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Mr Mark Feather
General Manager
Australian Energy Regulator

Submitted electronically via [REDACTED]

Essential Energy – CWO REZ class waiver to distribution ring-fencing guideline – Submission

Essential Energy welcomes the opportunity to provide a submission to the Australian Energy Regulator (AER) on its consultation regarding granting a class waiver under its electricity distribution Ring-fencing Guideline (the Guideline). The effect of the waiver would be to enable distribution network providers (DNSPs) to potentially build and operate transmission infrastructure in the Central-West Orana (CWO) Renewable Energy Zone (REZ).

In our opinion, it is appropriate for the class waiver to be granted. The electricity supply chain is currently undergoing a fundamental transformation and network infrastructure projects are critical to the success of the New South Wales (NSW) Electricity Infrastructure Roadmap (the Roadmap) in assisting with the transformation being managed as seamlessly as possible. Importantly, a contestable process will be used in the Roadmap to procure transmission network investments. Absent the waiver, the pool of potential competitors with deep domestic experience will be significantly reduced – lowering competitive tension and therefore raising costs for consumers in the contestable process.

We understand that in determining whether to grant the waiver, the AER must have regard to:

- > the National Electricity Objective (NEO);
- > the potential for cross-subsidisation and discrimination if the waiver is granted or refused; and
- > whether the benefit, or likely benefit, to electricity consumers from the DNSP complying with the obligation (including any benefit, or likely benefit, from increased competition) would be outweighed by the cost of the DNSP complying with that obligation.

The remainder of our submission sets out our opinion regarding each of these considerations. In short, we do not consider there are any material concerns in relation to the first two factors. Further, the benefits of competition arising from enabling DNSPs to participate in the contestable process outweigh any costs associated with granting the waiver. We also attach a **confidential appendix** that provides further details as to why the cost to consumers of DNSPs complying with the obligation – that is, not being permitted to participate in the contestable process – outweighs the benefits of DNSPs complying with the obligation.

Essential Energy acknowledges the collaborative approach undertaken by the AER to date, including the hosting of verbal feedback sessions. We look forward to continuing to work closely with the AER on this issue.

If you have any questions in relation to this submission, please contact Mr Anders Sangkuhl, Regulatory Strategy Manager via [REDACTED] or via phone on [REDACTED].

Yours sincerely,



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Executive General Manager, Corporate Affairs

Essential Energy submission to the AER's distribution Ring-fencing class waiver consultation for the CWO REZ

Clause 5.3A.2 and clause 5.3.2(a) of the Distribution Ring-fencing Guidelines provide that the AER must have regard to certain matters when assessing a class waiver and deciding whether to grant or refuse to grant a class waiver. Specifically, the AER must have regard to:

- > the National Electricity Objective (NEO);
- > the potential for cross-subsidisation and discrimination if the waiver is granted or refused; and
- > whether the benefit, or likely benefit, to electricity consumers from the DNSP complying with the obligation (including any benefit, or likely benefit, from increased competition) would be outweighed by the cost of the DNSP complying with that obligation.

The following sections set out our opinion that it is appropriate to grant the waiver by reference to each of these considerations. The **confidential appendix** provides further details as to why the cost to consumers of DNSPs complying with the obligation – that is, not being permitted to participate in the contestable process – outweighs the benefits of DNSPs complying with the obligation.

The extent to which the NEO is a relevant consideration is limited because the Roadmap sits outside the national framework

The first factor that must be considered by the AER is the NEO. The NEO is set out in the National Electricity Law (NEL) and is:

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

- *price, quality, safety and reliability and security of supply of electricity*
- *the reliability, safety, and security of the national electricity system.*

The NEO is the guiding principle that underpins all decision-making in the national framework. However, the Roadmap sits outside of the national framework. In particular, the regulatory framework for the Roadmap is set out in the NSW *Electricity Infrastructure Investment Act 2020* (the EII Act). The question of whether to grant the waiver therefore corresponds to whether DNSPs should be permitted to participate in an alternative regulatory framework, and any impact that this participation would have on the DNSPs activities under the national framework.

It is unclear to Essential Energy the extent to which the NEO is a relevant consideration for participation in an alternative regulatory framework. However, as we describe in detail below, granting the waiver would lead to the potential for significant benefits for consumers under this alternative framework, that in many respects would be consistent with promoting the NEO.

