discriminate against competitors in providing contestable connection services due to their monopoly role in providing the non-contestable elements of a connection. In particular, we heard concerns about potential harm occurring in two instances:

1. In generator connections, where a connecting party is seeking both contestable and non-contestable connection services and the TNSP discriminates in favour of generators completing all services with the TNSP (including with its related affiliates).
2. In distribution network connections, where an electricity distribution network service provider (DNSP) receives a connection application which requires upstream augmentation works on the shared transmission network, then the TNSP uses the information about the new potential connection to its advantage.

The AER was not able to consider this issue in the context of our review of the ring-fencing guideline because the National Electricity Rules (NER) limit the scope of ring-fencing to separating prescribed transmission services from other services provided by TNSPs. The NER does not allow for ring-fencing of negotiated transmission services, the most common of which is the non-contestable component of connections.

The purpose of this consultation paper is to explore whether changes to the NER are required to limit any ability of TNSPs to discriminate in favour of themselves or an affiliate when providing connection services and, if so, seek feedback from stakeholders on options to address this. Even the potential ability of TNSPs to discriminate can cause harm by dampening competition in the market for contestable services. This arises where potential competitors consider they are not able to compete on an equal footing with TNSPs. Where any restraint from competition is not credible, TNSPs can potentially increase costs, delay services, or otherwise behave in a way that is harmful to the market.

Ring-fencing is typically used to address concerns about discriminatory behaviour by requiring greater transparency, imposing information access and disclosure obligations and potentially requiring separation of the contestable and non-contestable components of a TNSP's services. Ring-fencing can also address concerns about cross-subsidisation. However, we consider that cross-subsidisation is already addressed via TNSPs' Cost Allocation Methodologies and so the focus of this paper is on the potential for discrimination.

This consultation paper seeks stakeholder views on the following key issues:

- The materiality of the potential for TNSPs to use their monopoly power with respect to negotiated transmission services, namely the non-contestable elements of a connection, to influence outcomes in the market for the contestable elements of a connection.
- Evidence of TNSPs using their monopoly power to discriminate in favour of themselves or an affiliate in providing contestable connections services.

Additionally, we are seeking stakeholder feedback on the following options to address the issues detailed above if they are found to be material:

1. Option 1: Introduce compliance reporting requirements within Chapter 5 of the NER to improve transparency in how TNSPs are meeting existing obligations embedded within the connections framework in the NER.
2. Option 2: Expand the ring-fencing framework in clause 6A.21.2(a) of the NER to include the ability to ring-fence negotiated transmission services, in addition to prescribed transmission services. This would provide the kind of reporting and compliance requirements sought by Option 1, but would also provide the AER with additional ring-fencing tools to directly address discriminatory behaviour.

In consulting on and potentially pursuing these rule changes, the AER notes that it does not require evidence that TNSPs have engaged in discriminatory conduct. Rather, it is sufficient for the AER to have concerns that in the absence of regulatory changes there is the potential for that conduct to occur and damage competition.

Neither option is intended to change the commercial negotiation of connection services. Rather, they are intended to provide greater transparency and accountability for TNSPs in how they engage in the negotiation process to provide greater confidence that TNSPs are not discriminating in favour of themselves or an affiliated entity.

We consider that both options could reduce the potential for discrimination to occur and so potentially improve competition in the transmission connections market. In doing so, the options could contribute to the achievement of the National Electricity Objective (NEO) by promoting:

- Efficient investment in, and operation of, transmission infrastructure with respect to connection services by providing greater transparency and reducing the potential for TNSPs to discriminate in the provision of connection services. This should improve contestability in connection services and so reduce costs and improve services.
- Reduced costs for generator connections, which should benefit customers where these lower costs are passed on to customers in the form of lower wholesale prices.
- Supporting reliability in the supply of electricity by increasing efficiency in generator connections to the transmission network, helping to ensure sufficient generation is installed quickly as aging coal-fired generators retire and the industry transitions towards net zero emissions.
- As a result of the above, promotion of the achievement of emissions reduction targets by facilitating more efficient and cost-effective connection of variable renewable energy sources and dispatchable firming capacity to the transmission network.

While Option 1 would seek to achieve these outcomes through increased transparency measures, Option 2 would more directly address the potential for discriminatory behaviour via ring-fencing tools.

Improving outcomes in the market for transmission connections is particularly important in the context of the energy transition. Significant investment in new transmission is already underway, and the Australian Energy Market Operator estimates over 125 GW of additional variable renewable energy will be connected by 2050 (including 48 GW by 2030). If there is insufficient competition in the market for connecting this new generation, this has the

potential to impact on the costs of connections and ultimately on consumers and the cost of the transition.

Next steps

We invite feedback from interested parties in response to the issues raised in this consultation paper by **9 June 2023**. This feedback will inform the AER's thinking on whether changes to the NER are required to strengthen non-discrimination requirements on TNSPs in providing connection services and, if so, what these changes should look like. Indicative timing is as follows.

Indicative date	Project milestone
12 May 2023	AER publishes consultation paper
9 June 2023	Submissions close
Late July	Communication to interested stakeholders about next steps

The rule change process, and subsequent implementation of a new rule, can be a lengthy process. If this consultation process demonstrates that discriminatory behaviour – or the potential for discriminatory behaviour – by TNSPs is already a material issue, we will also consider what action we can take under the AER's existing powers and functions.

1 Background and introduction

This paper follows the release of the latest transmission ring-fencing guideline on 1 March 2023.¹ During our consultation on this guideline, we received feedback from stakeholders that there is a potential for TNSPs to discriminate against competitors when providing contestable connection services. This consultation paper explores whether there is any ability for, or evidence of, TNSPs discriminating in favour of themselves or an affiliate in providing connection services and potential options to address any concerns. We invite stakeholders to provide feedback on whether changes are needed to the transmission ring-fencing framework and what those changes might be.

This section is structured as follows:

- Section 1.1 provides a summary of the purpose of ring-fencing and the harms it seeks to prevent
- Section 1.2 explains key concepts about the types of services that TNSPs provide and which services are subject to ring-fencing
- Section 1.3 explains key concepts about the types of connection services, how they are regulated, and how this translates to specific connection assets
- Section 1.4 sets out recent and potential future changes to the nature of transmission connections
- Section 1.5 considers the future role of ring-fencing in light of the changes set out in section 1.4.

1.1 What is ring-fencing?

Electricity transmission network service providers (TNSPs) are subject to ring-fencing requirements under the AER's Electricity Transmission Ring-fencing Guideline (Version 4) (guideline). Ring-fencing is a regulatory framework that involves the separation of business activities, costs, revenues, and decision-making for delivering regulated (monopoly) network services, from the delivery of other, unregulated services that are subject to competition.

In the context of electricity transmission, ring-fencing refers to the separation of prescribed transmission services provided by a TNSP (e.g., the installation, operation and maintenance of high voltage towers, poles, conductors and associated switching and protective equipment), from the provision of contestable services (such as electricity generation or retail services or the provision of connection services such as high voltage towers). The objective of ring-fencing is to provide a regulatory framework that promotes competitive markets, generally by seeking to ensure a level playing field for service providers in markets for contestable services while promoting the long-term interests of consumers.

There are two key harms that ring-fencing currently seeks to prevent:

- **Cross-subsidisation.** This can occur where a TNSP uses revenue that it earns from providing prescribed transmission services to subsidise its activities in other, contestable markets.

¹ AER, [Electricity Transmission Ring-fencing Guideline \(Version 4\)](#), 1 March 2023.

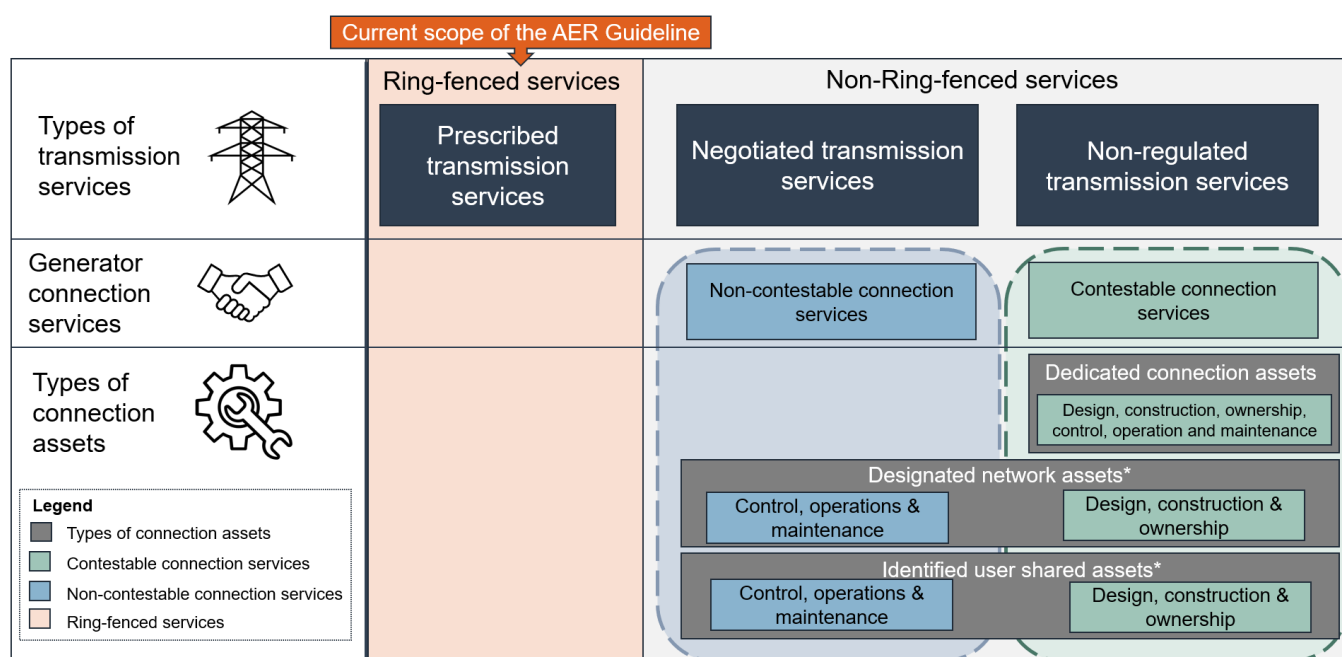
- **Discrimination.** This can occur where a TNSP is able to favour itself or an affiliated entity, or discriminates against a competitor, as a result of providing a monopoly service.

Both cross-subsidisation and discrimination can have the effect of undermining or damaging competition and innovation in related contestable markets. In addition, cross-subsidisation can result in consumers paying more than they should for regulated transmission services.

