# Ring-fencing guideline (electricity distribution)

## Explanatory Statement

Guideline – Version 4

**February 2025**

AUSTRALIAN ENERGY REGULATOR

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| Version | Date | Pages |
|---|---|---|
| 1 | December 2016 | 115 |
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| 3 | November 2021 | 92 |
| 4 | 27 February 2025 | 12 |

# Shortened Forms

| Shortened Form | Extended Form |
|---|---|
| AEC | Australian Energy Council |
| AER | Australian Energy Regulator |
| CPU | CitiPower, Powercor and United Energy |
| DNSP | Distribution network service provider |
| NECA | National Electrical Contractors Association |
| SAPN | SA Power Networks |
| SAPS | Stand-alone power system |

# Contents

# 1 Executive Summary

Australia's electricity market is undergoing a fundamental transformation, transitioning from a reliance on coal- and gas-fired power plants to renewable sources of energy (mainly wind and solar) to meet State and Federal renewable energy targets. This transition presents significant challenges and opportunities for Australia's electricity system.

The role of electricity distribution network service providers (DNSPs) is critical to supporting Australia's electricity transition, as monopoly providers of services that consumers in the National Electricity Market rely upon. Ring-fencing seeks to prevent DNSPs from using their position as monopoly providers of prescribed distribution services in ways that undermine or damage competition, efficiency and innovation in contestable markets.

DNSPs were previously subject to ring-fencing requirements under version 3 of the 'Ring-fencing Guideline – Electricity distribution' ('the guideline').[1] We have now published version 4 of the guideline and have set out the changes that have been made in the current version within this explanatory statement.

## 1.1 What is ring-fencing?

Ring-fencing refers to the separation of regulated services provided by a DNSP (for example, installation/maintenance of network poles and wires) from the provision of contestable services by a DNSP (for example, the installation of smart meters), or an affiliated entity. The guideline governs the extent to which DNSPs can provide contestable services.

The objective of ring-fencing is to provide a regulatory framework that promotes the development of competitive markets. It does this by trying to establish a level playing field for third party providers in new and existing markets for contestable services. Effective ring-fencing arrangements are an important mechanism for promoting market efficiency and more competitive outcomes in markets for energy services, ultimately leading to benefits to consumers.

The guideline aims to prevent cross-subsidisation and discriminatory behaviour by adopting a range of controls. In particular, the guideline stipulates a range of obligations on DNSPs to identify and separate costs and business activities of delivering regulated network services from the delivery of other services.

## 1.2 Updating the guideline

There are significant, long-term changes under way that will impact the energy industry, including DNSPs and consumers. As the energy transition progresses, the ring-fencing framework and the guideline will need to evolve.

Version 3 of the guideline was published in November 2021.

[1] Australian Energy Regulator, *Electricity Distribution Ring-fencing Guideline (Version 3)*, November 2021

In December 2024 we consulted on a draft version 4 of the guideline, in which we proposed two amendments to improve the operation of the ring-fencing framework:

1. Provide greater flexibility in determining the duration of ring-fencing waivers. We have modified clauses 5.3.4(b) and (c), by removing the current restriction on the maximum term for which ring-fencing waivers can be granted. The restriction previously limited waivers, other than for energy storage devices or stand-alone power systems (SAPS), to the current and upcoming regulatory control periods (i.e. 5 regulatory years, or a maximum of 5 years beyond the remaining duration of a DNSP's current regulatory control period)[2]. In lieu of a term period restriction, the AER will have full discretion over the maximum term of a waiver and will expect robust evidence in a waiver application to support a longer term.
2. Standardise the way in which DNSPs submit annual compliance reports. Specifically, by adding a requirement that DNSPs' annual compliance reports for ring-fencing must include a letter signed by the highest-ranking officer of that DNSP.

Our final decision is to include these two additional amendments in version 4 of the guideline. In addition:

1. We have included transitional wording to clarify that DNSPs will be required to comply with the updated clause for sign off of their annual compliance reports (under clause 6.2) for reporting on the 2025 calendar year, which will be due in April 2026, and any subsequent reports.
2. We have made one other administrative correction, clarifying clause 5.3A.2(d) so that cross-references are correctly expressed. Clause 5.3A.2(d) erroneously cross-references clause 5.3(b)(iii) & (iv), instead of correctly cross-referencing 5.3.2(b)(iii) & (iv). We have updated this to make the intended meaning of the clause clear.

In preparing version 4 of the guideline, we have considered views expressed previously by stakeholders, both from stakeholders who have engaged with the waiver process and from submissions to our draft proposal to update version 3 of the guideline.  Other aspects of the guideline will remain the same, besides removing now spent transitional provisions which addressed the transition from version 2 to version 3 of the guideline.