Further, Essential Energy is of the view that allowing DNSPs to participate in the contestable process for the CWO REZ would not be to the detriment of the DNSPs' provision of standard distribution services under the national framework, and so would not have an adverse impact on the NEO. As we outline below, we do not consider that participation in the contestable process gives rise to the risk of cross-subsidisation and discrimination. Further, to the extent that by owning and operating additional network infrastructure the DNSP is able to spread the cost of certain of its activities (in particular operations and maintenance) across a wider asset base, this has the potential to lead to lower costs to consumers for those activities under the national framework. This would further the NEO compared to the case where the waiver is not granted and the ownership and operation of the CWO REZ is

awarded to a business that is not a regulated NSP and so where these costs cannot be efficiently shared.

The separate regulatory framework for the Roadmap mitigates the potential for cross-subsidisation and discrimination

DNSPs are incentivised to always comply with the existing requirements that discourage cross-subsidisation and prevent discriminatory activities for reasons of reputational integrity as well as effective corporate governance. The existing incentives that drive behaviour and compliance in this area are robust.

These risks will be further addressed through the effective utilisation of the contribution order element of the Roadmap regulatory framework. Under the NSW arrangements, only the costs associated with providing the CWO REZ are apportioned to a specific CWO regulated asset base (RAB). The costs associated with undertaking standard distribution services would continue to be dealt with under the existing national framework. However, depending on the ultimate design of the REZ, there is the potential for some shared services which could lower the costs allocated to standard distribution services (as noted above).

More broadly, it will also be possible for DNSPs to ensure their audit processes validate that the services associated with being the network owner and/or operator of the CWO REZ are not being applied in a discriminatory manner. This could occur via an independent audit. We note that as part of the annual ring-fencing compliance process, the ring-fencing auditor will confirm that these transmission services are being applied within the CWO REZ in the manner in which the class waiver was granted. Both DNSPs and the AER are familiar and comfortable with these existing processes, meaning they can be effectively leveraged in this context.

Finally, Essential Energy notes that the AER has the ability at any time to self-initiate an investigation into perceived cross-subsidisation or discriminatory behaviour. In material circumstances this could lead to the revocation of the class waiver. It follows that the national regulatory framework provides for immediate recourse in the event that discriminatory behaviour is identified.

Granting the waiver would be net beneficial for consumers

The electricity supply chain is currently undergoing a fundamental transformation and network infrastructure projects are critical to the success of the NSW Roadmap in assisting with the transformation being managed as seamlessly as possible. Under the NSW arrangements, the required transmission investments are intended to be procured and operated via a contestable process. The key rationale for introducing the contestable process is to drive efficiencies for consumers – lowering the costs of network investment and operation for consumers.

Importantly, the benefits to consumers through efficiencies can only be expected to be realised if the contestable process in the Roadmap is sufficiently competitive. Central to this is having a sufficiently 'deep' market, that is, enough competitors that the resulting competitive tension drives lower cost outcomes for consumers. In this context, it is important to note that there are currently 14 DNSPs that are regulated by the AER. It follows that not granting the class waiver will significantly reduce the pool of potential competitors with deep domestic experience – lowering competitive tension and therefore raising costs for consumers. Enabling DNSPs with deep domestic experience (including in high voltage assets) to participate in the contestable process will drive efficiencies relative to stand-alone merchant providers or the limited pool of existing regulated TNSPs.

Some of these efficiencies may be realised through:

- > increasing the scope for innovative design concepts, drawing on the DNSPs' intimate knowledge of the local network area in some cases;
- > driving efficiencies in construction costs, because DNSPs will be able to leverage existing supply chain relationships to support project delivery in a timely and efficient manner; and
- > building social licence at lower cost, because DNSPs have well-established community engagement processes and in some cases have a relevant local presence and legacy programs to maintain community support and deliver benefits to regional communities.

More broadly, Essential Energy is concerned that refusing the waiver for the CWO REZ will set a precedent for future REZs under the Roadmap. This could result in a compounding effect where there is an insufficient competitive process for all REZs, significantly raising costs for consumers.

The attached confidential appendix provides further discussion on each of these factors. However, in our opinion, these factors demonstrate that granting the waiver would be net beneficial for consumers and, equally, refusing the waiver will lead to NSW consumers bearing higher network costs under the Roadmap.

