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Dear General Manager

Draft Decision: Ring-fencing Guideline Electricity Transmission

We appreciate the opportunity to submit a response to the Australian Energy Regulator's (**AER's**) draft *Electricity Transmission Ring-fencing Guideline* and accompanying draft *Explanatory Statement* (**Draft Decision**).

Ring-fencing guidelines and similar instruments play an important role in circumstances where there is a real, evidence-based risk that harms such as cross-subsidies, discriminatory behaviour or misuse of confidential information will distort market competition. However, given the existing regulatory arrangements in Victoria prevent these harms, AusNet remains of the view that there is no need for any Declared Transmission System Operators (**DTSOs**) (including AusNet) to be subject to additional ring-fencing obligations.

The declared functions of the Australian Energy Market Operator (**AEMO**) and the generally applicable contestability regime in Chapter 8 of the National Electricity Rules (**NER**) combine to deliver a robust and transparent market for contestable transmission services. Specifically, it is AEMO that is the planner of declared shared network augmentations and the party that determines the specifications and configurations for the existing network and all such augmentations; DTSOs do not direct or influence these activities. Further, it is Chapter 8 that determines which DTSOs (or potential DTSOs) will be responsible for, among other things, providing AEMO with shared transmission services in connection with such augmentations, ensuring DTSOs cannot discriminate between, or against, contestable electricity service providers.

While it continues to be our position that additional ring-fencing obligations would provide no net benefit in Victoria, we make the following submission in response to the Draft Decision.

The need for reform must be supported by evidence

DTSOs tend to be relatively small businesses from an operational and personnel perspective and, consequently, they have limited systems, offices, staff and functions. Therefore, incremental cost increases or changes to the business or operating model can have a material impact. That is why we have, and the industry more broadly has, repeatedly called for the AER to publish the evidence and analysis that demonstrates that the benefits of its proposed approach to ring-fencing outweigh the costs. Relying solely on economic theory and pursuing consistency with the Distribution Ring Fencing Guideline for consistency's sake alone is not sufficient to justify that the AER's proposed approach is reasonable, because it does not take account of the specific circumstances of the transmission sector. The AER's continued failure to present this evidence is inconsistent with regulatory best practice and hinders the ability for all stakeholders to meaningfully engage with and critique the Draft Decision.

The operation and pro-competitive impact of the contestability arrangements in Victoria underscore the need for stakeholders to access the evidence that underpins the Draft Decision. Decisions to invest in new Victorian transmission network assets are made by AEMO through a competitive procurement process which has maintained competition and market integrity in transmission investment projects in Victoria for over two decades. These arrangements have been fundamental to creating a framework that has helped:

- drive down costs;
- identify innovative design solutions; and
- provide greater certainty regarding the timely delivery of infrastructure.

As such, the concerns raised by the AER regarding the potential harms to competition and innovation arise largely due to the lack of any genuine contestable arrangements outside of Victoria, and the fact that in other jurisdictions a Primary TNSP undertakes the activities undertaken by AEMO in Victoria. We would, therefore, welcome the opportunity to review any analysis that demonstrates that compliance with the AER's proposed transmission ring-fencing guideline will not impose additional costs or erode the benefits of contestability currently in Victoria.[1]

The impacts will be disproportionate in Victoria due to the existing, broad-based, contestable transmission service regime

Service classification in Victoria differs to that in other National Energy Market (**NEM**) jurisdictions. A service that is contestable in Victoria may be a prescribed or negotiated service in another jurisdiction. This means:

- the breadth of contestable services in Victoria is greater compared to other NEM jurisdictions; and
- there are presently, significantly greater opportunities for interstate TNSPs, and new (including potential) DTSOs, to compete in Victoria.

Somewhat counter intuitively, the Draft Decision, if adopted, would have a greater impact on the cost of operations of DTSOs in Victoria – a jurisdiction in which there is a pre-existing, robust, contestable market, generally for all significant network augmentations (and correspondingly, the provision of contestable transmission services).

By comparison, the present scope for parties, other than the Primary TNSPs, to provide contestable transmission services in other NEM jurisdictions is extremely limited. Examples of significant, proposed augmentations for which there is no scope for contestable transmission services to be provided, include:

- Project EnergyConnect (both the South Australia and New South Wales sections);
- Hume Link; and
- the NSW section of VNI West.

These projects may be squarely contrasted with the Western Renewables Link, which was subject to a comprehensive, robust tender conducted by AEMO. The Victorian section of VNI West is expected to be contestable.

