

# Ring-fencing Guideline Electricity Transmission Issues Paper

May 2022

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AER reference: 13807099

# Glossary

Term	Definition
ACCC	Australian Competition and Consumer Commission
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AEO	Australian Energy Operations
CAM	Cost Allocation Method
CCA	Competition and Consumer Act 2010 (Cth)
Corporations Act	Corporations Act 2001 (Cth)
C/P/UE	Citipower, Powercor and United Energy
distribution guideline	Electricity Distribution Ring-fencing Guideline
DNSPs	Distribution Network Service Providers
ENA	Energy Networks Australia
guideline	Transmission Ring-fencing Guideline
GW	gigawatt
interim draft guideline	Draft Interim Transmission Ring-fencing Guideline (published 14 April 2022)
NER	National Electricity Rules
NEM	National Electricity Market
NSPs	Network Service Providers
PIAC	Public Interest Advocacy Centre
related business	the activities of generation, distribution and electricity retail supply
TNSPs	Transmission Network Service Providers

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# Request for submissions

Interested parties are invited to make written submissions to the Australian Energy Regulator (AER) regarding this Issues Paper by **close of business, 22 July 2022**.

Submissions should be sent electronically to [AERringfencing@aer.gov.au](mailto:AERringfencing@aer.gov.au).

Alternatively, submissions can be mailed to:

General Manager, Strategic Policy and Energy Systems Innovation  
Australian Energy Regulator  
GPO Box 520 Melbourne  
VIC 3001

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](http://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, March 2021 available on the AER's [website](#).

Enquiries about this paper, 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](mailto:AERringfencing@aer.gov.au).

# 1 Introduction

Electricity transmission network service providers (TNSPs) are subject to ring-fencing requirements under our Transmission Ring-fencing Guideline (the guideline). The guideline was developed by the Australian Competition and Consumer Commission (ACCC) in 2002, followed by minor updates in 2005. On 14 April 2022 we published a Draft Interim Transmission Ring-fencing Guideline (interim draft guideline) with additional minor updates, for reasons discussed below. As the interim guideline is still in draft form, throughout this paper we refer to the 2005 version as the current guideline.<sup>1</sup>

We commenced a review of the transmission ring-fencing arrangements with the release of a Discussion Paper in 2019. The review was put on hold due to a number of considerations at the time including the COVID-19 pandemic and the need to prioritise stakeholder engagement on other pressing issues.

This Issues Paper recommences our review. In this paper we seek stakeholder feedback on our revised approach to the review and the initial views we propose. In particular we are seeking feedback on:

- The services that TNSPs should be able to provide, including via technologies such as batteries that can be used to provide multiple services.
- The harms and benefits to consumers, the market and TNSPs of strengthening the functional separation requirements, such as separation of offices, branding and staff, between regulated and contestable services.
- Amending the current guideline to strengthen reporting and compliance requirements.

We have published a submissions template with this paper that we strongly encourage stakeholders to use in responding to this paper.

This paper does not repeat the content of the 2019 Discussion Paper, which should be read for further context, including on the potential harms ring-fencing is intended to address.

## 1.1 Consultation to date

In our 2019 Discussion paper we sought stakeholder input on broad concepts relating to ring-fencing principles and their relevance and applicability in the transmission sector and the evolving energy market.

We received 9 submissions in response, primarily from TNSPs.<sup>2</sup> Submissions were also provided by the Public Interest Advocacy Centre (PIAC), Australian Energy Operations (AEO)<sup>3</sup> and a joint submission from Citipower/Powercor/United Energy (C/P/UE). There was broad support for consistency with the aims and objectives of the distribution ring-fencing arrangements, noting the need to consider differences in transmission and distribution services where appropriate.

<sup>1</sup> The 2005 version of the guideline is available on the AER's [website](#).

<sup>2</sup> Submissions are available on the [AER's website](#).

<sup>3</sup> Australian Energy Operations is a contestable transmission business.

Key themes from TNSP submissions include:

- Overall, TNSPs do not see evidence of a harm occurring that would justify the costs associated with stronger regulation. The current guideline, combined with general competition law, are sufficient. As such, any proposed material changes must be justified with evidence that existing arrangements are inadequate.
- TNSPs must have a full suite of technologies to meet network needs. Consumers should also be able to benefit from market-facing services that such technologies can provide.
- The current 5% threshold that allows TNSPs to provide generation, distribution and retail supply activities should be maintained. However, the restriction on TNSPs conducting distribution activities should be relaxed so that these activities can be undertaken by the same legal entity, similar to distribution network service providers (DNSPs) being able to provide transmissions services.
- Both legal and functional separation would impose significant costs on TNSPs, which could result in some services no longer being provided. If legal separation were required, it should apply on a prospective basis. Functional separation is not required as sharing of resources is unlikely to result in material harms to competition.
- The cost of onerous compliance requirements is likely to outweigh any benefits.
- Ring-fencing needs to be consistent with, and not pre-empt, other developments in the national framework such as the Australian Energy Market Operator's (AEMO) Integrated System Plan and the consideration of a congestion management mechanism.
- The guideline must take into account the unique approach to transmission planning and development in Victoria, where AEMO has responsibility for acquiring augmentation services through a contestable process.

Key themes in submissions from other parties include:

- The current distribution ring-fencing guideline is an appropriate starting point for updating the transmission ring-fencing guideline.
- Stronger ring-fencing provisions are required to promote competition for transmission connections to address the potential for discrimination.
- Ring-fencing must not stifle innovation for new and emerging contestable services. There may be some consumer benefits to allowing TNSPs to provide new and emerging services including via grid scale storage.

While we have already conducted one round of consultation in 2019, we have decided to publish an Issues Paper rather than proceeding straight to a draft guideline. This provides an opportunity to consider relevant developments in the market, as set out in the next section, as well as for stakeholders to refamiliarise themselves with the issues.

We acknowledge that the AER needs to ensure that stakeholder discussions are balanced in terms of stakeholder participation with different or opposing interests. We are looking to hear more from consumer groups, retailers, generators and battery investors and operators, which were underrepresented in submissions to the 2019 discussion paper.

## 1.2 The current market context

Since the current guideline was drafted, new electricity services and areas of competition have emerged due to technological change and market reform. Some technologies operate at the boundary between regulated and unregulated electricity markets, challenging how the current guideline applies. These changes have also increased the potential for TNSPs to cross-subsidise activities using regulated revenues and discriminate in favour of their own or affiliated businesses. Consequently, the current guideline may no longer be fit for purpose.

### 1.2.1 Recent market developments

The scale, scope and role of TNSPs is changing, with associated implications for ring-fencing arrangements. AEMO is predicting that 10,000km of new transmission needs to be installed by 2050 to connect 122GW of renewable energy.<sup>4</sup> This scale of transmission investment is unprecedented. For context, the current combined value of the regulatory asset bases of the 7 TNSPs is approximately \$21.7 billion.<sup>5</sup> Transmission network investment identified as actionable in AEMO's draft 2022 Integrated System Plan is approximately \$12.5 billion – an increase in value of over 50%.<sup>6</sup> Under the current guideline, TNSPs will be able to increase their activities in generation, distribution and electricity retail supply, which are subject to a cap of 5% of their annual revenue.

TNSPs are deploying assets such as batteries and synchronous condensers that can be used to provide both contestable and network services. These technologies are blurring the lines between generation, network and retail services and increasing the potential for cross-subsidisation between regulated and non-regulated services, as well as discrimination by a TNSP in favour of an affiliated business. The opportunities for using such assets for multiple purposes are expanding, with new markets being implemented for fast frequency response and options being considered for the procurement of other essential system services such as inertia and system strength. Further, TNSPs have a role in procuring inertia and system strength.