TNSPs are subject to ring-fencing requirements under Chapter 6A of the NER. These rules require the AER to develop ring-fencing guidelines for the accounting and functional separation of TNSPs' prescribed transmission services from other services provided by the TNSP. Ring-fencing is an essential tool for levelling the playing field between TNSPs and third-party providers, helping them compete on an equal footing.

1.2 Current transmission ring-fencing framework

The below diagram provides a summary of the relationships between categories of transmission services, types of connection services and types of connection assets, and highlights the elements that are captured by the existing Guideline. Each of these concepts is explained further in sections 1.2.1, 1.2.2 and 1.3.



* There are some instances where the primary TNSP must provide detailed design, construction and ownership of identified user shared assets and designated network assets as non-contestable transmission services.

1.2.1 Categories of transmission services

There are three categories of transmission services under the NER:

- **Prescribed transmission services.** These consist of shared network services to load customers and connection services provided to other network service providers. They explicitly do not include negotiated transmission services. A TNSP's costs to provide prescribed transmission services are recovered from all transmission network users, with the revenue that a TNSP can recover for these services regulated by the AER in revenue determinations.

- **Negotiated transmission services.** These services consist of shared network services that exceed network performance requirements (whether as to quality or quantity); connection services provided to transmission network users (including generators) at a single transmission network connection point; other services specified as negotiated transmission services under clause 5.2A.4 of the NER; and undertaking system strength connection works. Unlike prescribed transmission services, the AER does not regulate the revenue a TNSP earns for providing negotiated transmission services. Rather, individual network users who need these services pay for them. The terms and conditions, including price, for these services are negotiated between the TNSP and the party who wishes to receive them under the framework set out in Chapter 5 of the NER.
- **Non-regulated transmission services.** These are all transmission services that are neither prescribed nor negotiated transmission services and are not subject to any form of economic regulation under the NER. Non-regulated transmission services are contestable, meaning they can be provided by any party.

Prescribed transmission services and negotiated transmission services can only be provided by the incumbent TNSP, whereas non-regulated transmissions services can potentially be provided by a third party.

1.2.2 Scope of the transmission ring-fencing guideline

The transmission ring-fencing framework is set out in Chapter 6A of the NER. Clause 6A.21.2 of the NER provides for the AER's development of transmission ring-fencing guidelines as follows:

- (a) Transmission ring-fencing guidelines must be developed by the AER in consultation with each *participating jurisdiction* for the accounting and functional separation of the provision of *prescribed transmission services* by *Transmission Network Service Providers* from the provision of other services by *Transmission Network Service Providers* (the *Transmission Ring-Fencing Guidelines*).

The consequence of the wording of clause 6A.21.2(a) is that the AER cannot require accounting or functional separation of negotiated transmission services from non-contestable transmission services. In turn, this means that the AER cannot require separation of the non-contestable components of a transmission connection from the contestable components of transmission connections provided by a TNSP. This is despite the fact that the non-contestable components of a transmission connection are provided on an exclusive basis by the incumbent TNSP in accordance with Chapter 5 of the NER.

In principle, all services that are provided on an exclusive basis by a single entity, should be covered by the ring-fencing framework, where there is a risk of cross-subsidisation or discriminatory behaviour. However, since negotiated transmission services are not currently covered by the ring-fencing framework, a rule change would be required to ring-fence these services. The benefits of any change to the rules will need to outweigh the costs.

In practice, we understand that the negotiated transmission services where exercise of monopoly power may be occurring relates to the non-contestable components of

transmission connection services provided to connecting parties.² Therefore, this paper focuses on issues with respect to connection services. However, we note that there may be other negotiated transmission services provided by incumbent TNSPs where issues may be arising and we would welcome feedback and evidence on these matters.

Question: Are there any other negotiated transmission services other than non-contestable connection services where a TNSP could potentially discriminate in favour of itself or an affiliate in providing those services?

1.3 Contestability in the transmission connections market

The framework for connecting to the transmission network was substantially reformed in 2017,³ in part to clarify the elements of a connection that could be provided contestably. The amendments took effect on 1 July 2018. The framework does not apply in Victoria, which is subject to its own contestability regime (see further below).

In summary, connection services outside of Victoria are a mix of contestable and non-contestable services, depending on the assets being installed and the services provided. Non-contestable services must be provided by the Primary TNSP as a negotiated transmissions service, and the Primary TNSP is also permitted to offer contestable services.

Under the framework introduced in 2018, three new types of connections were defined. Large Dedicated Connection Assets (DCA) and small DCAs were entirely contestable, meaning a party other than the Primary TNSP (the incumbent TNSP in a jurisdiction) could design, construct, operate and own the assets. The third type of asset, the Identifiable User Shared Asset (IUSA), was (and remains) partly contestable, except in certain circumstances where it must be provided in its entirety by the Primary TNSP.⁴ Where designed, built and owned by a third party, the owner of the IUSA must enter into a network operating agreement with the Primary TNSP to operate, maintain and control the IUSA.

A variety of measures were also codified in the NER to prevent TNSPs from discriminating against third party providers. This included, for example, amended information disclosure requirements, amended negotiating principles, and access to an independent engineer. In addition, the NER specifies details of the connection process, from submission of a connection enquiry through to finalisation of connection agreements.

The framework was revisited by the AEMC in 2021 to introduce more effective arrangements for allowing multiple generators to connect to large DCAs. The concept of the large DCA was replaced with the term Designated Network Assets (DNA), with different obligations and rights for connecting parties and the Primary TNSP. In terms of contestability, a DNA can be planned, built and owned by a third party but must be operated by the Primary TNSP under a

² See definition of negotiated transmission services in Chapter 10 of the NER.

³ See AEMC, *Transmission Connection and Planning Arrangements, Rule Determination*, 23 May 2017.

⁴ The Primary TNSP must provide the detailed design, construction and ownership as negotiated transmission services if the capital costs of the IUSA are expected to be \$10m or less, or if the components of the IUSA: (1) are old, require replacement of existing components, or involve the reconfiguration of existing components; and (2) will form part of the existing transmission network.

network operating agreement, similar to the IUSA.⁵ At the time, the AEMC acknowledged that this resulted in a reduction in the scope of contestability for connection services, but considered this was a necessary consequence of the revised framework.

Small DCAs, amended to just “DCAs” following the introduction of DNAs, are the only connection assets that remain fully contestable.

In Victoria, AEMO is accountable for the provision of the shared transmission network under its declared network functions. AEMO procures services from Declared Transmission System Operators (DTSOs) that own and operate the shared network assets. AEMO is responsible for ensuring that all new connections meet the necessary requirements. However, the connecting party is able to choose the party that provides the assets associated with the connection.

The AEMC has summarised the transmission connections process in Victoria as follows:⁶

- If a connection requires an augmentation to the declared shared network, e.g. the construction of a new substation, AEMO will determine whether the augmentation is contestable, non-contestable, or some combination of both.⁷
- If AEMO determines that the augmentation is contestable, then the connection applicant can either:
 - nominate a DTSO of its choice to build, own and operate the contestable assets (essentially it would conduct a private tender to determine who it wishes to appoint to provide these services), or
 - ask AEMO to select the DTSO, with AEMO running a competitive tender process to select the most appropriate party.
- If AEMO determines that an augmentation is not contestable, the services will be provided by the incumbent DTSO, e.g. AusNet Services. Typically, these are the interface works because they are considered 'not separable' from the incumbent's network.

1.4 Changes to the nature of transmission connections

The nature of transmission connections has evolved significantly over the past decade. Key contributing factors include:

- Regulatory changes to promote contestability
- The development of Renewable Energy Zones (REZs)
- The entry of new players seeking to connect smaller generation systems to the transmission network
- The transition from fossil fuel based generation to renewable generation driving an increase in connections activity.

⁵ Consistent with the IUSA, there are some circumstances under which all elements of the DNA must be provided by the Primary TNSP.

⁶ AEMC, *Connection to dedicated connection assets, Rule Determination*, 8 July 2021, pp. 23-24.

⁷ An augmentation is contestable if its capital cost is reasonably expected to exceed \$10 million and it is capable of providing a distinct service as defined in clause 8.11.6(a) of the NER.

This section outlines the impact that each of these factors has had, and will continue to have, on the transmission connections market.

1.4.1 Development of Renewable Energy Zones (REZs)

REZs are being developed in New South Wales, Victoria, Queensland and Tasmania, with the NSW framework most progressed.⁸ The purpose of REZs is to cluster new wind and solar projects in renewable hubs so that transmission investment can be made efficiently – in terms of time and cost.

The NSW Government is developing access schemes for its REZs to facilitate the connection of generation and storage projects to the network. These access schemes include REZ access standards and processes that are designed to create a streamlined connection process for projects that will improve connection timeframes, provide greater certainty and reduce re-work and costs compared to the open-access connection process.⁹ The access schemes will also provide for the competitive provision of transmission connection services through REZs. For example, the NSW Central-West Orana REZ access scheme proposed disapplying the DNA framework under the NER so that all connection assets are DCAs.¹⁰ Therefore there is potential for the connections process (including the construction of the connections assets) for this REZ to be contestable. As REZs continue to be developed across NEM jurisdictions, there may be increasing opportunities for third parties to provide connection services within these REZs.

1.4.2 New players connecting to the network

When the NER was developed, parties seeking connection to the transmission network were typically large, incumbent generators. However, the number of players in the generation market has increased. Over the last decade we have seen new entrants, including smaller players, seeking to connect that are less familiar with the regulatory framework. They are also connecting smaller generating systems. As a consequence, these parties may have less bargaining power than the parties historically seeking connection.

1.4.3 Energy transition from fossil fuels to renewables

There is significant investment required over coming years to connect sufficient new renewable generation as fossil fuel generators retire. It is critical that this be done quickly and at low cost. Approximately 52 renewable power projects are either committed or being commissioned at present, while over 500 projects have been publicly announced.¹¹ TNSPs will play a critical role in facilitating these connections in their role as the monopoly operator of the transmission network.

⁸ For a discussion of REZs, see AER, State of the Energy Market Report, 2021, p 58.

⁹ See EnergyCo, Access schemes: <https://www.energyco.nsw.gov.au/industry/access-schemes#:~:text=The%20CWO%20REZ%20Access%20Scheme%20Declaration%20sets%20out%20how%20generation,the%20CWO%20REZ%20Access%20Scheme>.

¹⁰ <https://www.energy.nsw.gov.au/sites/default/files/2022-08/cwo-rez-access-rights-and-scheme-design-positions-paper-220336.pdf>

¹¹ See AEMO, NEM Generation information, January 2023. 'Renewables' in this regard includes solar and wind farms, hydro power stations, and batteries

Historically, there have been relatively few connections each year. To reach the amount of generation anticipated under the Australian Energy Market Operator's (AEMO) Integrated System Plan, there will need to be a step change in the number of connections.