## 1.3 Next steps

Version 4 of the guideline will take effect as soon as it is published.

In consulting on the draft guideline, we invited stakeholders to notify the AER of other matters of concern with the guideline that may be considered in a subsequent, more comprehensive review. We appreciate all the feedback and input received in response to this invitation.

We are assessing the issues raised by stakeholders and will use this feedback to develop the scope of a future review of the guideline.

[2] National Electricity Rules, Chapter 10.

# 2 Proposed changes to the guideline

## 2.1 Modifying the maximum period for waivers

Version 3 of the guideline limited the maximum period for which a ring-fencing waiver could be granted. Under the previous clauses 5.3.4 (b) and (c), the AER could grant a waiver:

- *for a term that coincides with part or all of the DNSP's current regulatory control period, next regulatory control period, or both periods; or*
- *in the case of a waiver of clause 3.1 of this Guideline in relation to the use of a regulated stand-alone power system (SAPS) or of an energy storage device, for a different term or terms.*[3]

The limit on the maximum term of a waiver was introduced in version 1 of the guideline in 2016. At that time, we explained that the end date for a waiver:

> *should be linked to a DNSP's regulatory control periods on the basis that if a change to a waiver is made, it enables the DNSP to consider the treatment of any cost implications in its revenue proposal. Also, the regulatory determination process provides a sensible trigger to review an existing waiver.* [4]

However, the volume of ring-fencing waiver applications continues to increase, and the purposes of these waivers have become more diverse. We have observed that it is not always helpful or appropriate to automatically limit a waiver (apart from waivers in relation to the use of SAPS or energy storage devices) to no longer than the end of a subsequent regulatory period.

The technology used by the energy sector is continuously changing and the market itself is rapidly evolving. At the same time, however, we have observed instances where there may be little benefit to limiting the length of a waiver and requiring a DNSP to seek a new waiver within the length of two regulatory periods. For example, where:

- there is long-standing jurisdictional policy for a DNSP to deliver certain services which is unlikely to change in the foreseeable future
- a long-term contract exists for services that pre-dates the ring-fencing guideline
- a conflict has arisen between the guideline and the application of ring-fencing in the NER in a single jurisdiction
- there is no reasonable prospect of other providers of those services emerging in the future; or
- a DNSP is reasonably seeking greater certainty for planning future delivery than was available under the clause 5.3.4(b) in version 3 of the guideline.

[3] The guideline, clauses 5.3.4(b) & (c).
[4] AER, Electricity distribution Ring-fencing Guideline Explanatory statement November 2016 p.61.

In our draft position, we explained that allowing the AER to determine the most appropriate term for each waiver would provide flexibility to tailor the terms of waivers to individual circumstances.

## 2.2 Clarifying DNSP approvals of annual compliance reports

DNSPs are required by clause 6.2 of the guideline to submit annual reports concerning their compliance with the guideline and their ring-fencing obligations. The AER's Compliance Reporting Best Practice Manual[5] states that annual ring-fencing compliance reports should be submitted to the AER accompanied by a cover letter signed by the most senior executive of the DNSP (whether that person's position is titled chief executive officer, or managing director, or otherwise). We have observed that the majority of DNSPs have adopted this best-practice approach. However, some DNSPs have expressed uncertainty on the submission requirements. We have therefore codified this practice in version 4 of the guideline to improve clarity.

## 2.3 Transitional Arrangements

Version 3 of the guideline contained transitional arrangements in clauses 7.1 and 7.2, which were included for the commencement of version 3 in November 2021. Those clauses related to compliance with obligations during the transition from version 2 to version 3 of the guideline. These transitional provisions are now spent and we have removed them from version 4 of the guideline.

[5] Australian Energy Regulator, *Electricity Distribution Ring-fencing Guideline: Compliance Reporting Best Practice Manual (Version 3)*, page 6.

# 3 Stakeholder consultation

Consultation on the proposed changes to the distribution guideline was undertaken between 9 December 2024 and 28 January 2025. We received 11 written submissions as part of this consultation.

As part of our consultation, the draft explanatory statement noted that we are open to receiving submissions with feedback on other prospective changes to the guideline, which may be considered in a future review of the guideline.

## 3.1 Removing the maximum term limit on waivers

The majority of submissions that we received were in support of this change.