The issue of common ownership of transmission and generation has arisen recently through [Brookfield's attempted bid for AGL](#)<sup>7</sup> and the development of renewable energy zones, which may increase commercial interest in transmission and generation businesses combining under common ownership structures. We do not have the power to require full structural separation, but ring-fencing can help prevent adverse impacts on contestable markets where a TNSP could otherwise favour an affiliate through its operational decisions and information sharing. Similarly, reforms introducing contestability in [transmission connection services](#) and [dedicated connection assets](#) are also increasing the importance of clear ring-fencing arrangements to prevent cross subsidisation and ensure service providers can compete on a level playing field with TNSPs and their affiliates.

We recognise that TNSPs have a central role to play in the shift to net zero and, in doing so, face several challenges to ensure the system continues to operate securely. TNSPs need

<sup>4</sup> AEMO, *Draft 2022 Integrated System Plan*, December 2021, p. 8 and p. 36.

<sup>5</sup> AER, *State of the Energy Market*, 2021, p, 128.

<sup>6</sup> AEMO, *Draft 2022 Integrated System Plan – Overview*, December 2021, p. 3.

<sup>7</sup> Brookfields owns AusNet Services.



flexibility to adapt to these challenges, but the ability of TNSPs to provide contestable services in a new and wider range of markets means it is important to carefully consider the potential negative impacts on competition and consumers and the role of the guidelines in mitigating these impacts. While the role of TNSPs in the transitioning energy market and in providing new services is still developing, it is critical to have clear, effective and robust ring-fencing arrangements in place that are sufficiently flexible to accommodate future reforms.

Finally, a new version of the Electricity Distribution Ring-fencing Guideline (distribution guideline) was implemented in November 2021, which addresses several issues of relevance to transmission. For example, the new distribution guideline clarifies how batteries are treated from a ring-fencing perspective. The distribution guideline also introduces a cap on the amount of revenue a DNSP can earn from providing generation services, albeit in a DNSP's role as a provider of stand-alone power systems, which is not a role that TNSPs perform.

### **1.2.2 Implications for transmission ring-fencing**

Generally, we consider the current guideline requires strengthening to reflect the changed context in which TNSPs operate. The market is very different from 2002, when the role of TNSPs was narrower, the number of contestable electricity markets was limited and the lines between them clearer. The current guideline needs updating so it is fit-for-purpose for the way in which TNSPs are currently operating and are expected to operate in the future.

As well as strengthening the current guideline, we will improve clarity about the services TNSPs can (and cannot) provide. As we have seen in distribution, this will give TNSPs greater certainty about the markets in which they can operate. To the extent that TNSPs wish to participate in contestable markets, the guideline will need to ensure that the interests of consumers and competition are not negatively impacted.

## **1.3 Revised approach to the review**

Much time and effort has been invested by both the AER and stakeholders in considering ring-fencing issues in a variety of contexts. We intend to draw from the lessons learned and discussions held where relevant to this review. This includes discussions on the distribution guideline and other consultation processes such as the AEMC's [Transmission Connection and Planning Arrangements](#) and [Integrating Energy Storage Systems into the NEM](#) rule changes as well as submissions received on our 2019 Discussion Paper.

As noted above, a new version of the distribution guideline was finalised last year. We consider the distribution guideline represents a modern and flexible regulatory instrument that reflects the challenges and opportunities of the current and future market for network businesses. As such, we will have regard to the DNSP guideline and submissions received throughout that process in conducting our review of the transmission guideline. This approach also meets our obligation under clause 6A.21.2(c) of the National Electricity Rules (NER) to consider consistency between the two guidelines.

We recognise, however, that the ring-fencing approach to distribution will not necessarily apply for transmission due to differences in both the regulatory frameworks and operating environments. Ultimately, our objective is to put in place the most appropriate measures for the regulation of transmission network services.

We also recognise that there may be important considerations concerning the role of TNSPs in supporting the transition to net zero while maintaining a secure system. TNSPs need flexibility in the way they operate to ensure the transition happens smoothly and at lowest cost to consumers. As such, thought must be given to the appropriate mix of ring-fencing obligations so that TNSPs can continue to identify innovative solutions to the benefit of consumers. A pragmatic approach is required and we are open to moving away from alignment with the distribution guideline where evidence is provided that demonstrates that the costs associated with a proposed measure are not commensurate with the potential harms it is intended to address.

### **1.3.1 Ring-fencing objectives**

In the 2019 Discussion Paper we proposed to use the ring-fencing objectives and aims for the distribution guideline as a starting point for updating the current guideline, while recognising the differences in the regulatory regime and commercial environment for TNSPs and DNSPs. The objectives of the distribution guideline are to:<sup>8</sup>

- 1) promote the National Electricity Objective by providing for the accounting and functional separation of the provision of direct control services by DNSPs from the provision of other services provided by them or their affiliated entities.
- 2) promote competition in the provision of electricity services.

Submissions supported the adoption of these objectives for the transmission ring-fencing guideline, while noting that they would not necessarily apply in the same way due to differences in operating environments. As such, we intend to adopt these objectives.

## **1.4 Interaction with Interim Guideline**

We issued a [draft interim Transmission Ring-fencing Guideline](#) in April 2022. It recently came to our attention that when Chapter 6A of the NER was introduced in 2006, those changes did not include provisions to transition the current guideline to the new NER. No transitional provisions currently exist in the NER that deem the current guideline to have been made under clause 6A.21.

To address this, we re-issued a draft of the current guideline under clause 6A.21 of the NER in substantively the same form. Submissions on this process closed on 31 May. We intend to issue a final interim guideline by late June 2022.

<sup>8</sup> AER, *Ring-fencing Guideline Electricity Distribution Version 3*, November 2021, cl. 1.1.1.

## 1.5 Timeline

Below is an indicative timeframe for the full review of the current guideline.

**Table 1.1 Indicative transmission ring-fencing guideline timeline**

Step	Date
AER Issues Paper published	31 May 2022
AER workshop with stakeholders	June 2022
Submissions due	22 July 2022
AER release Draft Guideline	November 2022
Stakeholder workshops	November 2022
Submissions on draft Guideline due	December 2022
Final Guideline	March 2023

## 1.6 Structure of this paper

This paper is structured as follows:

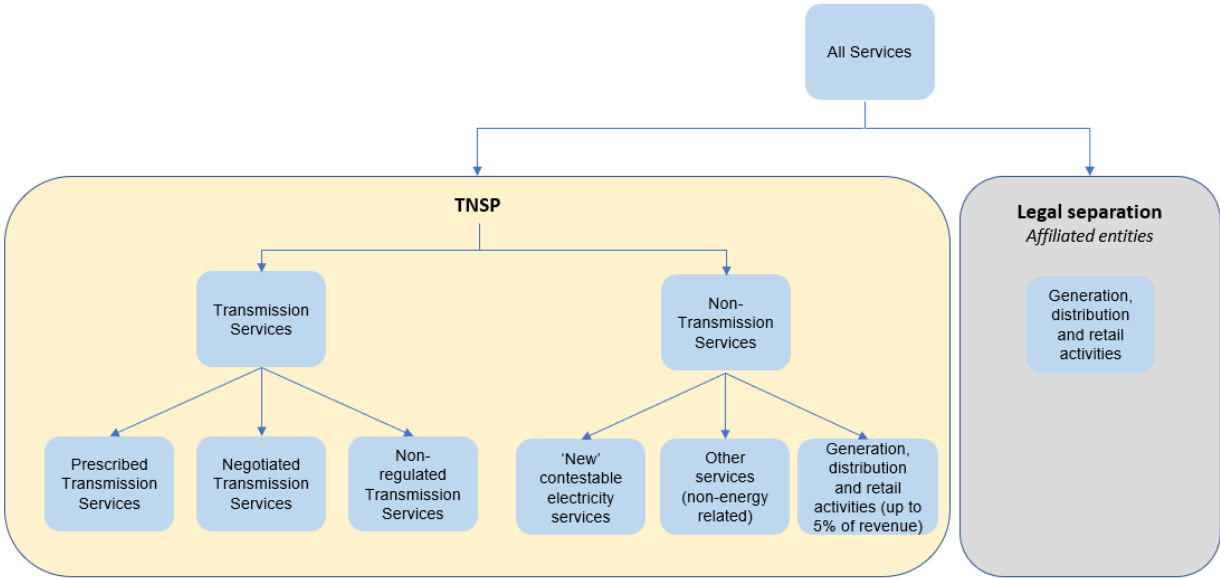
- Chapter 2 provides a discussion of our initial views and considerations in relation to preventing cross subsidies, including legal separation and accounting and transactional separation.
- Chapter 3 provides a discussion of our initial views and considerations in relation to preventing discrimination.
- Chapter 4 addresses reporting and compliance issues.
- Chapter 5 addresses other issues including waivers and transitional arrangements.

