



Endeavour
Energy



16 December 2022

Mark Feather

General Manager Strategic Policy and Energy Systems Innovation

Australian Energy Regulator (**AER**)

Via email: [REDACTED];

[AERringfencing@aer.gov.au](mailto:AERringfencing@ aer.gov.au)

Dear Mr Feather

NSW DNSP joint submission to AER's Transmission ring-fencing draft guideline (Draft Guideline)

Ausgrid, Endeavour Energy and Essential Energy (the NSW distribution network service providers (**DNSPs**)) thank the AER for the opportunity to provide a submission on the Discussion Paper.

While the NSW DNSPs broadly support the AER reviewing and updating ring fencing arrangements for transmission network service providers (**TNSPs**), we are concerned that the Draft Guideline does not adequately address the risk of TNSPs taking advantage of their monopoly position in providing negotiated transmission services. As a result, there would be a material inconsistency between the Draft Guideline and the ring fencing arrangements that apply to DNSPs. Consistency is vital to promote competition between DNSPs and TNSPs for contestable projects, and is consistent with the intent of ring fencing.

The NSW DNSPs would support measures aimed at providing a more level playing field for the delivery of contestable transmission projects as between DNSPs and TNSPs. This may include different measures for renewable energy zones (**REZs**) and non-REZ projects.

The NSW DNSPs would be happy to discuss any aspect of this submission with the AER.

Please contact the following with any questions:

- Ausgrid: Naomi Wynn at [REDACTED];
- Endeavour Energy: Patrick Duffy at [REDACTED]; and
- Essential Energy: Adam Young at [REDACTED].

Yours sincerely,

Alex McPherson
Head of Regulation
Ausgrid

Colin Crisafulli
Head of Network Regulation
Endeavour Energy

Anne Pearson
Chief Corporate Affairs Officer
Essential Energy



Attachment A: NSW distribution businesses

Joint submission to AER's Transmission ring-fencing draft guideline (Draft Guideline)

16 December 2022

1. Executive Summary

Ausgrid, Endeavour Energy and Essential Energy (**the NSW DNSPs**) welcome this opportunity to provide a joint submission on the draft ring fencing guideline for electricity transmission (**Draft Guideline**).

The NSW DNSPs' interest in this review

Distribution network service providers (**DNSPs**) can compete with transmission network service providers (**TNSPs**) in a range of contexts, including in relation to:

- Delivery of transmission projects that are treated as contestable under the *National Electricity Rules (NER)*;
- Participation in State-sponsored renewable energy zone (**REZ**) schemes; and
- In some cases, competing for connection of large customers.

DNSPs have a strong interest in ensuring that TNSPs do not have an unfair advantage in these competitive processes by virtue of their role in providing monopoly transmission services. A fair competitive landscape for network infrastructure investments is important to ensure economic efficiency for the people of NSW.

Inconsistent ring fencing obligations between DNSPs and TNSPs risk distorting competition

The Draft Guideline places the ring fence for TNSPs around the provision of prescribed transmission services. Negotiated transmission services are not inside the ring fence, and are also not treated as contestable electricity services (meaning that any affiliated entity of a TNSP that provides negotiated services will not be a related electricity service provider (**RESP**)).

As negotiated transmission services are not inside the ring fence, a TNSP will not be under any non-discrimination or information security obligations when it provides these services. This means that a TNSP could potentially use information acquired or generated in the provision of these non-ring fenced monopoly services to provide an unfair advantage to a RESP in the provision of contestable services (or in any tender process for contestable services).

If some TNSP monopoly services remain outside the ring fence (as is the case with negotiated transmission services under the Draft Guideline), this will create a material inconsistency between the transmission and distribution ring fencing guidelines. Under the distribution ring fencing guideline, DNSPs have no opportunity to use information acquired in the provision of monopoly services to obtain any kind of advantage in contestable markets. This will not be the case for TNSPs under the Draft Guideline.

Consistency is vital to promote competition between DNSPs and TNSPs for contestable projects, and is consistent with the intent of ring fencing.

Ensuring a level playing field for contestable projects

The NSW DNSPs would support measures aimed at providing a more level playing field for the delivery of contestable transmission projects, and avoiding the risk of TNSPs taking advantage of their monopoly position.

