

Decision

Distribution ring-fencing class waiver for the Central-West Orana Renewable Energy Zone

March 2022

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Shortened forms

Shortened Form	Extended Form
AER	Australian Energy Regulator
DNSP	Distribution Network Service Provider
EII Act	Electricity Infrastructure Investment Act NSW (2020)
EnergyCo	Energy Corporation of NSW
NEM	National Electricity Market
NER	National Electricity Rules
NEO	National Electricity Objective
REZ	Renewable Energy Zone

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1 Executive summary

In December 2021 the Infrastructure Planner, Energy Corporation of NSW (EnergyCo), commenced a competitive procurement process to select a Network Operator to build and operate network infrastructure for the planned Central-West Orana Renewable Energy Zone (REZ) under the *Electricity Infrastructure Investment Act 2020 (NSW)* (the EII Act).¹ Based on our understanding of the regulatory framework currently being developed by the NSW Department of Planning and Environment, distribution network service providers (DNSPs) may be prohibited from providing REZ network services as a Network Operator under the AER Ring-fencing Guideline Electricity Distribution (the Guideline).

To provide certainty that DNSPs may participate in the competitive procurement process to build and operate network infrastructure for the planned Central-West Orana REZ and provide REZ network services as a Network Operator for the planned Central-West Orana REZ, we have decided to grant a class waiver to all DNSPs in the National Electricity Market (NEM).

We would like to maximise competitive tension and drive efficient project delivery in EnergyCo's procurement process and consider there are benefits to NSW electricity consumers in allowing DNSPs to compete for the role of Network Operator to construct and operate the Central-West Orana REZ network project. We therefore initiated a class waiver process that, if granted, would allow all DNSPs in the NEM to provide REZ network services as a Network Operator for the Central-West Orana REZ. On 1 March 2022, we published a notice seeking stakeholder feedback.

Our decision is to grant a class waiver to all DNSPs in the NEM. Specifically, we grant a class waiver of DNSPs' ring-fencing obligations in respect of the following clauses of the Guideline:

- 3.1(b) (legal separation)
- 4.2.1(a) (physical separation/co-location)
- 4.2.2(a) (staff sharing)
- 4.2.3(a) (branding).

This class waiver applies to the provision of REZ network services for the planned Central-West Orana REZ only, should Energy Co select a DNSP as a Network Operator for the Central-West Orana REZ. The class waiver expires at the end of the concession period² agreed in the project deed³ signed between EnergyCo and the successful participant in EnergyCo's procurement process.

Further, the class waiver is granted on the condition that:

- Any DNSP that is selected by EnergyCo to be the Network Operator for the Central-West Orana REZ must amend its cost allocation methodology made under Chapter 6, Part F of the NER to include REZ network services for the Central-West Orana REZ. Under the NER, the AER must approve any amendments to a DNSP's CAM.
- The AER must be notified in writing by a DNSP that is selected by EnergyCo to be the Network Operator for the Central-West Orana REZ of the length of the concession period within 30 business days of signing a project deed. The AER must also be notified of any variations to the length of the concession period within 30 business days of any such variation.

For the avoidance of doubt, in circumstances where a DNSP (or DNSPs) participated in the competitive procurement process to build and operate network infrastructure for the planned Central-West Orana REZ,

¹ NSW Government, *Registration of Interest for Central-West Orana Renewable Energy Zone Network Operator - SR3289060679-1*, available online: <https://www.tenders.nsw.gov.au/?event=public.ft.showArchived&RFTUUIID=86CF9DAF-F822-7776-0EEC10D54CF193E8>

² The concession period refers to the term of the Project Deed signed between the Infrastructure Planner and the Network Operator selected to build and maintain network infrastructure under the EII Act.

³ A project deed refers to a contract entered by the Infrastructure Planner with the Network Operator to construct and maintain network infrastructure projects under s.63(4)(a) of the EII Act.

the class waiver will no longer apply to a DNSP (or those DNSPs) that are not selected to build, own or operate the Central-West Orana REZ, from the point in time when EnergyCo has concluded the procurement process by signing a project deed with the successful participant.