1.5 The future role of ring-fencing in protecting competition

Considering the external factors outlined in this section, there are increasing opportunities for contestability in the transmission connections market. However, without the ability to ring-fence negotiated transmission services, there may be potential for TNSPs to use their monopoly power in the provision of these services to discriminate in favour themselves or an affiliate and so hinder the competitiveness of the contestable connections market.

The market for contestable transmission connections is still nascent and should be supported where possible. The development and implementation of each generation project may cost several hundred million dollars to complete. Each project is likely to require a new connection the cost of which is likely to be approximately 10% of the overall project cost.¹² If TNSPs are acting in a manner which undermines customers procuring third party providers to deliver contestable works, this would negatively impact the cost of connections, increasing the cost of the energy transition. In this instance, there may be benefits from strengthening the ring-fencing framework. This, in turn, would improve competition and so drive down the cost of connections. These benefits would be passed through to consumers via lower wholesale prices.

The AER would like to hear from stakeholders as to whether additional regulatory protections are required to protect and encourage competition in the transmission connections market and, if so, whether the options outlined in this paper are appropriate.

The remainder of this consultation paper sets out:

- the nature and scope of the problem, including the evidence provided to date on whether TNSPs are able to exercise market power and discriminate when providing connection services,
- potential options for improving regulatory oversight of negotiated transmission services,
- how the potential options would enhance the National Electricity Objectives (NEO), and
- the benefits, costs and impacts on stakeholders of the potential options.

¹² See AEMC, Transmission connection and planning arrangements, Rule determination, 23 May 2017, Sydney, p ii.

2 Nature and scope of the problem

This section considers the nature and scope of the issues identified by stakeholders during the recent transmission ring-fencing review in relation to the potential ability of TNSPs to discriminate in favour of themselves or an affiliate when providing connection services. As noted above, the non-contestable elements of connection services are classified as negotiated transmission services and therefore do not fall within the current ring-fencing framework, despite being provided on a monopoly basis.

The section is set out as follows:

- Section 2.1 sets out the concerns raised by some stakeholders about the ability of TNSPs to discriminate when providing connection services, which those stakeholders considered could be addressed via ring-fencing
- Section 2.2 sets out the factors identified by TNSPs that could mitigate against any ability they have to discriminate when providing connection services.
- Section 2.3 sets out the available evidence of third party competition in providing contestable connection services
- Section 2.4 identifies some areas that could potentially be strengthened in the framework for preventing discrimination by TNSPs.

This section focuses on the harms associated with the potential for TNSPs to discriminate in favour of themselves or a related entity when providing connection services. Ring-fencing can also address concerns about cross-subsidisation between different services. The existing Guideline, combined with requirements on TNSPs to allocate costs in accordance with their Cost Allocation Methodologies, limits TNSPs' abilities to inappropriately allocate costs across services. For this reason cross-subsidisation is not considered further.

2.1 Concerns raised regarding TNSP discrimination in providing connection services

Submissions during our review of the Transmission Ring-fencing Guideline raised concerns about both information sharing and the potential for TNSPs to favour themselves or an affiliate when providing contestable connections. This is as a result of TNSPs' exclusive ability to provide the non-contestable components of a transmission connection (as a negotiated transmission service), while also participating in the market for the contestable components of such connections. In particular, we heard concerns about potential harm occurring in two instances:

1. In generator connections, where a connecting party is seeking both contestable and non-contestable connection services and the TNSP discriminates in favour of generators completing all services with the TNSP (including with its related entity).
2. In distribution network connections, where an electricity distribution network service provider (DNSP) receives a connection application which requires upstream augmentation works on the shared transmission network, then the TNSP uses the information about the new potential connection to its advantage.

Australian Energy Operations (AEO) raised several concerns with the current transmission connections framework, and considered that full functional separation is required to ensure

TNSPs do not share information or otherwise favour their affiliated business. Specific concerns raised related to:¹³

- The strong commercial incentive for a TNSP to share information with a related electricity service provider to gain an advantage in contestable markets.
- The potential advantages a TNSP could afford to an affiliate in terms of the timing and cost of the “cut-in” to the shared network, or through the price, terms and conditions associated with the ongoing operation and maintenance of assets that the TNSP is required to control.
- Transparency of offers from TNSPs involving both regulated and contestable connection services.
- Staff being involved in both specifying the technical requirements of a connection and the provision of contestable transmission services.

CitiPower/Powercor/United Energy raised similar concerns to AEO, including in respect of requiring greater transparency in the breakdown of costs between regulated and contestable connection services and the need for consistency of terms and conditions including price, timeframes for delivery, quality of service and variations.¹⁴ They also supported full functional separation of staff, offices and branding and cross-promotion. They noted that “Given that negotiated transmission services are subject to monopoly provision, there is ample scope for the incumbent TNSPs to abuse their position and act in a discriminatory manner, impacting the cost and viability of connections from the distribution to transmission networks”.¹⁵

The Clean Energy Finance Corporation (CEFC) noted that, from its experience, very few renewable generation projects have appointed a competitor to the local TNSP to provide contestable grid services and that grid connection costs have increased in absolute terms in recent years.¹⁶ The CEFC also noted the importance of providing transparency, confidence, and predictability for stakeholders to efficiently connect 33 GW of large-scale wind, solar and storage by 2030.

Iberdrola supported an increased role of the AER in overseeing the delivery of negotiated transmission services, particularly in the context of connections.¹⁷ They noted the importance of ensuring the connections framework will deliver efficient and cost-effective connections in order to transition to a low carbon system.

Ausgrid, Endeavour Energy and Essential Energy (the “NSW DNSPs”) considered “similar functional separation rules are likely to be appropriate for transmission and distribution businesses”,¹⁸ particularly in respect of information security and non-discrimination rules.

¹³ See AEO, *Ring-fencing Electricity Transmission Guideline Issues Paper* submission, May 2022 and AEO, *Submission to Draft Ring-fencing Electricity Transmission Guideline (Version 4)*, 16 December 2022.

¹⁴ CitiPower/Powercor/United Energy, *Ring-fencing Electricity Transmission Guideline Issues Paper* submission, May 2022, p. 1.

¹⁵ CitiPower/Powercor/United Energy, *Submission to Draft Ring-fencing Electricity Transmission Guideline (Version 4)*, 16 December 2022, p.2.

¹⁶ CEFC, *Submission to Draft Ring-fencing Electricity Transmission Guideline (Version 4)*, 22 December 2022, pp. 2-3.

¹⁷ Iberdrola, *Submission to Draft Ring-fencing Electricity Transmission Guideline (Version 4)*, December 2022, p.2.

¹⁸ NSW DNSPs, *Ring-fencing Electricity Transmission Guideline Issues Paper* submission, May 2022, p. 3.

They were also concerned that material inconsistencies between the approaches taken for transmission and distribution would not deliver a level playing field between DNSPs and TNSPs. Areas where DNSPs and TNSPs could compete include in:¹⁹

- delivery of any transmission projects that are treated as contestable under the NER;
- participation in State-sponsored renewable energy zone (REZ) schemes; and
- in some cases, competing for connection of large customers.

Jemena was also concerned about ensuring a level playing field between TNSPs and DNSPs when competing to connect large customers.²⁰

AusNet considered that the scope for contestable transmission services outside of Victoria is “extremely limited” and that recent reforms that introduced Designated Network Assets further reduced competition.²¹ AusNet suggested that wider market reforms be considered to improve contestability outside of Victoria, rather than pursuing improvements through the ring-fencing guideline.

While most submissions referred generically to TNSPs’ ability to discriminate, some referred specifically to Victoria.

For example, Iberdrola noted that, in Victoria, the regulated TNSP has access to detailed information about its own network, as well as being involved in the joint planning of the transmission network with AEMO. Iberdrola was concerned that the regulated TNSP could share certain information with its unregulated affiliate that would not be available to independent third parties and, as a result, “exclude independent third parties from the market”.²²

CitiPower/Powercor/United Energy also raised concerns about the ability of the incumbent TNSP, or Declared Transmission System Operator (DTSO), to share information with its affiliate. They noted “Where a connection to the distribution network involves terminal station works, we inform the incumbent DTSO of the connection. The incumbent DTSO can freely pass on that information to its unregulated affiliate or, use the information themselves to offer an alternate connection to the transmission grid.”²³ Consequently, they supported stricter ring-fencing, including separation of staff and offices, to prevent information sharing.

Finally, AEO also considered that full functional separation was particularly important in Victoria, noting that it would promote competition for connections and contestable services.²⁴

¹⁹ NSW DNSPs, *Submission to Draft Ring-fencing Electricity Transmission Guideline (Version 4)*, December 2022, p. 3.

²⁰ Jemena, *Ring-fencing Electricity Transmission Guideline Issues Paper submission*, May 2022, p. 2.

²¹ AusNet, *Submission to Draft Ring-fencing Electricity Transmission Guideline (Version 4)*, 16 December 2022, pp. 1-3.

²² Iberdrola, *Ring-fencing Guideline Electricity Transmission Issues Paper, Stakeholder feedback template*, pp. 5-6.

²³ CitiPower/Powercor/United Energy, *Ring-fencing Electricity Transmission Guideline Issues Paper submission*, May 2022, p. 3.

²⁴ AEO, *Ring-fencing Electricity Transmission Guideline Issues Paper submission*, May 2022, pp. 4-5.

Questions: is there any other evidence that TNSPs are discriminating in favour of themselves or an affiliate in providing contestable connection services? Are the issues encountered by connecting parties different in Victoria versus other jurisdictions and, if so, how?

2.2 Mitigating factors identified by stakeholders

2.2.1 Jurisdictions outside of Victoria

The ENA engaged Incenta Economic Consulting (Incenta) to consider the concerns expressed by stakeholders in submissions to the Issues Paper, existing measures for contestable connections in the NER that apply to TNSPs outside of Victoria, and whether additional ring-fencing measures are required to protect competitive outcomes for contestable connections. Incenta concluded:²⁵

- The existing framework for contestable connections was designed to prevent TNSPs from using their monopoly power to harm competitive outcomes.
- There are no obvious gaps in the regulatory framework that warrant more onerous measures, such as ring-fencing.
- Submissions provided to the AER raising concerns about the competitiveness of connections lacked evidence and did not highlight gaps in the framework.