## 2 Preventing cross-subsidies

The current guideline was written when the division between generation, network and retail services were clearer. Technologies such as batteries are blurring these lines, and new electricity services are being introduced such as microgrids and essential system services that were not envisaged in the current guideline. Given these and other significant changes to the NEM, it is timely to consider whether the ability of TNSPs to offer services outside of transmission services is appropriate or could be detrimental to competition in contestable markets due to their potential ability to cross-subsidise other services using revenue earned from providing prescribed transmission services.

The diagram below provides a snapshot of the current ring-fencing arrangements for TNSPs.

**Figure 1: Summary of the current ring-fencing arrangements for TNSPs**



There are three significant changes in the NEM that are particularly relevant to our consideration of the potential for cross-subsidisation:

- 1) The size of transmission investment is expected to increase significantly over the coming years. TNSPs are currently permitted to carry on generation, distribution and/or retail activities up to a cap of 5% of their annual revenue. Given the expected increase in transmission investment and so revenue, the absolute value of this cap will also increase. It is not clear that this approach remains appropriate.
- 2) New contestable markets are being developed that did not exist at the time the current guideline was written. Due to the way the obligations in the current guideline are specified, new and emerging services may not be covered if the services do not fit neatly into the categories of generation, distribution or retail. Consideration is required as to whether TNSPs should be permitted to provide these other electricity services to provide clarity for TNSPs and the market.
- 3) Technologies are now being used to provide prescribed transmission services that can also be used to provide non-regulated and contestable services. For example, batteries are being deployed by TNSPs to help manage their networks. However, these

technologies can also be used to provide services in contestable markets. While this creates opportunities to deliver economies of scale (and potentially less costly services), without appropriate controls and oversight there is an increased risk of cross-subsidisation between regulated and non-regulated services.

Cross-subsidisation has also been raised as an important issue in a number of recent reform processes. These include our consideration of stand-alone power systems and batteries in the context of the distribution guideline and in the AEMC's Integrating Energy Storage rule.<sup>9</sup>

The current guideline is relatively light handed in respect of the activities that can be undertaken by TNSPs outside of the provision of transmission services, particularly compared to DNSPs. The 2019 Discussion Paper identified several gaps in the current arrangements, including that the current guideline does not provide transparency over how costs should be allocated between transmission and non-transmission services. As a result of these gaps, combined with the significant change in market context, we consider current measures to prevent cross-subsidisation may need to be strengthened.

There are two tools that we can use to address cross-subsidisation: accounting and transactional separation; and legal separation. As flagged in the 2019 Discussion Paper, we consider that accounting and transactional separation measures should be clearer. Amendments to these requirements have been proposed in the draft interim Transmission Ring-fencing Guideline and we will have regard to submissions as part of that process. However, those measures may not be sufficient to address cross-subsidisation.

Legal separation gives an added layer of transparency and assurance about separation arrangements, including the way costs are allocated. For example, each legal entity is required to comply with the *Corporations Act* (2001) and the relevant requirements for the preparation of financial statements and company accounts. Legal separation also supports the non-discrimination ring-fencing provisions, discussed in chapter 3, by reinforcing the requirement for the TNSP and its affiliate entity to deal with each other at arms-length.

Submissions by TNSPs to the 2019 Discussion Paper pointed to the costs involved in both legal separation and strengthened obligations in respect of accounting and transactional separation. We acknowledge there would be some costs involved to the extent that TNSPs are currently engaged in the provision of non-transmission services to third parties, however we consider that the risk of cross-subsidy is higher than in 2002 and therefore the measures in place to prevent this may need to be strengthened.

We also acknowledge that TNSPs need to be able to identify and procure prescribed services in an innovative, flexible and cost-effective manner, and consider multiple options in order to invest efficiently and provide services at a low cost to consumers. On the other hand, in designing the ring-fencing provisions for transmission, it is also important that competition in new and emerging – as well as existing – markets is not harmed, and competitors are able to provide services on a level playing field. Fit-for-purpose ring-fencing measures must be designed in a way that achieves this balance.

<sup>9</sup> More information on this rule is available on the [AEMC's website](#).

The remainder of this chapter summarises our initial views and considerations on each of the measures available to address cross-subsidisation, with a focus on legal separation of services. Some of the issues in this section also touch on the potential for discrimination, which is discussed in chapter 3. This chapter also discusses amending the current guideline to refer to services rather than activities.

## 2.1 Defining the services

The current guideline defines a related business as involving “activities” rather than “services” in respect of generation, distribution and electricity retail supply.

Our initial view is that the current guideline should be updated to use consistent languages about “services”, to provide greater clarity for TNSPs, reflect the concepts in the National Electricity Law and the NER and provide consistency with the approach taken in the distribution guideline. This approach is consistent with the AER’s obligation to develop transmission ring-fencing guidelines for the accounting and functional separation of the provision of *prescribed transmission services* by TNSPs *from the provision of other services* by TNSPs.<sup>10</sup>

In providing prescribed transmission services TNSPs should be able to invest in the most efficient option, whether that be poles and wires, batteries or generators. By amending the current guideline to refer to services rather than activities, it is clearer that TNSPs are able to invest in any asset in order to provide prescribed transmission services, where it is the most efficient option. It is the service being provided via the asset that is of concern and so subject to ring-fencing, not the asset itself.

This approach should also clarify an issue raised by Energy Networks Australia (ENA) in response to the 2019 Discussion Paper about whether ownership of generation and storage for the purpose of network support is a prescribed transmission service. We agree that generation or storage may be deployed as an input to providing a prescribed transmission service, however the use of that asset to provide generation or any other services (such as leasing services) will need to comply with the updated ring-fencing guideline.

### Question for stakeholders – activities versus services:

1. What are the potential harms and benefits of the guideline referring to services, rather than activities?

## 2.2 Legal separation

This section considers the need for legal separation of services that TNSPs can provide, including:

- the way the legal separation obligation is expressed
- the scope of services a TNSP should be able to provide
- the treatment of batteries

<sup>10</sup> NER, cl. 6A.21.2.

- the appropriate form of any exceptions to legal separation
- grandfathering arrangements

### **2.2.1 Scope of services**

The appropriate scope of services that TNSPs should be able to provide is a core issue for this review. At a minimum, we consider TNSPs should be able to provide transmission services, including prescribed, negotiated and contestable transmission services, within the same legal entity, although functional separation may be appropriate between prescribed and contestable transmission services, which is discussed further in Chapter 3.

As noted above, TNSPs should have access to a range of innovative options to enable them to meet a network need. Focusing on the services that a TNSP provides, rather than the assets they deploy, allows TNSPs to invest with confidence in the optimal mix of assets to provide transmission services. The question then arises whether it is appropriate to continue to allow TNSPs to provide other services within the same legal entity, or whether harms associated with cross-subsidisation and discrimination may arise.

### **2.2.2 Nature of the requirement**

The current guideline prohibits a TNSP from carrying on a related business, being the activities of generation, distribution and retail electricity supply. Our initial view is that the current guideline should be amended to be explicit about the services TNSPs can (and only) provide. Framing the obligation this way would future-proof the guideline in case of further market development where participation of a TNSP could potentially hamper competition. The default would change from allowing TNSPs to provide other services not envisaged under the guideline, to preventing TNSPs from providing other services.

