



PO Box 4136  
East Richmond VIC 3121  
T 131 806  
F 1300 661 086  
W [redenergy.com.au](http://redenergy.com.au)

PO Box 4136  
East Richmond VIC 3121  
T 1300 115 866  
F 1300 136 891  
W [lumoenergy.com.au](http://lumoenergy.com.au)



31 January 2025

Mr Mark Feather  
General Manager Policy  
Australian Energy Regulator  
GPO Box 3131  
Canberra ACT 2601

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

Dear Mr Feather,

**Re: Ring-fencing guideline (electricity distribution) - Draft Guideline Version 4**

Red Energy and Lumo Energy (Red and Lumo) welcome the opportunity to make this submission to the Australian Energy Regulator's (AER's) proposed amendments to the current Electricity distribution ring-fencing guidelines (guideline).

The AER is consulting on two changes to the guideline (version 3) related to the waiver process. While it is only proposing to consider this change in this review, it has indicated that it is open to receiving feedback on other prospective changes to the guideline for the purpose of a future review.

Red and Lumo do not support the proposed changes to the guideline for the waiver framework. We see a risk that they will reduce the AER's ability to protect against cross-subsidisation and discriminatory behaviour in contestable energy markets.

We do, however, support a broader review of the guideline for a couple of reasons. First, the reduced threshold applied to waivers by the AER since the guideline was introduced in 2016 has diminished its ability to protect competition in contestable energy markets. Second, the guideline must keep pace with the energy transition. It is reasonable to argue that technological change, the growth of Consumer Energy Resources and consumers' increased willingness to more actively participate in the market mean that non-network solutions are an increasingly viable alternative to network investment. As such, it is more important than ever that the AER supports competition with a rigorous approach to ring-fencing.

With the market for contestable energy services being in their early stages of development, an incorrect decision on access by the AER could have serious consequences on long term competition in the contestable energy markets. To protect against this, it is important that the AER initiates its future review of the guideline as soon as possible to ensure it is fit for purpose and supports the energy transition.



PO Box 4136  
East Richmond VIC 3121  
T 131 806  
F 1300 661 086  
W redenergy.com.au

PO Box 4136  
East Richmond VIC 3121  
T 1300 115 866  
F 1300 136 891  
W lumoenergy.com.au



## **1. Proposed changes to the waiver framework in the guideline**

### **Maximum term of waivers**

The proposal to abolish the maximum term applied to waivers (other than for SAPS) could erode the effectiveness of the ring fencing framework. Waivers should be an exceptional response and subject to continual reassessment due to the rapid evolution of the competitive market. It is important for the AER to continue to test whether a monopoly solution delivers a net benefit to consumers and how it is influencing the competitive market. The current maximum term is reasonable and provides certainty for a Distribution Network Service Provider (DNSP) but an extension beyond the current maximum is likely to have harmful consequences for competition. Granting the AER with the discretion to determine the appropriate length of a waiver will add to uncertainty and should only occur following extensive consultation on the need for a waiver and its terms and conditions.

## **2. Prospective changes to the guideline for a future review**

### **Class waivers**

The need for class waivers should be re-evaluated in any future review of the guideline. This is due to the fact that the competition issues surrounding every waiver application are unique and the application of class waivers under the guideline en masse increases the risk of regulatory error.

While understanding that class waivers are intended to reduce the administrative burden of dealing with multiple waiver applications, the application of class waivers for DNSPs sets a concerning precedent. To preserve the integrity of the guideline and to ensure that competition develops in the contestable energy markets, waivers in our view should be the exception rather than the norm.

### **Waivers for legal separation**

Waivers for legal separation should be re-examined in any future review of the guideline.

Firstly, policymakers determined when the guideline was introduced in 2016 that absent full structural separation, ring-fencing that included the combination of legal, accounting and functional separation was the most effective way to prevent cross subsidisation and discrimination in contestable energy markets. To deliver on this policy objective, waivers for legal separation would need to be kept to a minimum.

Secondly, the AER's *Ring Fencing Fact Sheet*<sup>1</sup> specified that the AER would only 'be likely' to grant a waiver from legal separation in relation to other services provided by a DNSP that are

---

<sup>1</sup> Australian Energy Regulator (2016), *Ring fencing guideline: Fact Sheet*



PO Box 4136  
East Richmond VIC 3121  
T 131 806  
F 1300 661 086  
W [redenergy.com.au](http://redenergy.com.au)

PO Box 4136  
East Richmond VIC 3121  
T 1300 115 866  
F 1300 136 891  
W [lumoenergy.com.au](http://lumoenergy.com.au)



also regulated services and for services that a DNSP is required to offer by law. In our view, the AER should continue to apply this principle.

### **DNSP ownership of SAPS generation**

The AER should re-evaluate the exemption framework for DNSP Stand Alone Power Systems (SAPS) generation. Under this process, DNSPs are able to bypass the current waiver framework, which may crowd out third party providers from supplying SAPS and negatively impact the development of competition in a market.