As also previously submitted, the recent changes to the NER as they apply in jurisdictions other than Victoria[2] have further reduced the level of competition for the already somewhat limited contestable transmission connections regime in Chapter 5. In particular, the recent substitution of what were large, dedicated connection assets (**DCAs**)[3] with the concept of designated network assets (**DNA**s) has had the result that connecting parties have no choice but to rely on the Primary TNSP to design and operate these assets. We are, therefore, concerned that:

- requiring the Primary TNSP to provide the functional specification and O&M of DNAs as a negotiated service could reduce the level of competition and innovation present. This would, in-turn, increase costs compared with the existing large DCA regime; and

[1] While we welcome the AER agreeing that there is limited scope for TNSPs to discriminate in favour of itself or an affiliate in providing non-electricity services, we are concerned that the AER continues to have concerns about the scope for TNSPs to cross-subsidise these services, notwithstanding the strict and transparent cost allocation requirements we must adhere to when submitting information to the AER. For the non-transmission services that AusNet currently provides, these are offered to large, well-resourced and sophisticated customers. This means purchasers are well-placed to negotiate fair and reasonable commercial arrangements and do not require specific protection through the ring-fencing guideline. If a prospective purchaser is concerned by a DTSO's or TNSP's behaviour, it can raise those concerns with the vendor or with the Australian Competition and Consumer Commission (**ACCC**).
[2] *National Electricity Amendment (Transmission Connection and Planning Arrangements) Rule 2017 No 4* and *National Electricity Amendment (Connection to dedicated connection assets) Rule 2021 No. 7*.
[3] *National Electricity Amendment (Connection to dedicated connection assets) Rule 2021 No. 7*.

- the Primary TNSP not always offering low cost or innovative O&M services compared with third party service providers. Again, this could increase the costs that are ultimately borne by customers.[4]

While the AEMC has acknowledged our concerns about the reduction in contestability compared with the existing regime for large DCAs, and it agrees that by requiring the Primary TNSP to provide functional specification as a negotiated service there may be reduced opportunities for cost-saving and innovation, it nonetheless concluded that these reforms were appropriate.

If the AER's focus in updating the transmission ring-fencing guideline is to promote contestability and minimising harm to competition, we encourage it to carefully consider how recent rule changes have, and how future reforms could, undermine the very objectives it is seeking to achieve. Put simply, we consider there is an open question as to the level of contestability for the provision of transmission services in other NEM jurisdictions. As such, greater improvements to the regulatory framework could be achieved by focusing on wider market frameworks (including through the rule change process) rather than on transmission ring-fencing.

We have not referred to the development of the Central West Orana renewable energy zone in this discussion, as that is an entirely bespoke process, specific to NSW. In particular, it is not yet clear the status, under the NER or otherwise, that the consortia bidding for the development of that zone infrastructure will assume and whether or not they will, ultimately, operate the infrastructure and, consequently, provide associated transmission services.

To the extent the Draft Decision imposes obligations on TNSPs with respect to contestable transmission services, it imposes a disproportionate cost on DTSOs in Victoria while not providing any benefit. This, in-turn, raises concerns about the level of competition in Victoria relative to that which is allowed in other NEM jurisdictions.

Transition period

We note the AER's apparent intention to afford TNSPs a 12-month transition period to implement the transmission ring-fencing guideline. While we remain of the view that it is preferable to allow TNSPs at least two years to legally separate their contestable electricity services from their ring-fenced operations, a 12-month transition could be managed, provided TNSPs are actually able to use that time to focus on the transition to the new guideline.

As drafted, the AER's proposal does not provide a genuine implementation period. Rather, the Draft Decision anticipates that the material compliance and reporting obligations will begin on the date the guideline commences, describing it as a period of "limited assurance and reduced compliance…in the first year of Version 4 of the guideline".[5] Specifically, it states:

- 15-day breach reporting of all breaches applies from the commencement date; and
- annual compliance reporting is required for the period of commencement date to 31 December 2023. Reports should be submitted by 30 April 2024.

There are also some fundamental problems with the AER's proposed approach:

- There is an internal inconsistency in the AER's logic. If the guideline takes effect 12 months after the commencement date, there will be no binding obligations to breach, and therefore no breaches to report, for the first 12 months after the commencement date.
- By imposing these obligations from the commencement date, the transition period will be limited to the period between the date the final guideline is made, and the commencement date. This will give rise to several practical and operational problems, including:

[4] We are also concerned that the 30 km line length threshold which defines a DNA framework is not based on any evidence, and a change to this definition would facilitate much greater competition in connections (rather than arbitrarily restricting competition to assets less than 30km in length).
[5] AER, *Electricity Transmission Ring-fencing Guideline Explanatory Statement, version 4 - Draft*, p 51.