We note TNSP views that they need the capacity to participate in other services to find innovative solutions to maintain system security. The purpose of ring-fencing is not to prevent these innovations from occurring, where it is efficient to do so in the provision of prescribed transmission services and where the impact on competitive markets is limited. As such, our initial view is that if this change was made, TNSPs would still be able to request a waiver to provide a means for TNSPs to trial innovative solutions where appropriate. Related bodies corporate of TNSPs would also be permitted to provide such services.

### **Generation and retail services**

We are not proposing to amend the general restriction on the ability of TNSPs to provide generation or retail services. Whether TNSPs should be able to engage in these activities up to a cap is considered further below.

### **Distribution services**

DNSPs can provide both distribution and transmission services within the same legal entity. The distribution guideline explanatory statement and consultation documentation (Version 1) sets out our reasoning for this position.

In summary, we considered that, where relevant, a regulated DNSP must be permitted to be able to continue to provide regulated transmission services. We were comfortable with this

outcome, noting that one of the key areas of focus of ring-fencing under the rules<sup>11</sup> is on separating contestable electricity services from non-contestable electricity services. Prescribed transmission services are regulated and subject to cost allocation methodologies.

Further, requiring a DNSP to separate its regulated transmission business would impose significant costs on those relevant DNSPs, which may be passed on to consumers. It may also reduce the efficiencies those DNSPs can achieve from economies of scale from operating two regulated networks. Therefore, in the case of the distribution guideline, we considered it appropriate for transmission services to be exempted from the separation obligations.

We are interested in stakeholders' views on whether reciprocal arrangements should apply, so that TNSPs may provide distribution services. The ENA suggested reciprocal arrangements should apply.<sup>12</sup> We are interested whether this should only be the case if the TNSP is involved in the provision of regulated distribution services – consistent with the intention of the distribution guideline. We would like to understand the reasons why TNSPs may need to provide these services, whether they are currently providing distribution services, and the potential benefits and harms from them doing so.

We note there are waivers in place for TasNetworks and EnergyAustralia (now Ausgrid), permitting them to operate their distribution and transmission businesses within the same legal entities. Irrespective of the outcome of this review, we expect these arrangements to continue and we will work with those businesses to ensure any required transition is smooth.

### **New and emerging electricity services**

New electricity markets are developing that were not envisaged when the current guideline was drafted. The 2019 Discussion Paper provides a summary of the services that some TNSPs are already providing, including consulting services, laboratory services, demand response services and construction of private electricity networks, and the potential harms that may arise. The ENA suggested it may become uneconomic for TNSPs to provide some of these services if they must be ring-fenced, compromising competition in these markets.<sup>13</sup> This will need to be weighed against the ability of TNSPs to potentially cross-subsidise the provision of these services, at a cost to consumers.

The treatment of batteries is addressed in the next section.

### **Non-electricity services**

TNSPs currently provide a range of non-electricity services such as telecommunications and fibre optics. As noted in the 2019 Discussion Paper, we consider there is limited scope for a TNSP to discriminate in favour of itself or an affiliate to provide non-electricity services. However, there is a potential for cross-subsidisation to occur.

<sup>11</sup> See NER, cl. 6.17.2 and 6A.21.2 for distribution and transmission, respectively.

<sup>12</sup> ENA, *Submission to the AER's Discussion Paper*, January 2020, p. 3.

<sup>13</sup> ENA, *Submission to the AER's Discussion Paper*, January 2020, pp. 7-8.



### Questions for stakeholders – legal separation – scope of services

2. What are the potential harms and benefits for consumers, the market and TNSPs of requiring TNSPs to legally separate transmission and non-transmission services?
3. How would the definitions for transmission services set out in Chapter 10 of the NER cover these new and emerging electricity services?
4. What is the appropriate range of services TNSPs should be able to provide without legal separation? For example:
  - a. Distribution services;
  - b. Contestable electricity services; and
  - c. Non-electricity services.

What are the possible harms and benefits to consumers and the market from TNSPs offering these services?

### 2.2.3 Treatment of batteries

Some TNSPs are investing in batteries to meet a network need, which can also be used to deliver contestable electricity services. Under the current guideline, TNSPs are able to provide generation services, up to a cap. They are also able to lease out spare battery capacity to a third party with limited regulatory oversight. Existing examples of where this has occurred include ElectraNet's ESCRI battery and AusNet's Ballarat substation battery. See our 2019 Discussion Paper for further information on these examples.

This issue was considered extensively in the context of amending the distribution guideline. Throughout that process a number of potential harms were identified with allowing DNSPs to lease out spare battery capacity, including the potential for cross-subsidisation, particularly given the nascent and emerging status of battery services markets. On the other hand, we recognise the role that batteries will play in the energy system and that optimising the use of batteries will ensure their full value can be realised.

For distribution, we concluded that allowing DNSPs to lease spare capacity, or use it to provide non-network services, with appropriate regulatory oversight would provide an appropriate balance between the tensions of reducing potential harms, and optimising the value of batteries. As such, DNSPs are required to apply for a waiver where they wish to use a battery for purposes other than providing regulated distribution services. The AER has created a streamlined process for consideration of such applications. DNSPs can continue to own and operate a battery without a waiver if it is solely for network purposes.

We hold similar concerns about the ability of TNSPs to cross-subsidise contestable services via a battery, stifle development of the nascent market for batteries, and favour an affiliate in providing contestable services via a TNSP-owned battery. Specific concerns include:

- The ability of TNSPs to install a battery using regulated revenue and subsequently use it to provide other, contestable services, cross-subsidised by consumers of regulated services and providing the TNSP with an advantage in contestable markets.

- The incentive for TNSPs to oversize a battery at a cost to consumers, with the intention of obtaining additional revenue from supplying contestable services or a leasing fee.
- The ability for TNSPs to operate their network in a way that favours a third party that leases a TNSP-owned battery.

Concerns were also raised during the AEMC’s Integrating Energy Storage Systems into the NEM rule change process about the ability of TNSPs to connect their own or affiliates’ batteries on favourable terms. This is discussed in chapter 3.

We note that the current guideline would not prohibit TNSPs from procuring network support from a third-party provider (including a related body corporate) that owns a battery and uses it to provide multiple services. Further, it is not envisaged that any amendments to the current approach would impact a TNSP’s ability to lease network assets for non-electricity services, such as telecommunications. We continue to encourage TNSPs to take advantage of underutilised assets for consumer benefit where they comply with the ring-fencing guideline and shared asset rules and guideline.

#### **Questions for stakeholders – legal separation – scope of services**

5. In the case of TNSP-owned batteries, should TNSPs be able to lease excess capacity to third parties? What are the potential harms and benefits to consumers, the market and TNSPs of this?

#### **2.2.4 Exceptions to legal separation**

As noted above, TNSPs can undertake generation, distribution and electricity retail supply activities up to a cap of 5% of annual revenue. It is not clear that this revenue cap approach remains appropriate in the context of significantly expanding transmission investment. Further, since annual revenue changes over time, there is risk that TNSPs could breach the cap, and it is more difficult for us to monitor compliance than under a waiver system.

While the purpose of the existing revenue cap is not clear from the ACCC decision on the current guideline, the cap may have been implemented to recognise that generation, distribution or load may present more efficient solutions for managing the transmission network than traditional network solutions. If this is the case, then clarifying the service-based approach to ring-fencing, as discussed in section 2.1, combined with the ability for TNSPs to obtain a waiver from this requirement should avoid the need for a revenue cap.

Certain DNSPs are permitted to earn generation revenue up to a cap of either 0.2%, 0.07% or 0.02% of the DNSP’s annual revenue requirement, depending on the DNSP. This is to facilitate stand-alone power systems where third party providers are unable or unwilling to provide the service, they cannot meet the necessary technical standards, or it would not be economic to outsource. There are no equivalent services that TNSPs are required to provide under the NER.

### **Questions for stakeholders – legal separation – exceptions:**

6. In relation to non-transmission services, what would be the harms and benefits to consumers, the market and TNSPs of moving to a waiver approach rather than a revenue cap?
7. If a revenue cap approach was maintained, what would be the appropriate form and magnitude of that cap?