2 Background

2.1 What is ring-fencing?

Ring-fencing, in relation to DNSPs, refers to the separation of direct control services provided by a DNSP from the provision of unregulated or contestable services by a DNSP, or an affiliated entity. Ring-fencing operates to separate regulated activities from competitive business activities to support competitive markets. The Guideline is made under rule 6.17 of the National Electricity Rules (NER) and sets out obligations that apply to a DNSP should it wish to provide unregulated or contestable services. These obligations aim to benefit electricity consumers by addressing the potential risk of:

- consumers paying more than they should for regulated network direct control services because a DNSP cross-subsidises the cost of its unregulated services by attributing those costs to its direct control services; and
- DNSPs discriminating in contestable markets in favour of their affiliated entities. This may diminish the benefits created by a competitive market, such as downward pressure on prices in the long-term, and greater consumer choice.

Ring-fencing aims to drive effective competition where feasible, open new markets to competition, and support effective regulation where competition is not feasible.

The Guideline recognises that strict adherence to ring-fencing obligations might, in some circumstances, result in outcomes that are not in the long-term interest of consumers. Therefore, the Guideline makes provision for ring-fencing class or individual waivers.⁴ Waivers provide the ring-fencing framework with the flexibility to support opportunities for genuine innovation.

Under clause 5.3A of the Guideline the AER may, of its own initiative, in its absolute discretion, and at any time, grant a class waiver of certain obligations in the Guideline for multiple DNSPs, and may do so:

- for a term the AER considers appropriate; and
- subject to any conditions the AER considers appropriate.

2.2 Procurement of a Network Operator for Central-West Orana REZ

The EII Act sets out a framework to meet energy security and renewable energy generation targets in NSW. Among other objectives, the EII framework seeks to coordinate investment in generation and transmission infrastructure through the creation of REZs. The Central-West Orana REZ will be the first of several REZs to be developed as part of the NSW Government's Electricity Infrastructure Investment Roadmap (NSW Roadmap).⁵ The Central-West Orana REZ was formally declared on 5 November 2021.⁶ In December 2021 EnergyCo commenced a process to procure a Network Operator for the Central-West Orana REZ by soliciting registrations of interest from potential providers.

The EII Act establishes a range of new entities to carry out various functions. Entities of relevance to this class waiver are:

- Network Operator, whose role is to build, own or operate a REZ network infrastructure project.⁷
- The AER has been appointed as a Regulator under the EII Act.⁸ Our functions under the EII Act include determining the amounts payable to a Network Operator for construction and operation of

⁴ A DNSP may also apply for a waiver under clause 5.3 of the Guideline.

⁵ See: <https://www.energy.nsw.gov.au/government-and-regulation/electricity-infrastructure-roadmap>.

⁶ NSW Government, *Government gazette of the state of NSW*, number 569 – electricity and water, 5 November 2021, pp. 1-4.

⁷ According to the *Electricity Infrastructure Investment Act 2020 (NSW)*, dictionary, a network operator means a person who owns, controls or operators, or proposed to own, control or operate, network infrastructure.

⁸ The role of the Regulator is established in s.64 EII Act; The Commonwealth of Australia, the State of NSW, *Agreement – Conferral of functions on the Australian Energy Regulator under the Electricity Infrastructure Investment Act 2020 (NSW)*, available online: <https://www.aer.gov.au/system/files/Conferral%20Agreement%20between%20the%20Commonwealth%20of%20Australia%20and%20State%20of%20NSW>

REZ networks.⁹ As part of this role we are required to indicate how we will calculate the prudent, reasonable and efficient capital costs for the development and construction of a REZ network infrastructure project (known as the Transmission Efficiency Test).¹⁰ The EII Regulations will also require us to publish guidelines on how we intend to make revenue determinations for Network Operators under the EII Act.

- The Infrastructure Planner, who must recommend both network infrastructure projects to be built and the Network Operator.¹¹ Under the EII Regulations, the Infrastructure Planner is permitted to undertake a competitive procurement process to select a Network Operator.
- The Consumer Trustee, AEMO Services Ltd, may assess and authorise a Network Operator to undertake a network infrastructure project based on the recommendation of the Infrastructure Planner.¹²

Based on our understanding of the regulatory framework under development by the NSW Department of Planning and Environment, we expect that the EII Regulations will create a new class of 'REZ network services'. This service will be further defined in the EII regulations.

