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Mark Feather
General Manager
Australian Energy Regulator



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Dear Mr Feather

Ausgrid's submission – Consultation on class waiver under the distribution Ring-fencing Guideline – Central-West Orana Renewable Energy Zone

Thank you for the opportunity to comment on the proposal to grant a class waiver under version 3 of the Australian Energy Regulator's (AER) distribution Ring Fencing Guideline (the **Guideline**) to enable distribution network service providers (DNSPs) to potentially build and operate transmission infrastructure in the Central-West Orana (CWO) Renewable Energy Zone (REZ).

Ausgrid operates a shared electricity network that powers the homes and businesses of more than 4 million Australians living and working in an area that covers over 22,000 square kilometres from the Sydney CBD to the Upper Hunter. As a distribution service operator, we play an important role in providing safe, reliable and efficient network services that enable customers and communities to get the most value from investments in the energy sector, including distributed energy resources and renewables to support the energy system transition.

DNSPs such as Ausgrid are highly experienced in delivering network services in a safe, secure, reliable and efficient manner. It is our core capability and is embedded into our operations and business delivery. It is therefore in the long-term interests of consumers that DNSPs be allowed to participate in tender processes for the delivery of REZ network services.

Given the benefits of allowing DNSP participation, and no real risk of cross-subsidisation or discrimination in this context, we agree that there should be clarity around DNSPs' ability to participate in REZ network tender processes. This means that, to the extent that the Guideline currently prohibits DNSP participation in these processes, a class waiver should be granted from the legal separation obligation. Additionally, to the extent that REZ network services may be seen as 'contestable electricity services', a waiver should also be granted from the staff separation, physical separation and branding rules.

It is in the long-term interests of consumers and therefore consistent with the National Energy Objective for DNSPs to be allowed to participate in REZ network tender processes

Ausgrid considers that allowing DNSPs to participate in tender processes for the construction and operation of REZ transmission infrastructure will ultimately promote the long-term interests of consumers.

DNSPs are likely to be well placed to deliver REZ transmission infrastructure. We understand the responsibilities and regulatory obligations that come with operation of critical electricity infrastructure – including network safety, reliability, work health and safety, and network, data and cyber security obligations. We have a long history of delivering these technical network services to meet the long-term interests of consumers.

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While many DNSPs have affiliate entities that provide contestable services, these affiliate entities may not be able to offer the same level of experience and expertise in network operation. These affiliate entities are engaged in contestable activities that are mostly separate from the work required to operate an electricity network. As the Guideline restricts sharing of staff and office space between DNSPs and these affiliate entities, network expertise will typically remain within the DNSP and will not be shared with the affiliate entities.

It is also worth recognising that the time, effort and (ultimately) cost required for DNSPs to establish new affiliate entities specially to participate in REZ transmission infrastructure tender processes is unlikely to be in the long-term interests of consumers. That cost reflects the inefficiency created by segregating network expertise within a DNSP, and may ultimately not be recoverable in the event the affiliate entity is unsuccessful in its tender (as the affiliate will have no functional purpose if it does not win the tender, and therefore no revenue stream). It also means that there will be costs to unwind the unsuccessful affiliate entity, which will again reflect inefficiencies in removing segregation of network expertise and dismantling the non-functional entity.

The AER has previously recognised that it is likely to be in the interests of consumers for DNSPs to be able to provide transmission services.¹ The AER has observed that the joint provision of distribution and transmission services is not likely to harm competition, or potential competition, for contestable electricity services. The AER has also recognised that requiring separation of distribution and transmission business would impose significant costs on DNSPs, and may also reduce the efficiencies a DNSP can achieve from economies of scale. It is for this reason that DNSPs are permitted to provide transmission services under the Guideline, without any need for legal or functional separation measures.

Consistent with the AER's previous analysis, we consider that allowing DNSPs to offer REZ network services gives rise to no real risk of cross-subsidisation or discrimination, for the following reasons:

1. **No risk of cross-subsidisation.** The provision of REZ network services is unlike the provision of other contestable electricity services. Once the tender has been awarded, the provider of REZ network services will not operate in a competitive market. Instead, the REZ network operator will be the monopoly service provider subject to a regulated access scheme with ongoing oversight from the regulator of that access scheme. In this context, the usual risk of cross-subsidisation between monopoly and contestable services simply does not arise.
2. **Accounting separation and cost allocation rules will continue to apply.** Even if there was some risk of cross-subsidisation, the accounting separation and cost allocation rules (cl 3.2 of the Guideline) would still operate to address this risk. DNSPs cannot apply for a waiver of these obligations and will therefore continue to be bound by them.
3. **No risk of discrimination.** Again, the very different nature of REZ network services compared with BAU contestable services means that the risk of discrimination simply does not arise in this context. In some cases, where a DNSP or affiliate entity is providing contestable services, the DNSP may have the ability to favour its affiliate entity through discriminatory provision of network services or access to customer information. For example, there may be scope to provide favourable network access, or favourable access to customer information, to an affiliated solar PV installation business. However in this case the relevant customer is a State Government and the services to be provided (the REZ network services) do not rely on access to a DNSP's direct control services. There is therefore no sense in which a DNSP could favour a related entity (or a part of the DNSP itself) so as to give it an unfair advantage in the provision of REZ network services.