### **2.2.5 Grandfathering arrangements**

Some TNSPs are already providing non-transmission services. If legal separation were to be required between transmission and non-transmission services, we note the ENA's concern that there would be some costs associated with divesting these existing services to a separate legal entity, including tax impacts and establishing new commercial agreements, licences and other regulatory obligations. For this reason, the ENA suggested that if legal separation is required, it should only apply on a prospective basis.

DNSPs were required to transition all services to the new arrangements when legal separation between distribution and transmission services and other services was introduced. However, we recognised that legal separation would involve some cost and so provided additional time for DNSPs to comply with the new arrangements for existing services.

We also note that TNSPs would be able to apply for a waiver if the costs of complying with any legal separation requirements outweighed the benefits.

### **Questions for stakeholders – legal separation – scope of services**

8. If legal separation is applied, how should existing services be treated?

The rest of this chapter summarises, in relation to legal separation and accounting and transactional separation, current TNSP obligations, current DNSP obligations, stakeholder submissions to the 2019 Discussion Paper, and our initial views. In the following tables, "C/P/UE" refers to the combined submission from Citipower, Powercor and United Energy.

**Table 1.2 Legal separation**

Current TNSP obligations	Current DNSP obligations	Stakeholder views	AER initial views
<p>TNSPs must not carry on a related business (generation, distribution or retail) unless the related businesses attract <math>\leq 5\%</math> of annual revenue in total.</p>	<p>A DNSP may provide distribution &amp; transmission services but must not provide other services. DNSPs may apply for a waiver to enable them to provide other services.</p>	<p><b>TNSP views:</b> TNSP capacity to participate in new services should be retained, to find innovative solutions to maintain system security (supported by reasons to build/buy storage). TNSPs should also be able to provide distribution services. Legal separation would impose costs.</p> <p><b>C/P/UE &amp; AEO:</b> TNSPs should be able to provide contestable services where efficient e.g. frequency control ancillary services.</p> <p><b>PIAC:</b> There are potential benefits for consumers by leveraging economies of scale from TNSPs e.g. system strength, inertia. TNSPs are also well placed to build a pool of demand response.</p>	<p><b>Scope of services:</b> Our initial view is that the guideline should be amended to be explicit about the services TNSPs can (and only can) provide. We are not proposing to amend the general restriction on TNSPs providing generation or retail services. We are open to considering whether TNSPs should be able to provide distribution services, in relevant circumstances such as where TNSPs currently also provide regulated distribution services. We are interested in stakeholder views on the potential harms and benefits of TNSPs being able to offer contestable electricity services and/or non-electricity services.</p> <p><b>Exceptions to legal separation:</b> We are interested in stakeholder views on the merits of a revenue cap – and if so, the form and level – versus waivers.</p> <p><b>Grandfathering arrangements:</b> We are interested in stakeholder views on the appropriate grandfathering arrangements for non-transmission services that are currently being offered by TNSPs if those services are required to be ring-fenced.</p> <p>Our initial view is that TNSPs will continue to be able to apply for a waiver from legal separation requirements.</p>
	<p>A DNSP may receive revenue from other services in its role as a stand-alone power system Resource Provider. This revenue must not exceed 0.2% of a DNSP's annual revenue requirement at most, depending on the DNSP. DNSPs must obtain a waiver if they wish to utilise a battery for any purpose other than providing network services, including leasing out spare capacity.</p>	<p><b>TNSP views:</b> The 5% cap should be retained to include any devices a TNSP may use that can also provide incidental market facing services.</p>	<p><b>Treatment of batteries:</b> We are interested in stakeholder views on the ability of TNSPs to use assets such as batteries to provide services other than prescribed transmission services, whether this should be permitted up to a cap, or whether it should require a waiver.</p>



## 2.4 Accounting and transactional separation

Accounting and transactional separation helps prevent cross-subsidies between regulated and non-regulated services by requiring a TNSP to have separate accounts for different service categories, attribute costs appropriately and account for transactions with its affiliate.

**Table 1.3 Accounting and transactional separation**

Current TNSP obligations	Current DNSP obligations	Stakeholder views	AER initial views
<p>TNSPs must establish &amp; maintain separate accounts for ring-fenced services &amp; separate amalgamated accounts for entire business. TNSPs must comply with any accounting guideline published by the AER.</p>	<p>DNSPs must establish &amp; maintain accounting procedures to be able to demonstrate the extent &amp; nature of transactions between the DNSP &amp; its affiliates.</p>	<p><b>TNSPs:</b> Current arrangements, as implemented by businesses, are adequate to avoid harms from cross-subsidies. The AER needs to demonstrate a failure before changes are made.</p>	
<p>TNSPs must allocate costs between ring-fenced services &amp; other activities in accordance with any guidelines published by the AER or prepared by the TNSP and approved by the AER.</p>	<p>DNSPs must allocate costs to distribution services consistent with the Cost Allocation Principles &amp; approved CAM, as if the Cost Allocation Principles &amp; CAM otherwise applied to the allocation of costs between distribution &amp; non-distribution services.</p>	<p><b>C/P/UE &amp; AEO:</b> Cost allocation remains an issue for connections. TNSPs are advantaged in timing and cost of access to the shared network and price &amp; Ts&amp;Cs for shared assets. Separation of bids for regulated &amp; unregulated work would reduce risk of cross-subsidisation &amp; proforma connection contracts for regulated works.</p> <p><b>TNSPs:</b> Current arrangements, as implemented by businesses, are adequate to avoid</p>	<p>As set out in the 2019 Discussion Paper, the current guideline relies on financial reporting based on the Information Guidelines, which require cost allocation consistent with an AER-approved CAM. However, CAMs are only required to address cost allocation between different types of transmission services. There is no existing reporting mechanism or enforceable obligation that requires correct cost allocation between transmission and non-transmission services. This has been updated in the interim draft guideline, and we will consider stakeholder responses to these issues as part of that separate consultation process.</p>

		harms from cross-subsidies. The AER needs to demonstrate a failure before changes are made.	
The AER is able to waive this obligation.	A DNSP cannot apply for a waiver from these obligations.	<b>TNSPs:</b> Current arrangements, as implemented by businesses, are adequate to avoid harms from cross-subsidies. The AER needs to demonstrate a failure before changes are made.	Our initial view is that we will remove the ability for TNSPs to apply for a waiver from accounting requirements. As the scope of potential services a TNSP may offer increases and the nature of TNSPs' businesses are changing/growing, it is increasingly important to have transparency between costs that are allocated to transmission services and other services to help prevent cross-subsidisation.

### 3 Preventing discrimination

Similar to the ring-fencing measures that address cross-subsidisation, the measures in the current guideline to prevent discrimination by a TNSP in favour of an affiliate are relatively light handed compared to those for DNSPs. There are several reasons why it is timely to consider whether current ring-fencing measures aimed at preventing discrimination by a TNSP in favour of an affiliate need to be strengthened:

- TNSPs have a significant degree of influence over a generator's activities in the wholesale market due to control over connection requirements, access arrangements and network congestion, and so they have an ability to favour affiliates in this market.
- Under both the Transmission Connections and Planning Arrangements and the Dedicated Connection Assets framework, TNSPs determine which components of an identified user shared asset are separable from the existing transmission network and therefore contestable. TNSPs could favour their own business in making that determination. Further, any third party owner of an identified user shared asset must enter into a network operating agreement with the TNSP responsible for the shared network. A TNSP could favour an affiliated business in agreeing the terms and conditions of a network operating agreement.
- Changes to the way in which TNSPs may operate their businesses – including expanding into new markets and the use of batteries that can provide both regulated and contestable services – are increasing opportunities and associated risks for TNSPs to discriminate in favour of their own or an affiliated business. This includes, for example, leasing out spare battery capacity to be commercially traded in competitive markets including, for example, in new fast frequency response markets.
- TNSPs have a role in procuring inertia and system strength. TNSPs could potentially discriminate in favour of their affiliated business, or a third party leasing a TNSP's battery, in procuring these services.
- Concern about the preferential treatment of TNSPs or their affiliates in connecting batteries was raised during the AEMC's [Integrating Energy Storage Systems into the NEM](#) rule change process. Some stakeholders were concerned that the framework for negotiating battery connection agreements, including transmission use of systems charges, is opaque, and a TNSP could favour its own business or an affiliate.<sup>14</sup> Others pointed to the importance of ring-fencing to prevent this occurring.<sup>15</sup>
- The potential for common ownership of transmission and generation may be increasing in the context of renewable energy zones, as well as the recent [attempted takeover bid of AGL](#) by a consortium that included the owner of Ausnet Services. Therefore, the need for non-discrimination arrangements may increase to remain fit for purpose in the future.
- Legal separation by itself is not a sufficient ring-fencing tool to target discrimination where there is sharing of staff, offices, branding and commercially sensitive information.