In our view, DNSPs should be required to provide evidence of market testing before being able to own SAPS generation assets. In our view, this is best done ex-ante. Under this proposed model, a third party would purchase the asset and lease it to the DNSP who would pay an O&M charge over the life of the asset. This approach would allow the third party providers and the market that supplies these assets to flourish over the long term.

If there is clear and demonstrable evidence from the DNSP that there is no market to provide the services for those generation SAPS, then it is only in these circumstances that the DNSP should be able to supply the services directly.

### **Streamlined waivers**

The AER should revisit the process for streamlined waivers. It can be very challenging to predict how the market will develop within the context of a waiver or how it will influence DNSP behaviour. In some instances, there are no established processes or guidelines for making an ex ante assessment of the appropriate or efficient allocation of assets between regulated and competitive services and therefore, clear processes for avoiding cross subsidisation.

DNSPs are required to address cross subsidisation risks in any waiver evaluation process. For a DNSP to achieve this, the AER needs to be satisfied that a DNSP has evaluated the proposed use of the battery and correctly allocated costs to the provision of those network services from the battery. If the DNSP can do this, then the AER will grant the expedited waiver.

We have previously raised concerns about whether it was actually possible for a DNSP to determine the split between supplying regulated and contestable services of a battery. Given that battery use changes over time and has the potential to change in milliseconds, a cost allocation methodology that protects against cross cross subsidisation would somehow need to mitigate this risk.

In light of these challenges, our preference is for the AER to apply the full waiver process in the majority of instances. Streamlined waivers should remain the exception and only applied when there is strong evidence that the competitive market cannot deliver an efficient outcome.



PO Box 4136  
East Richmond VIC 3121  
T 131 806  
F 1300 661 086  
W [redenergy.com.au](http://redenergy.com.au)

PO Box 4136  
East Richmond VIC 3121  
T 1300 115 866  
F 1300 136 891  
W [lumoenergy.com.au](http://lumoenergy.com.au)



## **Stakeholder right to request a review of a waiver decision**

Given the uncertainty about the impact of waivers, we recommend the AER consider amending section 5.5 of the guideline to allow stakeholders to appeal waiver decisions or some aspects of the decision, potentially with some guidance on the information that the AER would expect that stakeholder to provide. This would coexist with the AER's power to vary or revoke a waiver decision at any time.

This would improve the ring fencing framework and enhance confidence in the framework because it would provide market participants with an opportunity to highlight any concerns they had with any decisions. At the same time, it would give the opportunity for the AER to review any decisions it had made to ensure that it had applied the guideline in the manner it was intended, drawing on any additional information that stakeholders can provide.

The AER's final decision on the *Ring-fencing class waiver Community batteries funded under the Commonwealth Government's Community Batteries for Household Solar Program* is a situation where an appeal process could have some merit. This program involves the use of network assets to offer core network services, while also granting some flexibility for the DNSP to participate in competitive markets.

In practice, the actual demand for regulated and contestable services (and how specific assets are actually used) will always end up being different from any forward estimate. Furthermore, there is also a risk that a DNSP might overestimate the benefit that it would derive from providing regulated services and allow it to cross subsidise its contestable services. All of this means the AER's cost allocation methodology, which includes a Regulatory Asset Base allocation based on an estimate at a point in time, leaves some possibility of cross subsidisation, the extent of which can only be quantified at some later point.

Given the difficult nature of accurately predicting the demand for regulated and competitive storage services, DNSPs will always be able to justify differences between these amounts as forecasting errors. The AER's decision to impose some reporting requirements on DNSPs that highlight the differences between the forecast and actual leasing revenues of a community battery from direct controlled services is important but this should also be made available to the broader market.

To this point, the AER's has refrained from modifying a DNSP's Regulatory Asset Base to revise the total quantified benefit to customers where actual revenues are different from forecast leasing revenues. We acknowledge concerns about the potential implications for the regulated Weighted Average Cost of Capital but there is considerable uncertainty about the longer term implications of a waiver as a result.



PO Box 4136  
East Richmond VIC 3121  
T 131 806  
F 1300 661 086  
W redenergy.com.au

PO Box 4136  
East Richmond VIC 3121  
T 1300 115 866  
F 1300 136 891  
W lumoenergy.com.au



While this example illustrates the challenge for the AER in assessing the future impact of a waiver decision, it is also relevant for competitive market participants. The ability for market participants to challenge or at least seek further information about how network assets are used would enhance confidence in the broader ring-fencing framework. Alternatively, the AER could impose more rigorous reporting obligations on DNSPs who have received a waiver and provide this information to the market to allow for a comprehensive assessment

### **About Red and Lumo**

We are 100% Australian owned subsidiaries of Snowy Hydro Limited. Collectively, we retail gas and electricity in Victoria, New South Wales, Queensland and South Australia and the ACT to over 1.4 million customers. Should you wish to discuss aspects or have any further enquiries regarding this submission, please call Con Noutso, Regulatory Manager, on [REDACTED]

Yours sincerely



**Geoff Hargreaves**  
Manager - Regulatory Affairs  
**Red Energy Pty Ltd**  
**Lumo Energy (Australia) Pty Ltd**