We support the AER developing specific ring fencing guidelines for REZ projects which reflect the different market, commercial and regulatory context in which these projects will be delivered as was articulated at the non-contestable transmission infrastructure test guideline consultation on 13 December 2022. Any REZ-specific ring fencing guidelines should be designed to ensure a level playing field for participation in REZ tender processes as between TNSPs, DNSPs and other participants. This may require some relaxation of the ring fencing obligations that usually apply to DNSPs for REZ projects. This would recognise the substantial benefits of allowing DNSPs to compete

for these projects and the limited benefits to consumers from requiring a DNSP to strictly comply with certain ring fencing obligations that are not replicated for TNSPs.

We would also encourage the AER to consider measures to ensure a level playing field for contestable transmission projects more broadly. This may include a general waiver to allow DNSPs to effectively compete for contestable projects, similar to the waiver granted by the AER for the Central-West Orana REZ.¹

We support cost / benefit analysis of any ring fencing measures

We welcome the AER's recognition that stronger functional separation measures may come at a significant cost and may not always be net beneficial. The AER correctly recognises that physically separating offices and staff who work across regulated / monopoly services and other services is likely to be costly – and for this reason the Draft Guideline does not include unduly strict functional separation measures.

However the NSW DNSPs do not agree that these controls are necessarily 'more costly for TNSPs than DNSPs'. Such controls can also impose a significant cost on DNSPs, regardless of their size and DNSPs arguably bear a significantly higher compliance cost burden for these controls than that assumed to be incurred by TNSPs. For example, relative to Transgrid:

- Ausgrid has over triple the number of depots / offices and over double the number of staff;
- Endeavour Energy has double the number of depots / offices and almost 1.5 times the number of staff; and
- Essential Energy has 12 times the number of depots / offices and almost triple the number of staff.

In any event, a comparison between TNSPs and DNSPs is not relevant to whether these controls deliver a net benefit for consumers.

The NSW DNSPs support a rigorous cost / benefit analysis of any requirements for network businesses to implement staff / office sharing measures or branding restrictions. If the AER's cost / benefit analysis in the context of the transmission guideline demonstrates that the cost of strict staff / office sharing rules outweighs any benefit, it should also revisit these aspects of the distribution guideline.

2. Scope of contestable and ring fenced services

Under the Draft Guideline, there are broadly three sets of services that a TNSP (or its affiliates) may potentially provide:

- **Ring-fenced monopoly services** – i.e. prescribed transmission services;
- **Non-ring fenced monopoly services** – these include negotiated transmission services which only TNSPs can provide; and
- **Contestable services** – these include other electricity services, but not negotiated transmission services, prescribed transmission services or direct control services.

The Draft Guideline places the ring fence around the provision of prescribed transmission services. It is the provision of these services that is the subject of non-discrimination and information security obligations. Negotiated transmission services are not inside the ring fence, and are not treated as

¹ AER, [Decision: Distribution ring-fencing class waiver for the Central-West Orana Renewable Energy Zone](#) (March 2022), section 3.5.

contestable electricity services (meaning that any affiliated entity of a TNSP that provides negotiated services will not be a RESP).

As negotiated transmission services are not inside the ring fence, a TNSP will not be under any non-discrimination or information security obligations when it provides negotiated transmission services. This means that a TNSP could potentially use information acquired or generated in the provision of these non-ring fenced monopoly services to provide an unfair advantage to a RESP in the provision of contestable services (or in any tender process for contestable services).

2.1. The AER's concerns regarding the scope of its ring fencing powers

The NSW DNSPs understand that the AER may have a concern regarding the scope of its ring fencing powers under the NER. The NER refers to the transmission ring fencing guideline providing for 'the accounting and functional separation of the provision of prescribed transmission services by [TNSPs] from the provision of other services'.² The AER's interpretation of this provision is that it only allows for the imposition of ring fencing controls around the provision of prescribed services, and 'we do not have the power to require accounting and/or functional separation of negotiated transmission services',³ In other words, the AER considers negotiated services must sit outside the ring fence.

It is not clear that the NER restricts the AER to only imposing ring fencing controls around the provision of prescribed services. The NER do not seem to expressly prohibit the ring fencing guideline from dealing with negotiated transmission services, and indeed cl 6A.21.2(e) appears to contemplate that a guideline may address these services. Moreover cl 6A.21.2(b) expressly does not limit the matters that may be dealt with in a transmission ring fencing guideline. It is at least arguable that a guideline may also include measures to address the risk of a competitive disadvantage arising from a TNSP's monopoly position in the provision of negotiated transmission services.