<sup>14</sup> See submissions by AGL (p. 2), EnergyAustralia (p. 7), Snowy Hydro (p. 2) and Iberdrola (p. 3) to the AEMC's draft determination.

<sup>15</sup> See, for example, the submission by Endeavour Energy (p. 2) to the AEMC's draft determination.



Our 2019 Discussion Paper identified a number of gaps in the existing arrangements, including that the current guideline only considers discrimination in relation to the provision of prescribed transmission services, not contestable services. Further, the functional separation arrangements are more relaxed for TNSPs than for DNSPs. Some measures have been put in place to address discrimination in the context of contestable transmission connection services, such as clarifying the contestable components of a transmission connection and imposing information requirements to support transparency for connection applicants and so competition.<sup>16</sup> However, we are concerned gaps may remain, as noted above.

As a result of these gaps, combined with the significant change in market context, we consider current measures to prevent discrimination need to be strengthened.

There are four tools that we may use to limit TNSPs' ability to discriminate in favour of their own, or an affiliated, business:

- a general obligation not to discriminate
- functional separation of offices, staff, branding and cross-promotions
- restrictions on sharing of confidential information and information sharing obligations to promote information symmetries
- application of non-discrimination measures to third party service providers.

It may be appropriate to implement a different mix of ring-fencing tools to prevent discrimination for TNSPs than DNSPs. There are differences in the operating environments that may warrant a less onerous application of some of the ring-fencing measures than for distribution. For example:

- TNSPs' customers tend to be larger and more sophisticated than those of DNSPs, with greater access to financial, technical and legal resources
- TNSPs tend to have a smaller, more specialised staff that may make staff and office separation more onerous.

Whether the benefits of strengthening the functional separation requirements, in particular, outweigh the costs is an issue we want to explore further with all stakeholders.

The ENA has suggested that competition concerns are addressed through a combination of the current guideline and the *Competition and Consumer Act 2010* (CCA).<sup>17</sup> The ENA further suggests that to the extent that competition concerns remain, including if new, contestable activities emerge, these should be addressed via the rules as was the case for connections. Similarly, the ENA suggested that the rule change process is an appropriate means to address any gaps in the arrangements should TNSPs' functions change as a result of ongoing market reforms.

We are able to set out specific obligations in the guideline to mitigate the risk of TNSPs favouring their own contestable services or their affiliates over other providers. This is particularly important in new and emerging energy markets in order to provide an equal

<sup>16</sup> See AEMC, *Transmission Connection and Planning Arrangements, Rule Determination*, 23 May 2017.

<sup>17</sup> ENA, *Submission to the AER's Discussion Paper*, January 2020, p. 7.

playing field for competitors of a TNSP or their affiliates, who could otherwise gain an advantage by reason of their relationship with the TNSP. In this respect, unlike the general competition laws, the guideline is industry-specific and is designed and enforced by us specifically to promote the national electricity objective.

The merits of the rule change process are outside the scope of this issues paper. However, we wish to clarify that the contestable connections rule change was initiated to address a range of issues in relation to both connections and planning and should not be seen as setting a precedent for future treatment of contestable transmission services. Rather, ring-fencing clearly falls within the purview of the AER and is complementary to the NER. This is also the view of the AEMC, which declined to institute a new framework for connecting storage assets owned by network services providers (NSPs), noting:<sup>18</sup>

*Given the AER manages ring-fencing arrangements for NSPs in the NEM, the Commission does not consider it appropriate to establish a new framework for connecting NSP owned assets whilst a review of these arrangements is ongoing.*

Contrary to the ENA's view that addressing gaps via rule changes rather than the guideline would "ensure a consistent approach is taken in the transmission framework", we consider a single, clear guideline is more likely to promote consistency than a series of rule changes. Further, the waiver approach provides more flexibility for any restrictions or obligations to be lifted, if the benefits of doing so outweigh the costs, than amending the NER. In addition, a single approach to ring-fencing via our guideline enables TNSPs to demonstrate, and us to monitor and assess, compliance under a single reporting framework.

The AEMC's final rule determination on the Transmission Connections and Planning Arrangements acknowledged that ring-fencing still had a role to play in connections, and that TNSPs would need to comply with the ring-fencing guidelines as well as the NER. The AEMC recognised concerns held by the TNSPs about the potential for strengthened functional separation arrangements to make it more costly to provide certain transmission connection services, particularly in relation to negotiated services that TNSPs are obliged to provide. The AEMC expressed a view that in terms of functional separation "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".<sup>19</sup>

Our initial view is that negotiated transmission services should not be functionally separated from the part of the business providing prescribed transmission services, since TNSPs are obliged to provide these services. However, we intend to consider further the appropriate arrangements for contestable transmission services and non-transmission services.

The remainder of this chapter summarises current TNSP obligations, current DNSP obligations, stakeholder submissions to the 2019 Discussion Paper, and our initial views on

<sup>18</sup> AEMC, *Integrating Energy Storage in the NEM, Draft rule determination*, 15 July 2021, p. 143.

<sup>19</sup> AEMC, *Transmission Connection and Planning Arrangements, Rule Determination*, 23 May 2017, p. 167-168.

each of the measures available for limiting the potential for TNSPs to engage in discriminatory behaviour. It also poses a number of questions for stakeholder consideration.

## 3.1 Obligation not to discriminate

**Table 1.4 Obligation not to discriminate**

Current TNSP obligations	Current DNSP obligations	Stakeholder views	AER initial views
Only considers discrimination in relation to prescribed transmission services, not contestable services, and has less definition around “discrimination” than the distribution guideline.	DNSPs must not discriminate between any related electricity service provider and its competitor in connection with direct control distribution services and/or contestable electricity services.	<b>TNSPs:</b> Any changes must be supported by robust analysis that focuses on specifics of TNSPs, how they operate in the market, specific harms that could emerge, and existing rules and competition law provisions to identify the gaps before considering ring-fencing options.	Our initial view is that we will broaden this obligation to apply to contestable electricity services. This approach aligns with distribution and recognises the ability of TNSPs to discriminate in favour of themselves or an affiliate in providing contestable services as a result of its position in providing prescribed transmission services.  Our initial view is that TNSPs would not be able to apply for a waiver from this obligation.

### Questions for stakeholders – preventing discrimination – obligation not to discriminate:

9. What are the key potential harms and risks that an obligation not to discriminate should target?
10. What are the potential harms and benefits to consumers, the market and TNSPs of strengthening the obligation not to discriminate?