¹ AER, Electricity Distribution Ring-fencing Guideline (Version 2) Explanatory Statement, October 2017, section 2.4.

4. **No risk of customer choice being influenced by use of DNSP branding or cross-promotion.** The rationale for the Guideline branding rules similarly does not apply in this context. This is not a case of contestable services being marketed to consumers, where there is the potential for branding or cross-promotion to influence consumer choice. The purchaser in this case is a highly sophisticated State Government, whose decision will not be influenced by branding.

For all these reasons, the benefits of DNSP participation in REZ network tender processes far outweigh any risk of cross-subsidisation or discrimination.

On the other hand, if DNSPs were to be *excluded* from the provision of REZ network services, this is likely to come at a cost to consumers. This would mean excluding from the field of potential providers a class of business that has strong technical expertise and experience in safely and efficiently delivering network services. Restricting the field in this way could lead to a loss of competitive tension in the tender process and mean that the REZ network infrastructure is delivered at a higher cost than would otherwise be the case. It may also mean compromising on the safety, security and reliability of services that are ultimately delivered.

Ausgrid would welcome clarity on DNSPs ability to offer REZ network services under the Guideline

As noted above, the Guideline currently allows DNSPs to provide 'transmission services'. This implies that, if the REZ Network Operator services meet the definition of 'transmission services', DNSPs will be permitted to provide those services and a waiver should not be necessary.

However Ausgrid understands that there may be some uncertainty as to the scope of REZ network operator services, and the extent to which these services will fall within the Guideline definition of 'transmission services'. This uncertainty is unlikely to be resolved until the issue of tender documents, at the earliest.

Given this uncertainty, it would be prudent for the AER to clarify the intended application of the Guideline to REZ network services. This could be done in one of two ways:

1. The AER could confirm that services to be provided by the REZ network operator will be treated as 'transmission services' for the purposes of the Guideline. As noted above, this would imply that DNSPs are permitted to provide these services, without any need for a waiver. It would also mean that these services would not be treated as 'contestable electricity services', and therefore a DNSP's provision of these services would not trigger any of the functional separation obligations (e.g. staff and office separation).
2. The AER could grant a class waiver of the cl 3.1 obligation, for the purposes of allowing DNSPs to offer REZ network services.

If the AER decides to grant the class waiver, we would ask that it provide reasons for its view that this is necessary. In particular, it should be explained which of the REZ network services a DNSP would otherwise be prohibited from providing under cl 3.1 of the Guideline. This will assist DNSPs in understanding the scope of the legal separation obligation going forward. For reasons discussed below, any class waiver from the legal separation obligation should also be accompanied by a class waiver from the staff separation, physical separation and branding rules (cl 4.2 of the Guideline).

The waiver process should clarify application of both the legal separation requirement and the functional separation rules

If a waiver from the legal separation obligation is considered necessary, this could imply that certain functional separation obligations would apply to the provision of REZ network services. If a waiver of cl 3.1 is needed, this would imply that at least some of the REZ network operator services are not 'transmission services'.² To the extent that they are not transmission services (and also not distribution services), these services are likely to meet the definition of 'other electricity services', and hence the definition of 'contestable electricity services'. If that is the case, the part of the DNSP providing the REZ network services would be treated as a 'related electricity service provider' and various functional separation obligations would be triggered, including:

- The part of the DNSP providing REZ network services would need to use separate office space from the DNSP itself (cl 4.2.1(a));
- Staff involved in the marketing or provision of the REZ network services could not also be involved in the marketing or provision of direct control services (cl 4.2.2(a)); and
- The DNSP would need to use independent and separate branding for direct control services and REZ network services (cl 4.2.3(a)).

Ausgrid understands that it is not intended that these functional separation rules apply to a DNSP's provision of REZ network services. Ausgrid supports this policy intent. For reasons explained above, there is no real risk of discrimination in this context, nor is there any risk of customer choice being influenced by use of DNSP branding or cross-promotion. Requiring DNSPs to comply with the staff separation, physical separation and branding rules would only give rise to unnecessary costs, and reduce the efficiencies a DNSP can achieve from economies of scale and scope.

Therefore, if the AER considers that a waiver of the cl 3.1 obligation is necessary, the class waiver should also cover the obligations in cl 4.2 of the Guideline.

Next steps

Ausgrid would welcome further engagement and consultation around the specific terms of any proposed class waiver.

If you wish to discuss any aspect of this submission, please contact Naomi Wynn, Manager Regulatory Policy, at [REDACTED].

Regards,



Rob Amphlett Lewis
Chief Customer Officer

² As noted above, a waiver should not be required if they are treated as transmission services.