CitiPower, Powercor, and United Energy (CPU) stated that removing the maximum term waiver will enhance administrative efficiency by reducing the frequency of renewals, and provide businesses with greater operational certainty, enabling long-term planning.[6] Endeavour Energy highlighted that certain types of assets would benefit from this amendment. It pointed out that community batteries have become a key driver of ring-fencing waivers, and for other types of assets that can similarly have an economic lifespan in excess of 15-year lifespans, longer waivers would cover the whole economic and provide investor certainty for new projects.[7]

Some stakeholders suggested that the AER could provide further support to support this change, such as providing additional guidance regarding the assessment of waiver periods. For example, Jemena suggested that the AER could provide further guidance on what we will consider in assessing waiver length, such as aligning the waiver period with the specific asset lifespan, and a reasonable timeframe for operating costs.[8]

Other stakeholders expressed views that giving the AER greater flexibility in determining the term of a waiver may risk weakening the ring-fencing framework,[9] undermining competition and result in greater advantages to Related Electricity Service Providers (RESPs) of the DNSPs. The Australian Energy Council (AEC) disputed that there were any benefits to removing the maximum term period for waivers, beyond convenience to the AER and relaxation of regulatory burden for DNSPs. [10] The National Electricity Contractors Association (NECA) expressed concerns that waiver proposals by DNSPs will not have sufficient scrutiny to ensure that the waiver does not undermine competitive markets or permit the DNSP's to arbitrage opportunities arising from the waiver in favour of their RESP.[11]

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[6] CitiPower, Powercor, and United Energy, *Distribution Ring-fencing Guideline Review – Submission*, January 2025, p. 2.

[7] Endeavor Energy, *Consultation paper – Distribution Ring-Fencing Guideline Updates*, January 2025, p. 1.

[8] Jemena, *Jemena submission to the AER on the proposed changes to Ring-fencing Distribution*, January 2025, p.1

[9] EnergyAustralia, *AER proposed changes to ring-fencing guideline (electricity distribution),* January 2025, p. 1.

[10] AEC, *AER Proposed changes to the Distribution Ring Fencing Guideline*, January 2025, p.4.

[11] NECA, *Submission to the Australian Energy Regulator regarding proposed amendments to the Ring-Fencing Guideline (Distribution) in March 2025*, January 2025, p. 1.

In response to stakeholder's concerns about a lower standard of scrutiny for waivers, we note that there is no change to the obligation for the AER to consider the impact of a proposed waiver on competition. Moreover, in many cases a ring-fencing waiver has been sought, and granted, for reasons unrelated to a RESP or where competition impacts have not been a limiting factor. For example, recently the AER has granted waivers in instances where:

- The purpose of the waiver was to enable the DNSP to collaborate with two retailers to investigate technical options for delivering flexible export limits to retail customers[12].
- Stakeholders argued that permitting the DNSP to provide the service in question would support competition in a downstream market for innovation in energy storage and microgrids[13].
- A DNSP is required by jurisdictional arrangements to operate a monopoly water supply business for a regional city[14].

## 3.2 Clarifying DNSP approvals of annual compliance reports

Stakeholder submissions expressed support, or were neutral to, standardising sign-off by the most senior executive, with multiple stakeholders noting that it is already their current practice to do so.

Separately, as part of consultation on our proposed changes as part of version 5 of the Ring-fencing Guideline (Electricity transmission), APA raised a concern that not all companies will have senior executives.

## 3.3 Transitional Arrangements

SA Power Networks stated that for the upcoming annual compliance report, timing is unclear in the draft explanatory statement and suggested more clarity in the explanatory statement to avoid unnecessary ambiguity.[15] The submission explained that the wording of 'immediately' contradicted our later references to '2026' as the year requiring sign-off of annual compliance reports.

We have included transitional wording in the final amendments to clarify that DNSPs are required to submit a cover letter signed by the most senior executive of the DNSP for reporting on the 2025 calendar year, which will be due in April 2026, and any subsequent reports. Compliance with this new requirement will not be required for the annual compliance report related to the 2024 calendar year which must be submitted to the AER within four months of the end of 2024.

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[12] SAPN, *Ring fencing waiver - Market Active Solar Trial*, January 2024

[13] Ergon Energy, *Ring-fencing waiver - competitive services,* March 2024

[14] Essential Energy, *Ring-fencing waiver – Essential Water,* November 2023

[15] SAPN, *Proposed changes to the AER's Ring-fencing Guideline*, January 2025, p. 1.

# 4 Final changes to the guideline

## 4.1 Modifying the maximum period for waivers

Our final position remains the same as our draft position, which is that restriction on the maximum length of waivers will be removed in version 4 of the guideline.