Incenta identified five key harms that could potentially eventuate from having a monopoly TNSP provide contestable connection services and describes the elements of the connections framework that it considers mitigates these harms. Incenta's summary of their analysis, with some adjustments for brevity, is set out in the table below.²⁶

Harm	Mitigating factors
TNSPs may shift costs from the provision of the contestable service to the regulated service in order to make it more price competitive in the contestable market	The allocation of costs between contestable connection services and regulated transmission services is regulated under Chapter 6A of the NER and established Cost Allocation Methodologies approved by the AER.
TNSPs may overstate the cost of maintaining connection assets that they become responsible for (i.e. identified user shared assets or dedicated network assets)	This is a negotiated transmission service that is regulated as per other negotiated transmission services. Key features of the regime include upfront negotiating obligations, principles to adhere to, transparency provisions (i.e., requirements to justify costs), and the opportunity for commercial arbitration

²⁵ Incenta Economic Consulting, *Competition issues for contestable transmission connection projects*, ENA, December 2022, p. 1.

²⁶ Incenta Economic Consulting, *Competition issues for contestable transmission connection projects*, ENA, December 2022, pp. 4-6.

	about the terms and conditions of the service (including the price).
TNSPs could define the Functional Specification in a manner that imposed additional requirements on competitors or otherwise discriminate in its own favour	<p>Incenta considers there is limited opportunity for a TNSP to harm competition via the functional specification on the basis that:</p> <ul style="list-style-type: none"> • There is extensive technical information that is required to be published under schedule 5.10 of the NER to inform prospective connecting parties • The transparency created through the requirement to provide a Functional Specification, which may be reviewed by an Independent Engineer, provides a substantial brake on the capacity to use technical requirements for anti-competitive purposes, and • The TNSP's own detailed design for an IUSA or DNA is also required to be consistent with the Functional Specification.
TNSPs may use information gained in their role as a monopoly service provider that provides an advantage when bidding on contestable services	<p>The regulatory regime includes an explicit requirement to protect confidential information that is received during a connection process as part of the TNSP performing its "gate keeper" functions. Also:</p> <ul style="list-style-type: none"> • TNSPs do not receive information about competing tenders during a connection process • whilst a TNSP may get some forewarning of an upcoming connection project through information received whilst performing its regulated activities, this is unlikely to provide a material competitive benefit • the AER's proposed information controls within the draft Transmission Ring-fencing Guideline²⁷ would limit information usage to its intended purpose and so would prevent this harm without the need to extend the scope of ring-fencing.
TNSPs could use the conduct of the connection process itself to discriminate against customers that seek contestable connections	The process by which TNSPs are required to assess and effect connections is highly prescribed in Chapter 5 of the Rules, which includes detailed requirements for all parties at each stage of the process, including the information to be provided and timelines. We think that, given the extent of the prescription of this process, there is little room left for

²⁷ Note the proposed information controls in the draft Transmission Ring-fencing Guideline were adopted for the final Transmission Ring-fencing Guideline.

	TNSPs to seek to discriminate against a competitor for a contestable connection process.
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Despite the introduction of contestability for certain connection services, Incenta considered “it was a clear intent of the AEMC’s framework that TNSPs would remain the dominant provider of contestable connection services but contestability would discipline the behaviour of the incumbent TNSPs”.²⁸

Finally, Incenta also expressed the view that if gaps in the regime are identified, these are better addressed via a change the connections framework within Chapter 5 of the NER rather than via the Transmission Ring-fencing Guideline.

Questions: do the mitigating factors identified by Incenta sufficiently address the concerns raised about the ability of TNSPs to discriminate in favour of themselves or an affiliate in providing connection services? If not, why not? Are there any other mitigating factors?

2.2.2 Victoria

AusNet’s submissions to the Transmission Ring-fencing Guideline review pointed to the unique approach to contestable transmission investment in Victoria and AEMO’s role in that process as a reason why more stringent ring-fencing obligations should not apply. Specifically, AusNet noted the following features of the Victorian transmission framework that it considered limits the need for ring-fencing obligations in Victoria:²⁹

- The key transmission services that would be subject to ring-fencing under the AER’s proposal are developed by AEMO, not by a DTSO.
- Victoria’s market-based approach to tendering for contestable augmentations requires a significant volume of information to be shared.
- AEMO is required to conduct a tender and evaluation process that accords with best practice.³⁰
- The bifurcation of the transmission function in Victoria means DTSOs do not have the opportunity to favour themselves or an affiliate in the provision of transmission services or inputs thereto.

Specifically in respect of connection services, AusNet noted:³¹

- AusNet’s transmission licence requires it to provide offers to connection applicants

²⁸ Incenta Economic Consulting, *Competition issues for contestable transmission connection projects*, ENA, December 2022, p. 11.

²⁹ AusNet, *Ring-fencing Electricity Transmission Guideline Issues Paper* submission, May 2022, p. 2.

³⁰ In the case of contestable connections, the connecting party can conduct the tender itself, or request AEMO to conduct the tender. It is our understanding that the connecting party usually conducts the tender.

³¹ AusNet, *Submission to Draft Ring-fencing Electricity Transmission Guideline (Version 4)*, 16 December 2022, p. 1.

- In Victoria, unlike in other jurisdictions, the connections process is overseen by AEMO.

Questions: does the Victorian framework for contestable transmission limit the ability of the incumbent DTSO to discriminate in favour of itself or an affiliate? If not, why not? Are there any other mitigating factors?

2.3 Evidence of third party competition

While the connections framework under Chapter 5 of the NER is reasonably comprehensive, it is difficult to know how well it is working in practice to prevent any potential discrimination by TNSPs because there is limited publicly available information on the number of connections completed by parties other than the incumbent TNSP. Further, the AER has very limited oversight of negotiated transmission services. The information that is available suggests that very few connection services are provided by third parties.

As of July 2021, when the connections framework was being revisited by the AEMC under the Dedicated Connection Assets rule change, only one large DCA had been developed. This had been constructed by an incumbent TNSP.³² While submissions to the rule change process suggested there were other large DCAs in various stages of planning, it was not clear who these were being planned by and whether they were intended to be built, owned and/or operated by a party other than the Primary TNSP.

There is no publicly available information on the number of DNAs that have been planned, built and/or owned by a party other than the Primary TNSP since the revised framework took effect in July 2021.

Between 1 July 2018 and July 2021, four small DCAs were registered with AEMO, all by the same Primary TNSP.³³ However, we have not identified any publicly available information on the number of DCAs that have been constructed since then and the parties being engaged to plan, construct, own and operate them.

Finally, submissions to the DCA rule change suggested that there were very few IUSAs being provided contestably prior to July 2021.³⁴

Submissions to the Transmission Ring-fencing Guideline Review also suggested there are few contestable connections being constructed by parties other than the Primary TNSP, yet there appears to be appetite for appointing alternative providers.

TNSPs and Incenta have suggested that the framework was deliberately designed so that most contestable connections would continue to be delivered by the Primary TNSP. Rather, the threat of competition would be sufficient to promote competitive outcomes. For this

³² TNSPs were required to register an access policy with the AER for large DCAs. Only one large DCA access policy was submitted to the AER for approval under the connections framework that operated from 1 July 2018 to July 2021.

³³ See AEMO's NEM Registration and Exemption List, available at www.aemo.com.au.

³⁴ AEMC, Connection to Dedicated Connection Assets, Final Determination, 8 July 2021, p. 132.

reason, the absence of third party providers may be viewed as an outcome of the design of the framework, rather than a sign of anti-competitive outcomes.

While TNSPs were clearly permitted to continue providing contestable services under the revised framework, it is not clear to the AER that the intention of the AEMC was to set up a contestable framework in which most services would continue to be provided by the incumbent. However, even if the framework was designed this way, we must be confident that the threat of competition exists in practice, not just in theory, to be an effective curb on monopoly power and so deliver timely and cost-effective connections. In this case, the absence of third party providers could be a result of TNSPs still being able to discriminate in favour of itself or an affiliate, meaning there may not be effective competitive pressure.

In Victoria, where AEMO procures many transmission services, including for the shared network, on a contestable basis, the incumbent TNSP owns and operates 99% of the transmission system.³⁵ Of the 15-20 transmission augmentations that have been delivered under the contestable framework, three were delivered by a party other than the incumbent.³⁶ These were all relatively small augmentations, being the construction and operation of new terminal stations.

Question: Why do stakeholders consider that third party providers are not being engaged to provide contestable connection services? Is there any evidence available to identify the cause(s) of the apparent lack of third party providers being engaged to provide contestable connection services?

2.4 Potential areas for strengthening the framework for preventing discrimination

This section first considers issues in respect of jurisdictions other than Victoria. Issues in respect of Victoria are considered separately in section 2.4.4.

As noted above, in developing the contestability framework for transmission connections the AEMC implemented several obligations to help manage the advantage TNSPs have in providing contestable services, since they alone provide the non-contestable elements of a connection. These cover several obligations that are similar to the types of obligations included in the ring-fencing guideline to prevent discriminatory behaviour, primarily around information access and disclosure.

However, the connections framework set out in Chapter 5 of the NER was never intended to be a *replacement* for ring-fencing. In its Final Determination the AEMC acknowledged that a Primary TNSP would be able to provide contestable elements of connection services “provided that it complies with the requirements of its cost allocation methodology and transmission ring-fencing guideline”,³⁷ and that changes to the connection services that must be provided as a negotiated transmission service and those that could be provided on a

³⁵ AusNet, *Ring-fencing Electricity Transmission Guideline Issues Paper* submission, May 2022, p. 1.

³⁶ AEMC, *Transmission planning and investment review – Contestability, Directions paper*, 24 November 2022, p. 18.

³⁷ AEMC, p. 151

contestable basis would have an implication for a TNSP's compliance with the ring-fencing guideline.³⁸

The AEMC also noted:³⁹

"The Commission considers that negotiated transmission services are more akin to alternative control services than negotiated distribution services. This is because, under the final rule, the Primary TNSP is required to provide certain negotiated transmission services (connection services) on an exclusive basis. This is not the case for negotiated distribution services (where the DNSP is not required to provide the service). Imposing a form of separation at the transmission level similar to that imposed at the distribution level (i.e. between direct control services and other services) may therefore not be appropriate. *The Commission is of the view that a more appropriate division would be between a TNSP's provision of prescribed transmission services and negotiated transmission services, and its non-transmission or other contestable transmission services* [emphasis added]."

The AEMC went on to note that the final rule did not amend aspects of the NER relating to ring-fencing, which were out of scope.

The AER is inclined to agree with the AEMC's view that negotiated transmission services are more akin to alternative control services (that is, a service that can only be provided by the regulated network service provider) and the implication that negotiated transmission services should therefore be provided within the ring-fenced entity. More generally, it may be appropriate that the ability to impose ring-fencing controls applies to all monopoly transmission services where there is the potential for discriminatory behaviour.