To the extent that there is a legal constraint, this would seem to be due to a disconnect between the rules providing for development of the guideline and the way in which transmission services are classified under the NER. Transmission services are not classified under the NER based on their degree of contestability or other factors which might be relevant to ring fencing. Instead, transmission services are classified according to technical definitions. Consequently, some services which fall outside the NER definition of a 'prescribed' service (and which meet the definition of a 'negotiated' service) may in fact be non-contestable – this would include, for example, non-contestable components of transmission connections. Given that transmission services are not defined by reference to contestability, it may not be appropriate to use these service definitions as a basis for imposing ring fencing controls.

This may be contrasted with distribution services, which are classified by the AER having regard to (among other things) the form of regulation factors.⁴ This means that service classifications for distribution services are likely to provide a reasonable guide to whether a service is a monopoly service or a contestable service.

As a general principle, any ring fencing controls should be imposed around the provision of monopoly services. If existing service definitions do not distinguish between monopoly and contestable services, the AER may need to conduct its own assessment of what monopoly services are in order to determine the appropriate scope of ring fencing controls.

2.2. Inconsistent ring fencing obligations between DNSPs and TNSPs risks distorting competition

If some TNSP monopoly services remain outside the ring fence (as is the case with negotiated transmission services under the Draft Guideline), this will create a material inconsistency between the

² NER, cl 6A.21.2(a).

³ AER, [Draft – Ring-fencing guideline \(electricity transmission\) - Explanatory Statement](#) (November 2022), p 26.

⁴ NER, cl 6.2.1.

transmission and distribution ring fencing guidelines. Under the distribution ring fencing guideline, DNSPs have no opportunity to use information acquired in the provision of monopoly services to obtain any kind of advantage in contestable markets. This is not the case for TNSPs under the Draft Guideline and there is a real risk that a TNSP could use information acquired or generated in the provision of non-ring fenced monopoly services (i.e. negotiated services) to obtain an unfair advantage in the provision of contestable services.

This inconsistency – and the broader risk that TNSPs may take advantage of their monopoly position in the provision of negotiated services – creates a risk to competition for contestable projects and would potentially undermine many of the policy initiatives aimed at promoting transmission contestability.

3. Ensuring a level playing field for contestable projects

The NSW DNSPs would support measures aimed at providing a more level playing field for the delivery of contestable transmission projects. This may include different measures for REZ and non-REZ projects.

3.1. REZ projects

We have previously noted that it may be appropriate for REZ projects to be treated separately to other projects for the purposes of ring fencing given the different market, commercial and regulatory context in which these projects will be delivered.⁵

The AER appears to agree with this position given that the Explanatory Statement to the Draft Guideline notes that the AER will be developing ring fencing guidelines that are specific to network operators who operate in NSW's REZs.⁶ AER staff reinforced this view at the AER's public consultation on the transmission efficiency test for non-contestable projects guidelines on 13 December 2022. The NSW DNSPs understand that these REZ-specific guidelines would apply to the exclusion of the national guidelines to avoid overlapping and potentially inconsistent obligations applying to REZ network operators and that this means the national guidelines would not apply to REZ activities. We understand that these guidelines would be developed once the AER finalises the transmission ring fencing guideline.

In developing the REZ specific guidelines, we recommend that the designs them to ensure a level playing field for participation in REZ tender processes as between TNSPs, DNSPs and other potential participants. This may require some relaxation of the ring fencing obligations that usually apply to DNSPs for REZ projects – recognising (as the AER did in granting a waiver for the Central-West Orana REZ)⁷ that:

- There are unlikely to be benefits to consumers from a DNSP complying with ring fencing obligations in relation to REZ projects, given the negligible risk of discrimination and limited risk of cross-subsidisation; and
- The benefits of DNSPs fully participating in REZ processes are likely to be substantial.

The NSW DNSPs welcome participating in future consultation on developing these REZ-specific guidelines, and any carveouts from the national guidelines for REZ-related activities.