Allowing the AER to determine the most appropriate term for each individual waiver provides the flexibility required to tailor the terms of waivers to individual circumstances. There are instances where there may be little benefit to limiting the length of a waiver and requiring a DNSP to seek a new waiver within the length of two regulatory periods. The guideline continues to require the AER to assess a waiver application by considering matters such as whether a waiver would further the National Electricity Objective[16], potential impacts on competition and the likelihood of any cross-subsidy in favour of a DNSP seeking to provide a competitive service. In considering these matters, we continue to have the option of managing residual risks by imposing conditions on a waiver. The conclusions we reach on all these matters weigh into the decision about the length of a waiver.

Applicants will still be required to provide evidence in support of a proposed term of a waiver. We consider that there continues to be value in the AER granting ring-fencing waivers with an explicit term. The requirement for a maximum term is intended to safeguard against a waiver becoming obsolete, or no longer appropriate, owing to a change in conditions. It remains the case that the grounds on which a waiver was granted are not static, circumstances can change over time and markets can develop in unforeseen ways.

We further note that the guideline was previously updated in respect of waivers for SAPS and for energy storage devices. Clause 5.3.4 was modified in version 3 of the guideline to exempt these technologies from the maximum waiver duration requirement.[17] Our changes for version 4 harmonise this approach to waivers, providing the AER flexibility to grant waivers for all types of energy assets and technologies. We again note that the AER will continue to use its discretion to consider whether waivers should be granted for longer or shorter periods than the previous limit of 2 regulatory periods.

In a ring-fencing waiver application, the AER will expect DNSPs to nominate a preferred waiver end date and, importantly, to provide evidence to support that term. Relevant evidence may include, but is not limited to:

- level of viable competition from other providers
- whether a waiver will permit an exclusive service
- whether the waiver empowers a trial that will inform industry and consumers
- any downstream benefits (e.g. growing a market for other services)
- relevance of any government policy (e.g. state requirements).

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[16] AEMC, National Energy Objectives, March 2024

[17] Electricity distribution ring-fencing guideline (version 3) │Explanatory statement, January 2025, page 8.

The AER welcomes DNSPs submitting draft ring-fencing waiver applications and seeking feedback from the AER, including on the evidence that the DNSP has provided to support their nominated waiver end date.

## 4.2 Clarifying DNSP approvals of annual compliance reports

Our final position is to amend clause 6.2 so to clarify that annual compliance reports must be accompanied by a cover letter signed by a DNSP's most senior executive (whether that person's position is titled chief executive officer, or managing director, or otherwise) and attesting that the contents of the report are accurate to the best of their knowledge. This responds to APA's feedback (see section 3.2) and ensures the transmission and distribution ring-fencing guideline are aligned.

We have clarified the timing of this change for upcoming annual compliance reports to avoid potential confusion for DNSPs regarding reporting requirements. Sign-off by the highest-ranking executive of a DNSP will be required for the annual compliance report in the 2026 reporting year, i.e. the annual compliance report which must be submitted to the AER within four months of the end of 2024. Annual compliance reports due in 2025 will not require sign-off by a DNSP's highest ranking officer, although we encourage DNSPs to do so in line with our recommendations in the AER's Compliance Reporting Best Practice Manual.

## 4.3 Administrative change

Clause 5.3A.2(d) erroneously cross-references clause 5.3(b)(iii) & (iv), two clauses that do not exist in the guideline.

This error was not identified in our explanatory statement for consultation, however, we do not believe that it has caused any confusion for stakeholders reading previous versions of the guideline.

As a result we believe it is appropriate to make this amendment without having sought stakeholder views through our consultation process.

## 4.4 Transitional arrangements

We have included transitional wording to clarify that DNSPs will be required to comply with the updated clause for reporting on the 2025 calendar year, which will be due in April 2026, and any subsequent reports.

Other changes will take effect immediately on publication of version 4 of the guideline.

For version 4 of the guideline, our changes are limited and are not expected to have any cost impact or significant compliance burden for DNSPs.

This has the effect that on and from the commencement date of version 4, the AER has discretion to grant a waiver for any period it considers appropriate under amended clause 5.3.4, even for applications on hand that were received under version 3 of the guideline. This notes that amended clause 5.3.4 in version 4 is more beneficial to applicants than grandfathering the existing arrangements, because version 4 provides greater discretion for a waiver period to be tailored to the applicant's circumstances.

For any waiver applications received before the commencement date of version 4 which we have not yet granted, we will include in any consultation we undertake on the waiver application the option of granting a waiver for a term longer than the previous maximum limit.

If a DNSP seeks to adjust the waiver term of an application that has been submitted to the AER but not yet granted, they should submit an accompanying letter to adjust the proposed waiver term and provide information to support this term.