This view was also expressed by the NSW DNSPs, who considered that "[a]s a general principle, any ring-fencing controls should be imposed around the provision of monopoly services, which include negotiated transmission services."⁴⁰

As noted in our Explanatory Statement accompanying the final Transmission Ring-fencing Guideline:⁴¹

A critical purpose of ring-fencing is to address competition concerns where access to a monopoly service is essential to facilitate effective competition in another market. This is the case for transmission connections, where generators and others must engage with a TNSP for the non-contestable elements of a connection, but in theory have access to multiple providers for the contestable elements of a connection. Allowing TNSPs to operate in the contestable market raises concerns about their ability to misuse their market power by tying the provision of non-contestable services to the provision of contestable services.

³⁸ Ibid, p. 167.

³⁹ Ibid, p. 168.

⁴⁰ NSW DNSPs, *Submission to Draft Ring-fencing Electricity Transmission Guideline (Version 4)*, 16 December 2022, p. 5.

⁴¹ AER, *Electricity transmission Ring-fencing Guideline, Explanatory Statement – Version 4*, March 2023. pp. 59-60.

Even if market power is not actually misused, the potential for such behaviour may be enough to deter new entry into, or limit competition in, contestable markets.

While there are mitigating factors already embedded in the NER, these could be considered not as a replacement for, but rather complementary to, fit-for-purpose ring-fencing arrangements tailored to negotiated transmission services. In this respect, we note there are several areas where an enhanced ring-fencing framework would go further than the NER:

- A general non-discrimination clause, requiring TNSPs not to discriminate in the provision of negotiated transmission services.
- The ability to impose functional separation as between staff involved in the provision of negotiated transmission services and staff involved in contestable transmission services.
- Reporting and compliance obligations.

We expand on these points in the next three sub-sections.

2.4.1 Obligation not to discriminate

The connections framework in Chapter 5 of the NER is intended to facilitate contestability for connection services and, as discussed in section 2.2.1, the rules include several provisions that are intended to level the playing field between TNSPs and third-party providers. However, unlike in the Ring-fencing Guideline, there is no general provision that prohibits a TNSP from discriminating in favour of itself or an affiliate when providing connection services. The obligation not to discriminate in the Guideline (clause 4.1) reinforces requirements for the TNSP to deal with their related electricity service providers (RESPs) on an arm's length basis (although this is currently limited to the provision of prescribed transmission services).

Some elements of the connections framework in Chapter 5 of the NER are intended to curb a TNSP's ability to use its monopoly power in providing the non-contestable components of a connection service. In doing so, these clauses could also help prevent a TNSP from favouring itself or an affiliate in providing the contestable components of a connection. These clauses include, for example:

- Timeframes that a TNSP must comply with in responding to a connection enquiry to prevent unnecessary delays.
- The ability of a connecting party to appoint an independent engineer to assess the TNSP's Functional Specification to prevent the TNSP from over-specifying – and so increasing the costs of – the connection requirements.
- Negotiating principles that TNSPs and connection applicants must negotiate in accordance with when providing or accessing negotiated transmission services. This includes when negotiating a network operating agreement where the TNSP becomes responsible for maintaining connection assets that a third party built and the TNSP becomes responsible for.

The absence of a compulsory obligation on TNSPs to report on their compliance with such components of Chapter 5 means compliance issues would not be immediately visible to the AER ahead of voluntary reporting or proactive compliance measures by the AER.

If a dispute arises between a connection applicant and a TNSP in relation to the price and/or other terms and conditions of a negotiated transmission service under Chapter 5, the parties may enter into commercial arbitration under rule 5.5 of the NER. A dispute could derive from a concern that the price and/or other terms and conditions associated with the non-contestable components of a connection are unreasonable due to the connecting party wanting to use a third party provider for the contestable components of the connection i.e. that a TNSP is discriminating in favour of itself or an affiliate. However, connecting parties may be reluctant to raise concerns given the need for an ongoing working relationship with the TNSP as the only entity that can facilitate a connection to their network.

Amendments to the connections framework introduced in 2018 made it easier for connecting parties to raise a dispute, including imposing a requirement that disputes be resolved within 30 days, limiting potential delays. While these elements help, they do not address the underlying issue that it may be difficult for connecting parties to raise a dispute with TNSPs, or report non-compliance of specific rules with the AER, due to the need to maintain an ongoing commercial relationship. Where TNSPs are able to exert monopoly power, there may be a reluctance for connecting parties to make use of the elements of the NER that are intended to benefit them.

Ring-fencing negotiated transmission services provides an additional avenue to prevent discriminatory behaviour by TNSPs in providing connection services. Connecting parties may still be reluctant to report breaches of ring-fencing obligations to the AER out of a desire to maintain an ongoing working relationship with the TNSP. However, the AER would have the ability to monitor how TNSPs operate in the negotiated transmission services space by requiring additional reporting. This may provide transparency for future rule changes or guideline reviews.

Question: Are existing measures in the NER sufficient to prevent TNSPs from discriminating in favour of themselves or an affiliate in providing connection services? If not, why not? Are there barriers to a connecting party reporting non-compliance with specific rules or using the dispute resolution process to resolve concerns about discriminatory behaviour by TNSPs?

2.4.2 Functional separation

Under our ring-fencing powers, we are able to require TNSPs to functionally separate ring-fenced services from the provision of other services. Functional separation can take several forms, including staff separation, office separation and limitations on cross-promotion and branding.

Staff and office separation can help reinforce other obligations. For example, information restrictions can be difficult to enforce in practice where individual staff members are involved in the provision of both monopoly and contestable services. Similarly, office separation can also be appropriate where there is a risk of sensitive information being passed between staff members, whether intentionally or otherwise.

In contrast, there are no functional separation obligations in the NER in respect of transmission connection services. Incenta noted:⁴²

“the arrangements already imposed by the AEMC would, in our view, require TNSPs to implement targeted, and time limited, quarantining of staff to restrict the use of any information it receives in the provision of non-contestable services when tendering for contestable services”.

However, this is not an explicit requirement under the rules and Incenta does not comment on whether this is common practice across TNSPs.

While we currently have the power to impose these obligations in respect of prescribed transmission services for TNSPs and direct control services for DNSPs, we do not do so lightly. The costs of requiring functional separation are not insignificant and must be carefully weighed against the benefits of doing so. This was recognised in our decision not to impose staff separation beyond marketing staff, office separation, or cross-branding and promotional restrictions, in the provision of prescribed transmission services under the current transmission ring-fencing guideline. However, just having the *ability* to impose such requirements can provide an effective curb on anti-competitive behaviour.

Question: Are there any benefits in the AER having the ability to impose functional separation between negotiated transmission services and non-regulated services where the costs of doing so are outweighed by the benefits? What are those benefits?

2.4.3 Lack of compliance and reporting obligations

Chapter 5 allows for commercial negotiation between TNSPs and connecting parties. Key provisions in Chapter 5 are intended to promote effective competition by mitigating against TNSPs taking advantage of their monopoly power when providing connection services and so help level the playing field for third party providers. The absence of a compulsory obligation on TNSPs to report on their compliance with these key provisions in Chapter 5 means compliance issues would not be immediately visible to the AER ahead of voluntary reporting or proactive compliance measures by the AER.

In contrast, under the Ring-fencing Guideline, TNSPs are required to report annually on how they are maintaining compliance with their ring-fencing obligations and details of any breaches. This provides transparency and, in doing so, confidence to third parties that they are able to compete on a level playing field.

As an example, clause 5.3.8(a1) prevents a Primary TNSP from using information it has obtained in providing non-contestable services to provide contestable services. However, unlike under the Ring-fencing Guideline, there is no requirement under Chapter 5 for TNSPs to provide transparency about how they enforce compliance with this information disclosure provision within their businesses.

⁴² Incenta Economic Consulting, *Competition issues for contestable transmission connection projects*, ENA, December 2022, p. 15.

Questions: what measures do TNSPs currently take to ensure they are complying with their obligations in Chapter 5 that support contestability for connection services? How transparent are these measures?

2.4.4 Victoria

In Victoria, AEMO has responsibility for several aspects of the connections process that in other jurisdictions are performed by the Primary TNSP. For example, AEMO is responsible for determining the elements of the connection that are contestable versus those that must be provided by the incumbent DTSO, and AEMO is responsible for specifying the technical requirements for the connection (the equivalent of the “functional specification” in other jurisdictions). This may lessen the ability of the incumbent DTSO to engage in discriminatory behaviour that would favour itself or an affiliate.

Despite this, several stakeholders raised concerns, specifically with respect to the ability of the incumbent TNSP to share information with its affiliate that could provide the affiliate with an advantage in providing contestable connection works. We note there are more limited constraints on information sharing between the incumbent DTSO and its affiliates than in other jurisdictions. For example, the requirement that prevents a Primary TNSP from using data and information obtained in relation to the provision of non-contestable services for the purpose of tendering for or negotiating contestable services⁴³ does not apply in Victoria.

Under the current ring-fencing guideline, services that fall within prescribed transmission services would be captured by the information access and disclosure obligations.⁴⁴ However, negotiated transmission services would not be captured by these obligations.

Stakeholders did not raise any specific concerns in respect of issues such as cost and delays to connections in the context of Victoria. We note the role AEMO has in determining key aspects of a connection, such as the elements that are contestable and the equivalent of the functional specification. However, we would be interested to hear from stakeholders whether there are any concerns about the incumbent DTSO’s role and potentially ability to discriminate. For example, we expect that AEMO would rely to some extent on technical information provided by the incumbent DTSO. Therefore, while AEMO may be the ultimate decision maker, its decisions may be based on inputs and advice provided by the incumbent DTSO.

Similarly, the incumbent DTSO is responsible for providing the interface works that are necessary to connect to the shared network. We would welcome any feedback from stakeholders on whether there is any evidence that the incumbent DTSO is able to accelerate or prioritise connections where it, or a related entity, is also performing the contestable works, as compared to connections where it is not involved in the contestable works.

⁴³ NER clause 5.3.8(a1).

⁴⁴ AER, Ring-fencing Guideline Electricity Transmission, Version 4, March 2023, clause 4.2.

Questions: In Victoria, is the combination of the new information access and disclosure obligations under the Transmission Ring-fencing Guideline (Version 4) and the contestability framework in Victoria sufficient to curb any potential discriminatory behaviour by the incumbent DTSO in respect of information sharing? If not, why not? What gaps remain?

Are there any concerns about the ability of an incumbent DTSO to discriminate in respect of other elements of a connection, such as delays to works that only the incumbent DTSO can perform, and costs associated with those works?

3 Options for improving oversight of negotiated transmission services

The AER has identified two options that could address the issues outlined in Chapter 2.

- Introduce new reporting requirements in Chapter 5 of the NER that would allow the AER to monitor more closely the provision of negotiated transmission services and compliance with Chapter 5 of the NER.
- Expand the ring-fencing framework to include negotiated transmission services.