⁵ See [NSW DNSPs submission in response to AER's Ring-fencing guideline \(electricity transmission\) Issues Paper](#) (22 July 2022), section 6.

⁶ AER, [Draft – Ring-fencing guideline \(electricity transmission\) - Explanatory Statement](#) (November 2022), p 7.

⁷ AER, [Decision: Distribution ring-fencing class waiver for the Central-West Orana Renewable Energy Zone](#) (March 2022), section 3.5.

3.2. Non-REZ projects

Outside of REZ projects, DNSPs potentially compete with TNSPs for other contestable transmission projects and for the connection of large customers. Some examples of this are set out in **Box 1** below.

Similar to REZ projects – there are unlikely to be benefits to consumers from a DNSP complying with ring fencing obligations in these situations, while the cost of strict compliance may be that the DNSP is at a competitive disadvantage compared to the TNSP who is not so constrained.

We would therefore encourage the AER to consider measures to ensure a level playing field for contestable transmission projects more broadly. This may include a general waiver to allow DNSPs to effectively compete for these projects, similar to the waiver granted by the AER for the Central-West Orana REZ.

Box 1: Examples of scenarios where DNSPs can compete with TNSPs (outside of REZ projects)

DNSPs can compete with TNSPs for contestable services associated with connection of large-scale energy-intensive facilities, such as an airport, data centre or large-scale electric vehicle charging depots.

The connection-related services required by one of these facilities, which will often be the subject of a competitive tender, can include:

- Contestable connection works (e.g. design and construction of any dedicated connection assets);
- Reticulation; and/or
- On-site generation.

For the same facility, a TNSP may be the monopoly provider of non-contestable connection works, including functional specification, operation and maintenance of any identified user shared assets. As these non-contestable connection works will be provided by the TNSP as a negotiated transmission service, the TNSP will not be restricted in how it uses any information obtained in providing that service, and may potentially use that information to gain an advantage in tendering for the contestable services.

DNSPs can also compete with TNSPs for connection of large customers in areas where connection to either network is potentially available (e.g. the enmeshed networks in the Hunter region). TNSPs may obtain an unfair advantage in such situations if they are able to use information obtained in the provision of monopoly negotiated transmission services.

4. Proposed TNSP ring fencing measures

4.1. Legal separation rules

The Draft Guideline provides for legal separation between transmission services and other services. However where a TNSP is also a regulated DNSP providing direct control services, we understand the intent is that the TNSP/DNSP should also be able to provide any distribution services, so long as they are complying with the distribution ring fencing guideline.

The NSW DNSPs support this position.

4.2. Functional separation rules

The Draft Guideline includes much lighter controls around staff separation (compared to the distribution guideline) and no office separation or branding requirements.

We understand that this partly reflects the AER's view regarding the scope of its legal powers. The AER states:⁸

'Given that many of the identified harms for transmission relate to the potential for discrimination in relation to a TNSP's monopoly position in providing negotiated transmission services (as part of delivering transmission connections), we wish to be clear that greater functional separation of prescribed transmission services cannot address these issues. Partly for this reason, we consider the benefits of strengthening staff, office and brand separation do not outweigh the costs at this time.'

Putting to one side the issue of the AER's legal powers (discussed in **section 3**), we welcome the AER's express recognition that stronger functional separation measures may come at a significant cost and may not always be net beneficial. The AER correctly recognises that physically separating offices and staff who work across regulated / monopoly services and other services is likely to be costly.⁹ However the NSW DNSPs do not agree that such controls are necessarily 'more costly for TNSPs than DNSPs'.¹⁰ Such controls can also impose a significant cost on DNSPs, regardless of their size.

The NSW DNSPs support a rigorous cost / benefit analysis of any requirements for staff / office sharing or branding restrictions. If the AER's cost / benefit analysis demonstrates that the cost of strict staff / office sharing rules outweighs any benefit, it should also revisit these aspects of the distribution guideline.

⁸ AER, [Draft – Ring-fencing guideline \(electricity transmission\) - Explanatory Statement](#) (November 2022), p 33.

⁹ AER, [Draft – Ring-fencing guideline \(electricity transmission\) - Explanatory Statement](#) (November 2022), p 34.

¹⁰ AER, [Draft – Ring-fencing guideline \(electricity transmission\) - Explanatory Statement](#) (November 2022), p 34.