## 3.2 Functional separation

**Table 1.5 Functional separation**

Current TNSP obligations	Current DNSP obligations	AER specific initial views
<b>Offices</b>		
No obligation.	DNSPs must use offices that are separate from a related electricity service provider, subject to certain exemptions.	Separation of offices helps prevent sharing of commercially sensitive information between regulated network staff and staff of an affiliate. While this is an important harm to address, this will need to be balanced against the cost. TNSPs would be able to apply for a waiver from these requirements.
<b>Staff</b>		
TNSPs must ensure that:	DNSP must ensure that its staff involved in the provision or marketing of direct control services are not also involved in the provision or marketing of	TNSPs and DNSPs have different workforce profiles, which impacts the staff roles that may be in a position to provide an affiliate with a discriminatory advantage through staff sharing. However, there may be risks if staff provide

<ul style="list-style-type: none"> <li>Marketing staff do not work for an 'associate' that takes part in a 'related business'.</li> <li>None of its staff are marketing staff of an associate that takes part in a related business.</li> </ul>	contestable electricity services by a related service provider, subject to certain exemptions.	specialised input across multiple services and where TNSPs have available confidential information about their networks not generally available to competitors.  TNSPs would be able to apply for a waiver from these requirements.
<b>Branding and cross-promotion</b>		
No obligation.	DNSP must use branding for regulated distribution services that are independent and separate from branding used by a related electricity service provider, & must not cross-promote services offered by the related electricity service provider, subject to certain conditions.	In terms of branding and cross-promotion, direct customers of TNSPs tend to be larger, sophisticated corporate entities with access to significant financial resources and specialist legal and technical advice. Harms associated with branding and cross-promotion may therefore be lower than for distribution.  TNSPs would be able to apply for a waiver from these requirements.
<b>Stakeholder general views</b>		<b>AER general initial views</b>
<p><b>TNSPs:</b> Connections are the main contestable transmission service and these are already addressed in the NER. Any gaps should be addressed through rule changes.</p> <p>Creating catch-all provisions for any new services risks overly onerous arrangements. If new contestable activities emerge with competition concerns, these should be addressed at the time.</p> <p>The potential introduction of a congestion management mechanism and the Integrated System Plan have the potential to require TNSPs to provide new services, undertake new functions or preclude TNSPs from providing services in particular ways. Any changes to ring-fencing now should not conflict with or pre-empt these outcomes.</p> <p>If onerous ring-fencing measures were to apply, it may not be economic for TNSPs to continue to offer some services, reducing competition in those markets.</p> <p><b>C/P/UE &amp; AEO:</b> Ring-fencing must not stifle innovation, must allow third party access to TNSPs' regulated resources and allow TNSPs to provide contestable services where efficient e.g. frequency control ancillary services.</p> <p><b>PIAC:</b> Direct customers &amp; competitors of TNSPs are larger and more sophisticated than for DNSPs.</p>		<p>Our initial view is that strengthened ring-fencing obligations in relation to functional separation may be appropriate. However, differences in operating environments between TNSPs and DNSPs mean that some differences may be appropriate. TNSPs will be able to apply for a waiver.</p> <p>We will consider the need for functional separation in the context of the different types of services that TNSPs may offer and whether there is scope for a TNSP to harm the competitiveness of a market by using their position as TNSP to discriminate in favour of an affiliate providing those services.</p> <p>For transmission services:</p> <ul style="list-style-type: none"> <li>Negotiated transmission services are provided on a monopoly basis by a TNSP, subject to an AER-approved negotiating framework, and so there is limited scope for harms arising from discrimination.</li> <li>While some non-discrimination provisions are included in the NER for contestable connection services, as noted above opportunities for discrimination may still arise in determining the contestable components of a connection and the Ts&amp;Cs of the network operating agreement.</li> <li>There may be other contestable transmission services to consider.</li> </ul> <p>For electricity generation and retail services, as noted above, TNSPs have a high degree of influence over a generator's activities in the wholesale market due to control over connection requirements, access arrangements and network congestion, and so an ability to favour affiliates.</p> <p>For new and emerging services:</p> <ul style="list-style-type: none"> <li>The 2019 Discussion Paper sets out examples of where discrimination may occur in relation to a TNSP leasing the use of its battery to an affiliate and the TNSP is contracted to build a behind-the-meter microgrid. TNSPs may also be able to discriminate in favour of an affiliate that owns and operates a battery and is participating in wholesale or system security services markets.</li> </ul>

	<ul style="list-style-type: none"> <li>Some TNSPs already offer services that were not envisaged when the current guideline was drafted. There may be limited opportunities for discrimination in some of these markets, such as electricity-related consultancy services and specialised testing and laboratory services, in which case it is possible that the cost of functional separation may outweigh the benefits.</li> </ul> <p>TNSPs can currently use the same offices to provide prescribed and contestable services, and there are no restrictions on branding or cross-promotion. The staff sharing restrictions are limited to marketing staff.</p>
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**Questions for stakeholders – preventing discrimination – functional separation:**

11. What are the potential harms and benefits to consumers, the market and TNSPs of introducing additional functional separation obligations for:
  - a. staff sharing;
  - b. office sharing; and
  - c. branding and cross-promotion?
12. Should any new functional separation obligations apply to all contestable services? Should any exceptions apply, and if so, why?

### 3.3 Information access and disclosure

**Table 1.6 Information access and disclosure**

Current TNSP obligations	Current DNSP obligations	Stakeholder views	AER initial views
TNSPs must ensure that information regarding prescribed transmission services given to an affiliate taking part in a related business is available to others.	DNSP must keep private electricity information confidential and only disclose under certain circumstances. If a DNSP does disclose confidential information to a related electricity services provider they must make that information available to the competitors of the related electricity provider through a public information sharing register, governed by an	<p><b>TNSPs:</b> Not specifically addressed, but generally they consider the current framework is sufficient, particularly as a result of the Transmission Connections and Planning Arrangements rule change. Any gaps in the arrangements should be addressed through rule changes.</p> <p><b>C/P/UE &amp; AEO:</b> information provision remains an issue that cannot be overcome by</p>	<p>Our initial view is that we will align the transmission guideline with the distribution guideline by:</p> <ul style="list-style-type: none"> <li>Introducing a new obligation to protect ring-fenced information.</li> <li>Introducing a new obligation to address the circumstances under which ring-fenced information may be disclosed.</li> <li>Strengthening the obligation that requires ring-fenced information to be shared where it is disclosed to an affiliate.</li> <li>Introducing a new obligation to establish, maintain and keep an information register to facilitate information sharing.</li> </ul>

	information sharing protocol.	customers and potential competitors of TNSPs.	<p>This recognises the potential for TNSPs and their affiliates to gain an unfair advantage from information they obtain from providing prescribed transmission services.</p> <p>We will consider the application of these proposed obligations under the Transmission Connection and Planning Arrangements to ensure consistency. Our initial view is that the proposed provisions are complementary and extend the requirements to include information not captured by the existing information sharing requirements.</p> <p>Our initial view is that TNSPs would not be able to apply for a waiver from this obligation.</p>
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**Questions for stakeholders – preventing discrimination – information access and disclosure:**

13. What are the potential harms and benefits to consumers, the market and TNSPs of aligning the transmission and [distribution guideline](#) in relation to information access and disclosure?
14. Are there any potential inconsistencies with the [Transmission Connections and Planning Arrangements](#) rule change we need to consider?

### 3.4 Requirement for service providers to comply

**Table 1.7 Requirement for service providers to comply**

Current TNSP obligations	Current DNSP obligations	Stakeholder views	AER initial views
No obligation on third parties providing prescribed services on behalf of a TNSP	Non-discrimination obligations are extended to service providers that enable or assist the DNSP to supply direct control services.	Not raised in the 2019 Discussion Paper.	<p>Amend the current guideline to align with the distribution guideline for consistency and to recognise that discrimination and information leaks can also come from third party service providers.</p> <p>Our initial view is that TNSPs would be able to apply for a waiver from some, but not all, elements of this obligation, consistent with the distribution guideline.</p>

**Question for stakeholders – preventing discrimination – requirement for service providers to comply:**

15. What are the potential harms and benefits to consumers, the market and TNSPs of aligning the transmission and distribution guidelines in relation to obligations on third party service providers that support the provision of prescribed transmission services?

## 4 Compliance

To date, we have had limited oversight of TNSP compliance with the current guideline. While we have the ability to require TNSPs to report on measures taken to ensure compliance, including an independent audit, this has not been exercised in recent years.

Regular reporting is necessary for two reasons. First, it enables us to carry out our responsibilities to monitor TNSP compliance with the guideline. Second, it provides transparency to the market, giving competitors confidence that TNSPs are operating within the rules and assurance that they can offer services on a level playing field. Without this protection, potential competitors may be reluctant to enter a market, limiting the scope for competition to increase.