Neither option is intended to change the commercial negotiation of connection services. The existing framework for agreeing price and other terms and conditions would remain unchanged. Rather, the options are intended to provide greater transparency and accountability for TNSPs in how they engage in the negotiation process to provide greater confidence that TNSPs are not discriminating in favour of themselves or an affiliated entity.

The rule change process, and subsequent implementation of a new rule, can be a lengthy process. If information is presented through this consultation that discriminatory behaviour – or the potential for discriminatory behaviour – by TNSPs is already a material issue, we will consider what action we can take under the AER's existing powers and functions. In particular, the AER may consider it appropriate to investigate compliance with TNSP's existing obligations with respect to acting in good faith and transparently in the negotiated connections space.⁴⁵

3.1 Option 1: Add compliance reporting requirements within Chapter 5

3.1.1 Description of Option 1

The intent of this option would be to require TNSPs to report regularly on how they are complying with the obligations in Chapter 5 which are intended to enable competition in the provision of transmission connections and facilitate more efficient investment in, and use of, transmission assets built to connect generation to the 'shared' network. This would go beyond the AER's existing powers to obtain information for the purpose of performing our compliance monitoring functions,⁴⁶ by requiring TNSPs to demonstrate that they have the appropriate policies and procedures in place to comply with the relevant provisions of Chapter 5. The purpose of the option would be to provide greater regulatory oversight, accountability, and transparency for other stakeholders.

Key obligations that TNSPs could be required to demonstrate compliance with could include, for example:

⁴⁵ NER clause 5.3.6(f) and clause 5.3 generally.

⁴⁶ See, for example, Rule 8.7.2 of the NER, which provides a framework for the AER to establish reporting requirements for registered participants for the purpose of performing our compliance monitoring functions.

- Clause 5.2A.6, which requires the TNSP to comply with the negotiating principles including, demonstrating that charges for providing a negotiated transmissions service including network operating agreements reflect the relevant costs.
- Clause 5.3.6(b4), which requires the offer to connect includes an unbundled price.
- Clause 5.3.8(a1), which focuses on the protection of confidential information.
- Clause 5.3 generally, which contains timeframes that a TNSP must comply with in responding to a connection enquiry (to demonstrate there's not deliberate delay).

The NER could also allow the AER to conduct an audit of the processes TNSPs have in place to ensure compliance with the key obligations, potentially triggered by being made aware of concerns that would warrant further investigations.

In addition to introducing reporting obligations to assess the robustness of TNSP's compliance processes and their actual compliance with key obligations, the NER could also require TNSPs to report annually on relevant connection information. This would assist in assessing the effectiveness of the Chapter 5 measures for promoting competition and transparency with respect to negotiated transmission services. Relevant connection information could include, for example:

- how many connection enquiries were received
- how many connection applicants tendered for the contestable connection elements (if known)
- how many connections proceed with a non-incumbent provider
- connection timeframes and costs. To preserve commercially sensitive information, the information could be collated and reported in aggregate by the AER.

In order to implement this option, Chapter 5 could be amended to introduce a power for the AER to make a binding Guideline which requires TNSPs to provide information and data relevant to compliance with relevant obligations. The rule change would specify the minimum matters to be set out in the AER binding guideline, including, for example:

- requirements on TNSPs to establish and maintain appropriate internal policies and procedures to ensure it complies with key obligations under Chapter 5
- ability for the AER to request that the TNSP demonstrate the adequacy of its policies and procedures; and
- annual or other periodic compliance reporting obligations including:
 - identifying measures TNSPs take to ensure compliance; and
 - notifying of any breaches of key provisions under Chapter 5.

In making (or amending) such guideline, the AER would propose to follow the transmission consultation procedures.

3.1.2 How Option 1 would address the identified issue

This option does not directly address the potential for discriminatory conduct occurring in respect of negotiated transmission services – for example, addressing behaviour where a

TNSP unfairly expedites a transmission connection if the customer requests that the TNSP or a related party deliver the contestable component. However, it would provide greater transparency with respect to confidentiality, pricing and delivery requirements specified under Chapter 5. That is, this option would improve transparency of some information that would inform a view of whether TNSPs were acting in a manner consistent with existing rule requirements related to transmission connection services.

By providing greater transparency to stakeholders and oversight by the AER, TNSPs would face greater accountability. This should assist in curbing any discriminatory behaviour, encouraging downward pressure on prices and potentially promote more innovative solutions offered by TNSPs. Greater transparency would also provide stakeholders with more confidence in the market.

Option 1 may be appropriate where there are already sufficient controls on TNSP behaviour within the NER, but greater transparency is required to monitor compliance. As discussed above, there is currently a lack of visibility of the types of measures TNSPs have in place to comply with their obligations under Chapter 5 of the NER. Requiring policies and process for complying with their Chapter 5 obligations to be developed and published, and compliance with those policies reported on, would provide greater confidence for connecting generators and potentially competitors to TNSPs that TNSPs are not favouring themselves or an affiliate.

Depending on which obligations require reporting, this option would not address any concerns about discriminatory behaviour in Victoria, where not all elements of Chapter 5 of the NER apply.

Questions: Would Option 1 sufficiently address any concerns that TNSPs are using their market power to discriminate in favour of themselves or an affiliate in the provision of connection services? What clauses in Chapter 5 of the NER should TNSPs be required to report compliance with? Should Option 1 extend to requiring TNSPs to report certain connection information and, if so, what information should be required? How effective would this option be in addressing concerns about potential discriminatory behaviour in Victoria?

3.2 Option 2: Include negotiated transmission services within the scope of the ring-fencing framework

3.2.1 Description of Option 2

The intent of this option would be to extend the ring-fencing framework to incorporate negotiated transmission services. This would allow the AER to make Transmission Ring-fencing Guidelines that govern the behaviour of TNSPs in respect of the provision of negotiated transmission services, as well as prescribed transmission services.

In practice, the proposed amendments would allow for (but not require) the legal and/or functional separation of negotiated transmission services from non-regulated transmission services.

Currently, clause 6A.21.2(a) of the NER requires that:

Transmission ring-fencing guidelines must be developed by the *AER* in consultation with each *participating jurisdiction* for the accounting and functional separation of the provision of *prescribed transmission services* by *Transmission Network Service Providers* from the provision of other services by *Transmission Network Service Providers* (the *Transmission Ring-fencing Guidelines*).

Option 2 would extend and clarify this clause to provide for:

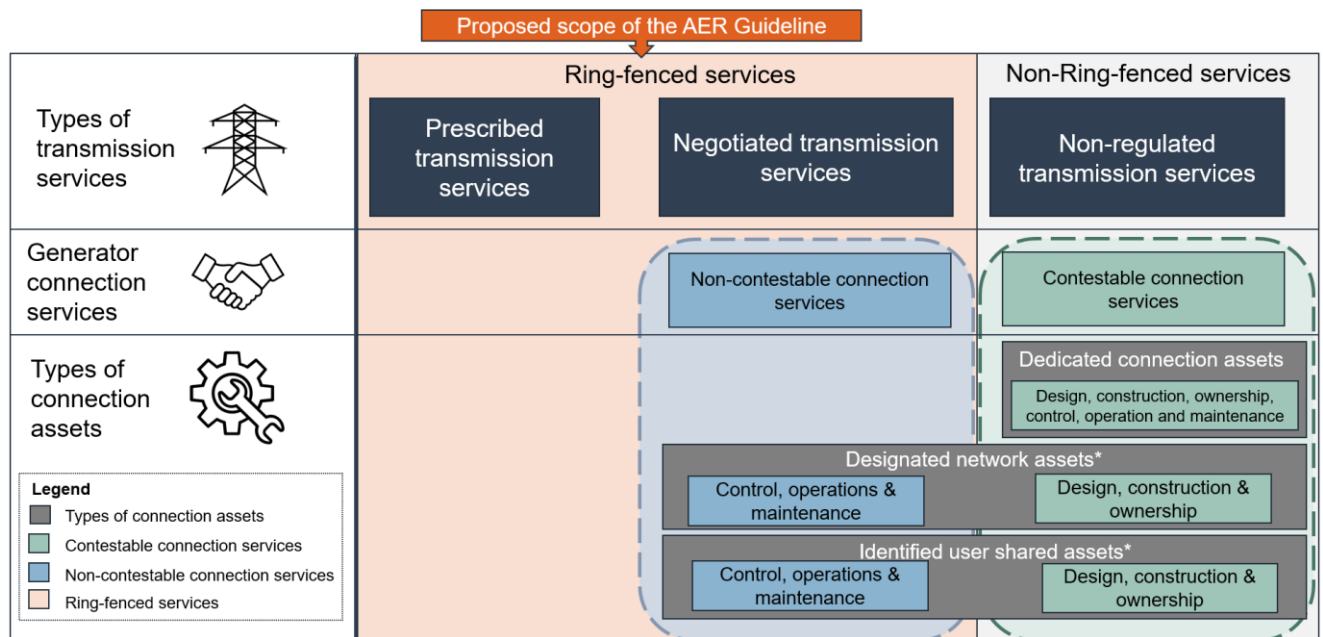
...the accounting and functional separation of the provision of *prescribed transmission services* and negotiated transmission services by *Transmission Network Service Providers* from the provision of other services by *Transmission Network Service Providers*...

For completeness, references in clause 6A.21.2(b) to prescribed transmission services would also be extended to include references to negotiated transmission services. This clause sets out the matters that the Transmission Ring-fencing Guideline may include (without limitation). The affected sub-clauses would be:

- 6A.21.2(b)(1)(ii), which would allow the Guideline to require the establishment and maintenance of consolidated and separate accounts for negotiated transmission services, as well as prescribed transmission services.
- 6A.21.2(b)(1)(iii), which would allow the Guideline to require the allocation of costs between negotiated transmission services and non-regulated transmission services, as well as between prescribed transmission services and other services.
- 6A.21.2(b)(1)(v), which would allow the Guideline to limit the flow of information where there is the potential for a competitive disadvantage between those parts of the TNSP's business which provide negotiated transmission services and parts of the TNSP's business which provide any other services.

It is not the policy intent that legal and/or functional separation would be permitted between prescribed transmission services and negotiated transmission services. Both of these services are required to be provided on a monopoly basis by the Primary TNSP and, as such, we do not consider it appropriate or desirable to be able to legally separate provision of prescribed from negotiated services.

The below diagram demonstrates the proposed expanded scope of the ring-fencing framework compared to the diagram in section 1.2.



* There are some instances where the primary TNSP must provide detailed design, construction and ownership of identified user shared assets and designated network assets as non-contestable transmission services.

3.2.2 How Option 2 would address the identified issue

Option 2 is likely to be more effective in addressing the potential for TNSPs to discriminate in respect of negotiated transmission services than Option 1. Option 2 would enable similar information and monitoring tools identified in Option 1, but would also extend to providing the AER with the full suite of regulatory tools available under the ring-fencing framework to address potential discriminatory behaviour in the provision of negotiated transmission services.