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⁹ EII Act, s. 38(1-6).

¹⁰ EII Act, s. 38(5).

¹¹ EII Act, s. 63.

¹² EII Act, s. 60.

3 Assessment

The Guideline sets out classes of services that must be ring-fenced from the DNSP. To provide certainty that DNSPs may participate in the competitive procurement process for the planned Central-West Orana REZ network project, we have assumed that REZ network services will likely be ‘other electricity services’ as defined in the Guideline.¹³ This view is subject to how ‘REZ network services’ are defined in the forthcoming EII Regulations being developed by the NSW Department of Planning and Environment. ‘Other electricity services’ are subject to legal and functional separation requirements in clauses 3.1 and 4.2 of the Guideline, unless subject to a class or individual waiver.

In assessing whether to grant a ring-fencing class waiver, we must have regard to:

- The National Electricity Objective (NEO);
- The potential for cross-subsidisation and discrimination if the class waiver is granted or refused; and
- Whether the benefit, or likely benefit, to electricity consumers of the DNSP complying with the obligations (including any benefit or likely benefit from increased competition) would be outweighed by the cost to the DNSP of complying with that obligation.¹⁴

In assessing the merits of a class waiver, we have considered each factor listed above, as well as stakeholder feedback outlined below.

3.1 Stakeholder views

On 1 March 2022, we sought stakeholder feedback on granting a class waiver to all NEM DNSPs in respect of REZ network services for the Central-West Orana REZ. On 9 March we held a feedback session to receive questions and views from stakeholders. At the stakeholder feedback session, participants clarified that our consideration of granting a class waiver was driven by creating competitive tension in EnergyCo’s procurement process.

We received three written submissions from Ausgrid, Endeavour Energy and Essential Energy.¹⁵ All three DNSPs supported us granting a class waiver to enable DNSPs to potentially build and operate transmission infrastructure in the Central-Orana West REZ, which removes ambiguity¹⁶ on the level of participation a DNSP may have in a competitive REZ process. Further:

- Endeavour Energy supported granting a class waiver of legal separation obligations in the Guideline.¹⁷
- Ausgrid supported granting a class waiver of both legal and functional separation obligations in the Guideline.¹⁸ Alternatively, Ausgrid submitted that we should confirm that REZ network services meet the definition of ‘transmission services’, thereby avoiding the need for a class waiver.

¹³ AER, *Ring-fencing Electricity Distribution Guideline (Version 3)*, October 2021, cl. 1.4 defines ‘other electricity services’ as meaning services for the supply of electricity or that are necessary or incidental to the supply of electricity other than transmission services (as defined in Chapter 10 of the NER) or distribution services (as defined in Chapter 10 of the NER).

¹⁴ AER, *Ring-fencing Electricity Distribution Guideline (Version 3)*, October 2021, cl. 5.3.2.

¹⁵ Ausgrid, *Consultation on class waiver under the distribution Ring-fencing Guideline – Central-West Orana Renewable Energy Zone*, 14 March 2022, p. 1; Endeavour Energy, *Consultation on class waiver to the distribution ring-fencing guideline*, 14 March 2022, p. 1; Essential Energy, *CWO REZ class waiver to distribution ring-fencing guideline*; 14 March 2022, p. 1.

¹⁶ Endeavour Energy, *Consultation on class waiver to the distribution ring-fencing guideline*, 14 March 2022, p. 2.

¹⁷ Endeavour Energy, *Consultation on class waiver to the distribution ring-fencing guideline*, 14 March 2022, p. 1.

¹⁸ Ausgrid, *Consultation on class waiver under the distribution Ring-fencing Guideline – Central-West Orana Renewable Energy Zone*, 14 March 2022, p. 1.