- the resources that should be focused on successfully transitioning will, instead, be focused on meeting the new requirements or setting up the processes and procedures to ensure compliance; and

- the time and resourcing pressures, which will ultimately increase costs to TNSPs which, as the AER has acknowledged, are likely to be passed on to customers.[6]

- It appears the AER intends for clause 3.1(c) to take effect on the commencement date, but the waiver process (which would allow the TNSP to enter into agreements with third parties to use batteries to provide non-network services) would not be available for 12 months. This would effectively impose a year-long moratorium on TNSP involvement in the market for battery-related services. In Victoria, this might also have the result of excluding TNSPs from participating in tenders run by AEMO with respect to equipment such as synchronous condensers where, only very recently, AEMO ran a tender for services from such equipment on the basis the services would be "non-network services". Under the Draft Decision, a TNSP would be prevented from tendering for this service, as it would not be a "transmission service" and, as such, a waiver would be required to permit a TNSP to participate.

We invite the AER to reconsider and clarify, at the earliest opportunity, its proposal for transitioning to the new guideline. We suggest that the entirety of the new guideline – including the breach and compliance reporting requirements – do not come into effect until 12-months after the commencement date.

While we acknowledge the reduced functional separation requirements of the Draft Guideline, compared to the Ring-Fencing Guideline for Electricity Distribution (**Distribution Guideline**), the legal separation requirements are not without significant cost or time implications. Transferring or amending contracts with counterparts can be costly and time consuming, and may also involve a requirement to provide a level of credit support or other form of bonding, depending on financial position of such new entities. Obtaining any requisite regulatory approvals (such as those from the Foreign Investment Review Board (**FIRB**)) to facilitate corporate restructures or business, asset or land transfers necessary as a result of the legal separation requirements may also be costly and time consuming. In the case of AusNet, there are also accreditations for certain "contestable electricity services" that may be unable to be transferred and may, in effect, need to be re-applied for or established in a new legal entity. These issues further support the position that TNSPs should be given the full 12-month transitional period to focus their efforts of effecting the necessary legal separation, and system establishment or enhancement steps. Imposing compliance burdens during this period, will only further increase costs.

Waivers

We recognise it is not always possible to design regulatory frameworks to deal adequately with every possible scenario, particularly when the sector is as fast-moving as the energy sector currently is. Therefore, while our preference is always for frameworks to be designed thoughtfully and carefully to ensure they are fit-for-purpose, we acknowledge that a waiver process can give the regulator – and market participants – the flexibility necessary to respond to unforeseen circumstances.

However, a waiver process, by its very nature, introduces uncertainty into a regulatory framework because it allows for exceptions to the general rule. This uncertainty is exacerbated when key elements of the framework operate on a "prohibit and waive" basis – as is intended to be the case in the proposed transmission ring-fencing guideline.[7] To balance the uncertainty this creates, it is essential that the guideline clearly describe the steps in the process, the obligations on both the AER and the waiver applicant, and the consequences of failing to follow those steps. If the waiver process lacks transparency or is inconsistent, it will slow down and increase the costs and risks associated with the energy transition, to the detriment of energy consumers.

We support the Energy Network Australia (**ENA**) submission outlining changes to the waiver framework, and we make the following supplementary observations:

[6] Ibid, p 50.
[7] Ibid, p 20.

- The AER must be required to make a decision in response to a waiver application. Although clause 5.3.1 requires the AER to consider an application, it does not require it to determine the application by making any one of the decisions in paragraphs (a), (b) or (c). Without a firm obligation to resolve the application, it is theoretically open for the application to remain open, indefinitely.

- The guideline must stipulate a firm and binding time limit by which the AER must decide a waiver application. Currently the guideline is silent as to any time limit. The AER states it will "endeavour to make a final decision on each waiver application within 90 days of the application being lodged."[8] We consider 90 days is reasonable (but note that it could be shorter) and submit that the timeframe should be specified in the guideline and expressed as a firm limit. If the AER fails to make a decision within that firm time limit (90 days), the application should be automatically deemed to be approved.

  The absence of a clear deadline and the consequence for failing to meet it creates material uncertainty and risk for waiver applicants. Furthermore, the potential to repeatedly issue interim waivers could delay a final decision indefinitely. The AER's proposed approach creates significant uncertainty, could undermine the stability of the regulatory regime and could see a fall in investment and/or lack of market development. The importance of this part of the process to investment and the energy transition currently underway is why we continue to press for a waiver process with a fixed short time frame within which the AER must decide a waiver application.