With the increasing size and scope of TNSPs and the markets that they or their affiliates may operate in, effective monitoring of compliance will only become more important. This is particularly the case in nascent markets where, if competition is to flourish, every competitor must have access to the same opportunities.

The ENA considered that compliance reporting should remain as it is today on the basis that onerous compliance reporting arrangements would introduce substantial new costs and that we already have powers to require compliance reporting at any time.<sup>20</sup> In contrast, we consider that regular monitoring is increasingly necessary for reasons noted above. Further, we consider that in the long run, having a formal system in place for regular reporting will be less onerous than ad hoc requests from us that are likely to increase in frequency.

Our initial view is that the scope of reporting should also be expanded from simply reporting on measures taken to ensure compliance to include breaches, services provided by TNSPs other than those explicitly permitted in the guideline, and the purpose of all transactions between the TNSP and any affiliate. The purpose of the increased scope would be to provide both us and the market with greater transparency and evidence that a TNSP is complying with ring-fencing obligations.

To facilitate compliance reporting, both regular reporting and reporting of breaches, we could publish a compliance reporting best practice manual and a template for reporting breaches, as we have done for DNSPs.

The remainder of this chapter summarises current TNSP obligations, current DNSP obligations, stakeholder submissions to the 2019 Discussion Paper, and our initial views on compliance obligations. It also poses a number of questions for stakeholder consideration.

<sup>20</sup> ENA, *Submission to 2019 Discussion paper*, p. 20.



**Table 1.8 Compliance**

Current TNSP obligations	Current DNSP obligations	Stakeholder views	AER initial views
<b>Maintaining compliance</b>			
TNSPs must establish appropriate procedures to ensure compliance.	DNSPs must establish appropriate procedures to ensure compliance.	Not raised in the 2019 Discussion Paper.	Amend the guideline to align with distribution and modernise the language.
<b>Reporting compliance</b>			
As required by the AER, TNSPs must report on measures taken to ensure compliance. This could include an independent audit.	DNSPs must prepare an annual compliance report covering measures taken to ensure compliance, any breaches, all “other services” provided by the DNSP & the purpose of all transactions between the DNSP & any affiliate. The report must be assessed by an independent auditor.	ENA considers reporting and compliance must be fit for purpose. Onerous compliance and reporting requirements would impose costs that may outweigh the benefits.	Align the current guideline with distribution by requiring regular compliance reporting, including independent assessment obligations, and expand the scope of reporting. There will be a cost to TNSPs, but reporting is critical for us to monitor behaviour and provide transparency to the market. Further, we consider the costs of implementing regular, systemic reporting are likely to be lower in the long run than frequent ad hoc reporting.
<b>Breaches</b>			
TNSPs must report any breaches of the guideline immediately.	A DNSP must notify us within 15 business days of becoming aware of a breach of its obligations under the Guideline.	Not raised in the 2019 Discussion Paper.	Amend the guideline to allow TNSPs 15 business days to notify us of any breach to align with the distribution guideline.
<b>Complaints and investigations</b>			
No obligation.	Allows us to require a DNSP to provide a written response to a concern we raise about compliance.	Not raised in the 2019 Discussion Paper.	Amend the guideline to introduce the same obligation on TNSPs to allow us to carry out our monitoring function.
			Our initial view is that TNSPs would not be able to apply for a waiver from these obligations.

**Questions for stakeholders – compliance:**

16. What are the potential harms and benefits to consumers, the market and TNSPs of expanding the scope of compliance reporting?
17. Should the timeframe for reporting breaches be extended to 15 days?

## 5 Other issues

This chapter sets out current TNSP obligations, current DNSP obligations, stakeholder submissions to the 2019 Discussion Paper, and our initial views on three issues:

- waivers, including the assessment criteria we propose to adopt for considering waivers
- transitional arrangements
- additional ring-fencing obligations, that are already permitted to be imposed under the current guideline.

### 5.1 Waivers

Experience with the distribution guideline has shown that waivers provide useful flexibility in applying ring-fencing provisions. Where certain activities or services are broadly prohibited, waivers provide a mechanism to exempt a service provider from having to comply where the costs of compliance with a specific provision/s outweighs the benefits to consumers. While waivers are permitted under the current guideline, the process for applying for waivers and the way in which we assess such applications is not well specified. Further, waivers can currently be granted for any ring-fencing obligation. We propose to limit the obligations for which a waiver can be granted, as noted throughout the tables.

**Table 1.9 Waivers**

Current TNSP obligations	Current DNSP obligations	Stakeholder views	AER initial views
The AER may waive any of the TNSP's obligations if it is satisfied the benefit to the public is outweighed by the cost to the TNSP of complying with the guideline. In deciding whether to grant a waiver the AER must consult.	Address details on a range of issues relating to the application and consideration of waivers, including class waivers.	<b>TNSPs:</b> If a change was made such that waivers could be revoked at any time, or were time limited, this would impact on staff resourcing, services and costs which will ultimately impact on customers.	Our initial view is that we will adopt the same waiver assessment criteria as for DNSPs. We will further consider the application of other aspects of the distribution guideline waivers, including: <ul style="list-style-type: none"> <li>• the length of time for which a waiver may be granted, particularly in light of the service classification framework which is less flexible for TNSPs and</li> <li>• whether class waivers may be appropriate.</li> </ul>

#### Questions for stakeholders – waivers:

18. Would there be benefit in the AER providing more clarity on the application and assessment process for waivers?
19. Do you agree with the AER's initial views that certain clauses should not be subject to waivers (e.g. the obligation not to discriminate and information access and sharing)? Please explain your reasons.

- 20. Which elements of the assessment criteria used to assess waiver applications by DNSPs would be appropriate for transmission?
- 21. What factors should we take into account in considering the duration of waivers?
- 22. Are there any circumstances where class waivers may be appropriate for transmission?

## 5.2 Transitional arrangements

**Table 1.10 Transitional arrangements**

Current TNSP obligations	Current DNSP obligations	Stakeholder views	AER initial views
n/a	Sets out the date by when DNSPs must comply with the guideline and other transitional arrangements.	Duration of transitional period depends on extent of the changes. Significant changes can have material effects on operation, potentially requiring new staff to be hired. This may also prompt considerations of whether to stop providing some services.	A relatively short transition is our preferred approach, but this will depend on the nature of the final guideline and so the time required, as relevant, to legally separate services, establish appropriate accounting and transactional separation processes, comply with functional separation requirements and establish compliance reporting mechanisms.  For reference, the DNSP guideline was published in November 2016, and DNSPs were required to comply with the guideline by 1 January 2018. However, for longer term transitional activities, waivers were considered.

## 5.3 Additional ring-fencing obligations

**Table 1.11 Additional ring-fencing obligations**

Current TNSP obligations	Current DNSP obligations	Stakeholder views	AER initial views
The AER may impose additional obligations on a TNSP if it is satisfied the cost to the TNSP & its affiliate of complying with additional obligations is outweighed by the benefit to the public. The AER must consult on proposed obligations.	n/a	<b>TNSPs:</b> Noted this ability.	By implementing more comprehensive and robust ring-fencing requirements the ability for us to impose additional ring-fencing obligations will no longer be required. As such, our initial view is that if the guideline is strengthened, this clause would be removed.  An alternative approach to strengthening the current guideline would be to rely on this clause to impose obligations on TNSPs as and when required. However, we consider this approach would create significant uncertainty and risks for TNSPs and reduce transparency for other market participants. Further, TNSPs would not have confidence about their ability to offer certain services.  As such, we consider it better regulatory practice to establish a more comprehensive and stable set of guidelines rather than relying on an ad hoc approach to ring-fencing.

**Question for stakeholders – additional ring-fencing obligations:**

23. What are the potential harms and benefits to consumers, the market and TSNPs of removing the ability of the AER to impose additional obligations on a TNSP (clauses 9 and 10 of the guideline)?