We do not intend to pre-empt the type of measures that the AER may impose to ring-fence negotiated transmission services from non-regulated transmission services if the scope of ring-fencing was expanded. However, examples of how this power could be exercised include:

- Requiring additional reporting on the provision of negotiated transmission services, similar to Option 1.
- Extending the current obligation not to discriminate under clause 4.1 of the Guideline to include prohibiting discrimination between a RESP and competitor of a RESP in connection with the provision of negotiated transmission services.
- Extending the definition of “ring-fenced information” under the current Guideline to include electricity information acquired or generated by a TNSP in connection with its provision of negotiated transmission services. In effect, this would extend the current information access and disclosure requirements under clause 4.2 of the Guideline (noting that there are already obligations on TNSPs in respect of information access and disclosure in respect of connections under Chapter 5 of the NER).
- Extending the current obligation in respect of marketing staff separation. Currently, the obligation under clause 4.3 of the Guideline only requires separation of marketing staff involved in the provision of prescribed transmission services from the provision

of other services. This could be extended to: (1) separate marketing staff involved in the provision of negotiated transmission services from staff involved in the provision of contestable electricity services; and/or (2) widen the scope of staff separation beyond marketing staff.

- Introducing separation obligations for cross-branding and promotions, and potentially office separation requirements.

While the AER would have the power to impose these obligations if this option was implemented, it is important to note that the AER would not necessarily do so. A review of the Guideline, subject to the relevant consultation procedures, would be required. However, we also note that simply having these tools in the regulatory toolkit would help curb potential TNSP behaviour and promote competition in contestable connections services. Further, unlike option 1 (where aspects of Chapter 5 are disapplied or modified for Victoria), this option would apply equally across all NEM jurisdictions.

3.2.3 Stakeholder views on expanding the ring-fencing framework

As part of the recent review of the Transmission Ring-fencing Guideline, we asked stakeholders whether they would support a change to the NER that would expand the ring-fencing framework to include negotiated transmission services.

Several respondents supported the AER pursuing a rule change. This included the AEC, AEO, CEIG, CEFC, CitiPower, Iberdrola, Snowy Hydro, Squadron Energy and Tilt Renewables.⁴⁷ The reasons these stakeholders gave for supporting a rule change included:

- the general view that the current arrangements for contestable connections are inadequate;
- the need for functional separation between those staff involved with specifying the technical requirements of the connection (a negotiated transmission service) and those involved in the provision of non-regulated transmission services; and
- a view that there is a risk of information disclosure without functional separation.

The NSW DNSPs considered that “[a]s a general principle, any ring-fencing controls should be imposed around the provision of monopoly services”, which include negotiated transmission services. Generally, the NSW DNSPs were concerned about inconsistencies between the treatment of TNSPs and DNSPs and the potential for distortions to arise, as well

⁴⁷ See AEC, *Submission to Draft Ring-fencing Electricity Transmission Guideline (Version 4)*, 16 December 2022, p. 2; AEO, *Submission to Draft Ring-fencing Electricity Transmission Guideline (Version 4)*, 16 December 2022, pp. 1-2; CEIG, *Submission to Draft Ring-fencing Electricity Transmission Guideline (Version 4)*, 15 December 2022, p. 3; CEFC, *Submission to Draft Ring-fencing Electricity Transmission Guideline (Version 4)*, 22 December 2022, p. 3; CitiPower, *Submission to Draft Ring-fencing Electricity Transmission Guideline (Version 4)*, 16 December 2022, p. 2; Iberdrola, *Submission to Draft Ring-fencing Electricity Transmission Guideline (Version 4)*, 16 December 2022, p. 2; Snowy Hydro, *Submission to Draft Ring-fencing Electricity Transmission Guideline (Version 4)*, 16 December 2022, p. 3; Squadron Energy, *Submission to Draft Ring-fencing Electricity Transmission Guideline (Version 4)*, 16 December 2022, p. 2; and Tilt Renewables, *Submission to Draft Ring-fencing Electricity Transmission Guideline (Version 4)*, 16 December 2022, p. 2.

as implications for the competitiveness of contestable connections due to the risk of a TNSP taking advantage of its monopoly position.

Transgrid submitted that there is no justification for pursuing a rule change given there is no evidence of harm from the current arrangements.⁴⁸

The ENA and Network REZolution, while not expressing an explicit view, questioned the benefits of including negotiated transmission services within the ring-fencing framework.⁴⁹ The ENA also noted that, even if the AER had the power to impose greater functional separation, it would not be warranted.⁵⁰

Questions: Would Option 2 sufficiently address any concerns that TNSPs are using their market power to discriminate in favour of themselves or an affiliate in the provision of connection services? If this option were to be implemented, should clauses of the NER that currently address discriminatory behaviour in respect of connections, such as those relating to information access and disclosure be shifted to the Guideline?

Questions: Are there any other options that we should consider? How would any additional options address the identified issue?

Will additional transparency and/or functional separation address concerns with the contestability framework or are there other fundamental challenges with the framework that mean that competition will always be challenging to promote?

⁴⁸ Transgrid, *Submission to Draft Ring-fencing Electricity Transmission Guideline (Version 4)*, 16 December 2022, p. 9.

⁴⁹ ENA, *Submission to Draft Ring-fencing Electricity Transmission Guideline (Version 4)*, 16 December 2022, p. 3; and Network REZolution, *Submission to Draft Ring-fencing Electricity Transmission Guideline (Version 4)*, 16 December 2022, p. 6.

⁵⁰ ENA, *Submission to Draft Ring-fencing Electricity Transmission Guideline (Version 4)*, 16 December 2022, p. 3.

4 Achieving the National Electricity Objective

In considering the options to address any potential concerns about the ability of TNSPs to discriminate when providing connection services, the AER has had regard to the National Electricity Objective (NEO). Additionally, any rule change by the AEMC must contribute to the achievement of the NEO, which is:

to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to:

- a) Price, quality, safety, reliability and security of supply of electricity; and
- b) The reliability, safety and security of the national electricity system.

Energy Ministers have also agreed to introduce an emissions reduction objective into the NEO.⁵¹ While emissions reductions are not formally part of the NEO yet and the proposed amendments to the National Electricity Law have not been finalised, it is possible that the NEO will be amended before the end of the year. Therefore, the AER considers it is appropriate to also consider the potential impact the proposed options might have on achieving targets for reducing Australia's greenhouse gas emissions.

The AER's initial view is that both of the proposed options are likely to contribute to the achievement of the NEO compared to the status quo. While there may be a limited number of connections at the moment, connections will only increase. It is therefore important that the framework is fit for purpose and connecting generators have confidence that they can use third party providers that may offer lower costs and/or more innovative services than incumbent TNSPs, without concern about having non-contestable connection services delayed or otherwise unfavourable terms and conditions.

Both options will improve transparency in the way in which TNSPs comply with aspects of the connection framework that are intended to encourage TNSPs to act fairly and transparently and minimise the potential for TNSPs to exercise their market power to the detriment of connecting parties and competitors in related markets. This should provide third party providers with greater confidence that they are competing on a level playing field, enhancing competition. At the very least, increased reporting requirements and transparency will provide an increased degree of scrutiny on the connection process.

However, Option 2 is likely to be more effective by providing the AER with a broader set of tools beyond reporting and compliance measures to take direct action to mitigate discriminatory behaviour in respect of negotiated transmission services, such as through functional separation. While the benefits of imposing functional separation would need to outweigh the costs for the guideline to require such separation, we consider that the threat of additional regulatory measures would also help curb the potential for any discriminatory behaviour.

Specific elements of the NEO that may be enhanced are:

⁵¹ Department of Climate Change, Energy, the Environment and Water, *Consultation on proposed legislative changes to incorporate an emissions reduction objective into the national energy objectives*, 20 December 2022: <https://www.energy.gov.au/government-priorities/energy-and-climate-change-ministerial-council/priorities/national-energy-transformation-partnership/consultation-proposed-legislative-changes-incorporate-emissions-reduction-objective-national-energy-objectives>.

- **Efficient investment in, and operation of, electricity services.** Both options are likely to provide connecting parties with greater negotiating power in the transmission connections market through increased accountability of TNSPs, and transparency in the provision of negotiated connection services. This in turn will provide connecting parties with a greater ability to manage the timing and cost of their connection, improving competition in the provision of contestable connection services which should, in turn, drive efficiencies and reduced costs, benefiting consumers.

Improved competition for connections will also support **reliability** in the supply of electricity in light of the retirement of coal-fired generators during the transition towards net zero emissions, particularly if there are risks that connections are currently being delayed to suit the circumstances of the incumbent TNSPs. Ensuring that connections of new generation and firming capacity happen as quickly as possible, without unnecessary delay, will help shore up supply as coal-fired generation becomes increasingly unreliable due to age and ultimately retires.

- Downward pressure on wholesale electricity **prices** reflecting lower connection costs. As noted in section 1.5, the connection costs can be 10% of a project's overall costs. Lower connection costs could therefore lead to reduced costs for consumers where connection costs savings are passed through via lower wholesale prices. This is likely to be particularly beneficial given the level of investment required in transmission and generation for the energy transition. AEMO's ISP forecasts the withdrawal of 14 GW of coal capacity by 2030 and 23 GW by 2050.⁵² This will require the introduction of over 125 GW of additional variable renewable energy by 2050 (including 48 GW by 2030) and over 60 GW of firming capacity (e.g. dispatchable storage, hydro and gas-fired generation) to be connected by 2050.⁵³ Ensuring that connections happen at efficient cost will be critical to ensuring the energy transition occurs at the lowest possible cost to consumers.
- Promote the achievement of **emissions reduction targets**. As mentioned above, significant new variable renewable energy and firming capacity are required to replace coal-fired generation. Facilitating more efficient and cost-effective connection of these energy sources to the transmission network will assist with Australia's transition away from coal-fired generation and consequently promote the achievement of emissions reduction targets.

Both option 1 and option 2 will likely provide greater reporting, transparency and oversight over the provision of contestable connection services. However, option 2 has the added benefit of providing the AER with additional tools to monitor and, if necessary, ring-fence, the provision of negotiated transmission services to ensure that monopoly power is not being used to distort outcomes in competitive markets. We do not intend to pre-empt the type of measures that the AER may impose to ring-fence negotiated transmission services from non-regulated transmission services if the scope of ring-fencing was expanded. However, if prohibitions on information sharing are insufficient and the expansion of the ring-fencing framework alone does not curb TNSP behaviour, then the AER would have access to the

⁵² AEMO, 2022 *Integrated System Plan*, June 2022, pp. 48.