- If the AER is concerned that 90 days may not always be sufficient to decide a waiver application, the guideline can provide for "clock stoppers" or extensions of time. These mechanisms are commonly used and could be easily and transparently incorporated into the guideline to give the AER additional time to consider novel or complex issues raised by waiver applications. We consider the cost pass through application process as a useful exemplar.

- The guideline should require waiver decisions (including for interim waivers) to be published on the AER website and be accompanied by sufficient information to enable stakeholders to understand the application, the decision and, importantly, the basis for the AER's decision. Providing transparency to the market is critical to not only ensure accountability, but also to educate TNSPs and other market participants about the AER's approach to applying the transmission ring-fencing guideline. Interim waiver decisions should also indicate when the AER expects to make a final decision and why it considered that timeframe appropriate.

- The power to unilaterally vary or revoke a waiver must be clearly delineated, transparent and limited. While we recognise that the circumstances that gave rise to a waiver may change, the AER's proposed approach creates significant uncertainty and risk (cost) which could jeopardise projects or, if those projects do proceed, they proceed more slowly and/or at greater cost. Therefore, it is appropriate that the guideline stipulate the circumstances in which the AER can vary or revoke a waiver, and that it be limited similarly to regulators' powers to vary or revoke licences.[9]

  We also note the disproportionately short period that the AER considers is appropriate to enable a TNSP to implement the changes to commercial and operational arrangements to comply with the guideline if a waiver is varied or revoked. Such changes, which the proposed guideline does not presently require the AER to consult with the affected TNSP about, could have significant repercussions for a business. This aspect of the Draft Decision requires significant review and revision. Failure to provide sufficient certainty to TNSPs and prospective market participants will undermine the stability of the regulatory regime and could deter investment and/or new entry, all of which will have adverse consequences for customers.

- The guideline must clearly guide the AER's assessment of waiver applications for assets such as batteries and generators that are built primarily for network support purposes but can provide other market facing services. While we appreciate that the energy sector is operating in an ever-changing regulatory

[8] Ibid, p 45.
[9] See, for example, the Essential Services Commission's powers under sections 29 and 31 of the *Electricity Industry Act 2000* (Vic) and clauses 20 and 21 of AusNet's transmission licence.

landscape, the AER needs to provide further guidance about how it will assess waiver applications. To this end, we support the introduction of a streamlined process for waivers for batteries used in the transmission network.

- The scope for the waiver process as currently proposed could preclude TNSPs from participating in new technology markets, including energy storage. This could hinder innovation and prevent the market from developing mechanisms to deliver network services in a dynamic and rapidly changing grid.[10, 11]

- The waiver process must be designed to facilitate the achievement of the stated objectives of the transmission ring-fencing guideline. The processes it establishes and obligations it imposes should all be focused on promoting competition in the provision of contestable services to the benefit of end users. It should not be used as an opportunity to:

    - collect a significant volume of information and data that would be better collected through a more efficient and targeted mechanism (i.e., through the RIN process); or

    - exert increasing control on what specific (energy transition) investment needs to occur to achieve the AER's (rather than a TNSP's) objectives.

Other amendments

Obligation to not discriminate

We support the obligation to not discriminate with respect to prescribed transmission services, as set out in section 4.1(b)(i) of the Draft Guideline. And, while we generally agree with the submissions of the ENA with respect to section 4.1(b)(ii) of the Draft Guideline, we also appreciate the concerns that the AER may have regarding the absence in the Interim Guideline of a broader obligation not to discriminate against other entities competing in downstream (e.g., retail) or upstream (e.g., generation or ancillary service) markets. To that end, we would not object to a non-discrimination obligation relating to any such services provided by any other legal entity, provided the obligation does not apply in respect of "non-regulated transmission services".

As explained above, and in our previous submission, a material part of our core TNSP function is to compete for and, where successful, provide non-regulated transmission services, made possible by the broad application of the contestability regime in Chapter 8 of the NER. Many of the transmission services in other NEM jurisdictions which are prescribed or negotiated transmission services are non-regulated transmission services in Victoria (e.g., services associated with any separable augmentation which exceeds $10M). It is paramount to ensuring effective competition that TNSPs are able to compete with, and thereby, discriminate against each other (as well as potential TNSPs or exempt service providers) in the context of the provision of non-regulated transmission services, particularly in Victoria.

While we appreciate section 4.1(b)(ii) is modelled on an equivalent provision in the Distribution Guideline, unlike Electricity Transmission, there is no contestable market for non-regulated distribution services under Chapter 8 of the NER. Nor does AEMO, in the case of Victoria, perform declared functions in relation to electricity distribution networks, such as it does for the declared shared transmission network in Victoria. Indeed, when the Distribution Guideline was developed the prevailing view was that there was no justification for DNSPs to be generally permitted to provide non-regulated distribution services.

By contrast, Victorian TNSPs must, and do provide non-regulated transmission services, and they are core part of the services provided by TNSPs. Non-regulated transmission services are subject to the contestability regime under Chapter 8 and the declared functions of AEMO. Accordingly, section 4.1(b)(ii) must, at a minimum, be amended

[10] AusNet, Response to Transmission Ring-fencing Issues Paper, 22 July 2022, p. 3.

[11] We note the AER has concluded that BESS has contributed to important knowledge development on the potential application of grid-scale batteries. We consider there could be other situations where our involvement could continue to help in the development of this market, including with respect to the provision on useful information. We also note that the AERs proposed restrictions, together with the restrictions imposed under the recent update to the distribution ring-fencing guideline, are all measures that will hinder the transformation process that is currently underway.

to exclude "non-regulated transmission services" from the term "contestable electricity services" or, alternatively, the term "contestable electricity services" should be amended to universally exclude "non-regulated transmission services". Indeed, such a universal amendment would also address, what appears to be an unintended anomaly in section 4.3 of the Draft Guideline (explained further below).

Functional separation – marketing staff

We do not object to legal separation requirements with respect to "marketing staff", similar to the Interim Guideline. However, we consider section 4.3 (a) of the Draft Guideline unintentionally includes staff of a TNSP that work on "non-regulated transmission services" provided by the TNSP itself.

It would be counter-intuitive for a TNSP to be permitted to provide non-regulated transmission services (as indeed, it must be, as non-regulated transmission services are services that are only permitted to be provided by a registered TNSP under the NER, as well as, in Victoria, a licenced transmission company under the *Electricity Industry Act 2000* (Vic)) but for persons that may qualify as "marketing staff" for such services to not be permitted to be employed by the TNSP.

This issue arises because the definition of "related electricity service provider" includes (among other things) that part of a "TNSP" that provides "contestable electricity services", and "contestable electricity services" include "non-regulated transmission services". This anomaly can be addressed by amending section 4.3(a) or the definition of "contestable electricity services" to exclude "non-regulated transmission services".

Legal separation

While we do not generally object to the legal separation requirement in section 3.1(a) of the Draft Guideline, compliance with this obligation is not equivalent to the mere stroke of a pen or click of a mouse. Establishing new, or acquiring, legal entities involve taking on serious, legal and fiduciary obligations for promoters, investors and officers. Among other things, entities must be capitalised and as was explained above, transferring into, or establishing new operations, within a new entity may involve the need to obtain regulatory approvals (e.g., FIRB) and/or require the payment of duties on land or asset transfers, taxation advice, contract, staff or asset transfers. Staff transfers can also have consequences with respect to the coverage of awards and other industrial instruments. All of these steps are likely to involve not insignificant time and cost.

In respect of a comment made in the Explanatory Memorandum to the Draft Decision in the context of references to commercial brands or entities of Transgrid and TasNetworks[12], it should also be noted that there is a distinct difference between the costs and time involved in establishing a separate legal entity or brand, and the costs that would be involved if TNSPs were required to establish standalone or separate offices, staff, corporate services, operations centres, systems or financing in connection with non-regulated transmission services or contestable electricity services. The latter would certainly be prohibitive. To this end, we consider the Draft Guideline broadly strikes the right balance by not seeking to impose broader, functional separation requirements, provided the issues we have identified with sections 4.1(b)(ii) and 4.3 of the Draft Guideline are appropriately addressed.

Compliance

We accept that requiring all breaches to be reported within 15 days provides more certainty and transparency over the reporting timeframe relative to current arrangements. However, it does not provide a lot of time to fully assess and perform the necessary quality assurances prior to submitting information to the AER.

While the current compliance reporting requirements are fit-for-purpose and further reform is unnecessary, the new annual reporting requirements can be implemented at additional cost (which will ultimately be borne by customers).

[12] AER, *Explanatory Statement*, p 14.

Information access and disclosure

We have not identified any significant concerns with the requirement to keep information confidential and having to share that information when required. The same holds for the requirement for an information sharing protocol and information register. These are arrangements we are already familiar with.

Accounting separation

We have no concerns with the proposed requirement to allocate costs between transmission and non-transmission services or from the requirement that prohibits us from allocate or attribute costs to transmission services that properly relate to other services. These proposals are consistent with how we currently operate. We do, however, note that consideration could be given to aligning reporting with our end of March annual RIN reporting requirements.

If you have any questions regarding this submission, please contact Ian McNicol by email on [redacted].

Yours sincerely

[redacted]

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AusNet