⁵³ AEMO, 2022 *Integrated System Plan*, June 2022, pp. 48.

options described in section 3.2.2. Furthermore, unlike option 1, option 2 would entirely apply in Victoria.

Another advantage of Option 2 is that it provides the AER with the flexibility to adapt and amend the ring-fencing guideline (via the transmission consultation procedures) to respond to the changing needs of the market. This includes loosening, as well as tightening, controls if the balance between the costs and benefits of certain ring-fencing measures changes over time.

We note TNSPs' concerns about not having enough work to justify two separate connections teams, one for non-contestable connections and one for connections. The AER would need to carefully weigh up the costs and benefits of any ring-fencing requirements through a full review of the Guideline.

Question: how else would the two options contribute to the NEO compared to the status quo? Alternatively, what advantages in terms of the NEO does the status quo have compared to the two options identified?

5 Expected costs, benefits and impacts of amending the NER

This chapter sets out the potential costs, benefits and impacts for all stakeholders of the proposed options, including TNSPs, connecting generators, service providers, consumers, the AER and other market participants.

5.1 Benefits

The key stakeholders that would benefit from either of the options are consumers, connecting generators and third party service providers of contestable connections services.

5.1.1 Connecting generators

Generators looking to connect to the transmission network may benefit from more competition in the provision of contestable connection services. Increased competition could lead to more efficient service delivery from service providers, less risk of delays to connections, lower costs of contestable connection services and more transparency over the cost of negotiated transmission services. While both options could improve competition in the transmission connections market, option 2 establishes additional regulatory tools to monitor the provision of negotiated transmission services and provides the potential for stronger regulatory action, enforcement and compliance to prevent discrimination if the ring-fencing guidelines were to be changed. Therefore option 2 may have greater benefits to connecting generators than option 1.

5.1.2 Third party service providers

Service providers that can provide contestable connection services will also benefit from increased transparency in the connections market. Both options will remove barriers to entry to the contestable transmission connections market because there will be less risk, or less perceived risk, of TNSPs using their monopoly power to influence connecting generators' decisions about choosing contestable connection service providers. Third party service providers will be in a better position to compete with TNSPs in the provision of contestable connection services and more likely to obtain work from connecting generators. Similarly to connecting generators, we anticipate that option 2 will have greater benefits to connecting generators than option 1 due to the additional regulatory tools to monitor, and if necessary ring-fence, the provision of negotiated transmission services.

Question: what other benefits could arise under either option that we have not identified here?

5.2 Costs

5.2.1 TNSPs

Under option 1, TNSPs will have additional reporting obligations and therefore increased compliance costs to meet these obligations. We welcome feedback from TNSPs about the likely quantum of such costs and the impact this may have on their businesses.

Costs incurred by TNSPs under option 2 would depend on the ring-fencing arrangements under any revised transmission ring-fencing guideline. These costs would be assessed as part of a review of the Guideline that would need to occur if the ring-fencing head of power was extended. However, there is potential for TNSPs' costs to increase not only for increased compliance reporting but also if other ring-fencing measures were required between negotiated transmission services and contestable transmission services. ENA noted in its submission to the draft guideline that requiring functional separation between negotiated transmission services and other services would be detrimental to TNSPs due to the potential of insufficient work in the contestable connections space to justify establishing a functionally separated team.⁵⁴ AusNet submitted that any increased cost of regulation can have a material impact on TNSPs' businesses.⁵⁵ The AER would need to carefully weigh up the costs and benefits of any ring-fencing requirements through a full review of the Guideline.

Question: what other costs could be incurred under either option that we have not identified here? Would any other stakeholders incur costs? Can likely costs to TNSPs of each option be quantified?

5.3 Expected impacts

5.3.1 TNSPs

The expected impacts of both options on TNSPs include increased regulatory burden and some uncertainty to business operations due to an increased scope of regulation. TNSPs would need to adjust their business operations to comply with any new regulations for the provision of contestable connection services. It is likely that option 2 will have greater regulatory burden on TNSPs than option 1. However, as noted previously, any change in obligations under option 2 would be subject to consultation through a review of the Guideline.

5.3.2 Connecting generators

Both options would be expected to positively impact outcomes for generators connecting to the transmission network, including through:

- Increased confidence and bargaining power in negotiating for connection services with incumbent TNSPs and third-party providers as a result of increased transparency in the transmission connections market.
- Potentially cheaper connections through improved competition.
- Less risk of delays in the connection process, reducing risks associated with finalising project financing and planning approvals.

Option 2 would also provide the opportunity for stronger regulatory action, enforcement and compliance to prevent discrimination if the ring-fencing guidelines were to be changed

⁵⁴ ENA, *Submission to Draft Ring-fencing Electricity Transmission Guideline (Version 4)*, 16 December 2022, p. 6.

⁵⁵ AusNet, *Submission to Draft Ring-fencing Electricity Transmission Guideline (Version 4)*, 16 December 2022, p. 1.

5.3.3 Consumers

The options discussed in this paper are not expected to have a direct impact on consumers. However, consumers may indirectly benefit from potential increased competition in the connections market leading to downward pressure on connection costs. This may flow through to lower wholesale electricity prices.

5.3.4 DNSPs

We expect that both options, but in particular option 2, would level the playing field for contestable connection services between TNSPs and DNSPs. As noted in section 2.2, several DNSPs raised concerns that TNSPs have an opportunity to leverage information acquired in the provision of negotiated transmission services to provide an unfair advantage in the provision of other contestable services, including where TNSPs and DNSPs compete to connect customers.

Option 1 would address this issue to some extent by improving transparency in how TNSPs comply with their obligations under Chapter 5 in respect of information access and disclosure. Option 2 would potentially go further by imposing staff and office separation if the benefits of doing so were found to outweigh the costs.

5.3.5 AER

Both options will require increased monitoring and compliance from the AER. The implementation of both options may also have resourcing implications for the AER. Option 1 would require resources to prepare and consult on the establishment of a binding Guideline to govern TNSP's provision of information and data relevant to compliance with relevant obligations under Chapter 5. Option 2 may require resources to prepare and consult on potential amendments to the transmission ring-fencing guideline and any subsequent enforcement or compliance activities.

Both options should assist the AER in the effective regulation of TNSPs.

5.3.6 Other market participants

We do not anticipate that there would be any adverse impacts on other market participants, under either option.

Question: what other impacts could be incurred under either option that we have not identified here?

5.4 Comparison of the two options

Option 2 establishes tools to directly address discrimination in the provision of negotiated transmission services, whereas Option 1 provides for greater oversight of the provision of contestable connection services. Both options are expected to have benefits to consumers and connecting parties, costs for TNSPs, and resourcing implications for the AER. Depending on the materiality of the problem, the benefits to consumers and connecting parties of Option 2 may be greater than Option 1. The regulatory burden on TNSPs also has the potential to be greater with Option 2. TNSPs have argued that given the small number of connections that have historically occurred, it would not be financially viable to have two

separate connections teams, one performing negotiated services and the other performing contestable services. However, this could change in coming years given the unprecedented amount of generation required to be connected to the transmission network.

The optimal solution depends on the materiality of the problem and whether oversight will be sufficient to curb the potential for discriminatory behaviour, or whether positive obligations on TNSPs are required. We note that the materiality of the problem may also change over time. The need to impose ring-fencing of negotiated transmission services may become greater as the industry transitions. It may be beneficial to expand the ring-fencing framework to include negotiated transmission services so that the AER has the option to ring-fence these services if the need arises as the industry transitions.

Appendix A – Questions for stakeholders

For ease of reference, a full list of questions that are noted throughout this consultation paper are listed below.

- 1) Is there any other evidence that TNSPs are discriminating in favour of themselves or an affiliate in providing contestable connection services? Are the issues encountered by connecting parties different in Victoria versus other jurisdictions and, if so, how?
- 2) Do the mitigating factors identified by Incenta sufficiently address the concerns raised about the ability of TNSPs to discriminate in favour of themselves or an affiliate in providing connection services? If not, why not? Are there any other mitigating factors?
- 3) Does the Victorian framework for contestable transmission limit the ability of the incumbent DTSO to discriminate in favour of itself or an affiliate? If not, why not? Are there any other mitigating factors?
- 4) Why do stakeholders consider that third party providers are not being engaged to provide contestable connection services? Is there any evidence available to identify the cause(s) of the apparent lack of third party providers being engaged to provide contestable connection services?
- 5) Are existing measures in the NER sufficient to prevent TNSPs from discriminating in favour of themselves or an affiliate in providing connection services? If not, why not? Are there barriers to a connecting party reporting non-compliance with specific rules or using the dispute resolution process to resolve concerns about discriminatory behaviour by TNSPs?
- 6) Are there any benefits in the AER having the ability to impose functional separation between negotiated transmission services and non-regulated services where the costs of doing so are outweighed by the benefits? What are those benefits?
- 7) What measures do TNSPs currently take to ensure they are complying with their obligations in Chapter 5 that support contestability for connection services? How transparent are these measures?
- 8) In Victoria, is the combination of the new information access and disclosure obligations under the Transmission Ring-fencing Guideline (Version 4) and the contestability framework in Victoria sufficient to curb any potential discriminatory behaviour by the incumbent DTSO in respect of information sharing? If not, why not? What gaps remain?
- 9) Are there any concerns about the ability of an incumbent DTSO to discriminate in respect of other elements of a connection, such as delays to works that only the incumbent DTSO can perform, and costs associated with those works?
- 10) Would Option 1 sufficiently address any concerns that TNSPs are using their market power to discriminate in favour of themselves or an affiliate in the provision of connection services? What clauses in Chapter 5 of the NER should TNSPs be required to report compliance with? Should Option 1 extend to requiring TNSPs to report certain connection information and, if so, what information should be required? How effective would this option be in addressing concerns about potential discriminatory behaviour in Victoria?
- 11) Would Option 2 sufficiently address any concerns that TNSPs are using their market power to discriminate in favour of themselves or an affiliate in the provision of connection services? If this option were to be implemented, should clauses of the NER that currently

address discriminatory behaviour in respect of connections, such as those relating to information access and disclosure be shifted to the Guideline?

- 12) Are there any other options that we should consider? How would any additional options address the identified issue?
- 13) Will additional transparency and/or functional separation address concerns with the contestability framework or are there other fundamental challenges with the framework that mean that competition will always be challenging to promote?
- 14) How else would the two options contribute to the NEO compared to the status quo? Alternatively, what advantages in terms of the NEO does the status quo have compared to the two options identified?
- 15) What other benefits could arise under either option that we have not identified here?
- 16) What other costs could be incurred under either option that we have not identified here? Would any other stakeholders incur costs? Can likely costs to TNSPs of each option be quantified?
- 17) What other impacts could be incurred under either option that we have not identified here?