Ausgrid and Endeavour Energy noted that it is currently unclear how services involved in performing REZ Network Operator role will be defined for ring-fencing purposes, including whether they would fall within the definitions of ‘transmission services’ and ‘contestable electricity services’.¹⁹

The NSW DNSPs’ submissions outlined several benefits of allowing DNSPs to compete to provide REZ network services for the planned Central-West Orana REZ, including:

- that DNSPs have the requisite experience, knowledge, asset planning, management and safety systems, and understanding of the responsibilities and regulatory obligations needed to deliver network services in a safe, secure, reliable and efficient manner.²⁰
- Ausgrid noted that existing affiliates of DNSPs may not be able to offer the same level of experience and expertise in network operation.²¹
- 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 transmission network service providers (TNSPs).²²

The NSW DNSPs also noted several possible costs to consumers if we did not grant a class waiver in respect of the Central-West Orana REZ and instead required compliance with the Guideline:

- Endeavour Energy considered that EnergyCo’s competitive process is likely to be practicably restricted to the NSW network service providers given the capabilities and resources required to act as a Network Operator, and that there would be no viable alternative to the incumbent TNSP acting as the Network Operator if the NSW DNSPs are unable to participate in this process.²³
- Ausgrid considered that restricting DNSPs from participating in the procurement may reduce competitive tension, which might result in procurement outcomes that are higher cost or of lower quality.²⁴ Similarly, Essential Energy submitted that absent the class 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.²⁵
- Ausgrid considered that the cost of establishing a new affiliate of a DNSP (for DNSPs that do not have an appropriate affiliate already) to compete to provide REZ network services would not be in the long-term interests of consumers.²⁶

3.2 National Electricity Objective

The NEO requires us 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 NEO is the guiding principle that underpins all decision-making in the NEM framework and is a requirement we must consider in deciding whether to grant a class waiver under clause 5.3A of the Guideline.

¹⁹ Endeavour Energy, *Consultation on class waiver to the distribution ring-fencing guideline*, 14 March 2022, p. 2; Ausgrid, *Consultation on class waiver under the distribution Ring-fencing Guideline – Central-West Orana Renewable Energy Zone*, 14 March 2022, p. 3.

²⁰ Ausgrid, *Consultation on class waiver under the distribution Ring-fencing Guideline – Central-West Orana Renewable Energy Zone*, 14 March 2022, p. 1; Endeavour Energy, *Consultation on class waiver to the distribution ring-fencing guideline*, 14 March 2022, p. 1.

²¹ Ausgrid, *Consultation on class waiver under the distribution Ring-fencing Guideline – Central-West Orana Renewable Energy Zone*, 14 March 2022, p. 2.

²² Essential Energy, *CWO REZ class waiver to distribution ring-fencing guideline*; 14 March 2022, p. 1.

²³ Ausgrid, *Consultation on class waiver under the distribution Ring-fencing Guideline – Central-West Orana Renewable Energy Zone*, 14 March 2022, p. 1.

²⁴ Ausgrid, *Consultation on class waiver under the distribution Ring-fencing Guideline – Central-West Orana Renewable Energy Zone*, 14 March 2022, p. 1; Endeavour Energy, *Consultation on class waiver to the distribution ring-fencing guideline*, 14 March 2022, p. 3.

²⁵ Essential Energy, *CWO REZ class waiver to distribution ring-fencing guideline*; 14 March 2022, p. 4.

²⁶ Ausgrid, *Consultation on class waiver under the distribution Ring-fencing Guideline – Central-West Orana Renewable Energy Zone*, 14 March 2022, p. 2.

We note Essential Energy's point that the NSW Roadmap is an alternative regulatory framework set out in NSW legislation (the EII Act) and therefore queries the extent to which the NEO is a relevant consideration.²⁷ The question of whether to grant the waiver directs consideration 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.

We strongly encourage competition in the NEM, where such competition is feasible. Our position does not change for the provision of REZ network services, particularly when the costs of NSW Roadmap are directly passed through to NSW electricity consumers.

We consider that granting a class waiver to allow DNSPs to tender for the role of Network Operator for the Central-West Orana REZ will support promotion of the NEO by:

- creating greater competitive tension for REZ network services, which in turn will promote more efficient pricing, quality, safety and reliability for REZ network services.
- driving more efficient project delivery, reducing information asymmetries by revealing efficient costs, and promoting equal assessment between network and non-network options at the planning stage.²⁸
- supporting the NSW Department of Planning and Environment and EnergyCo in delivering the policy intent to '...reduce barriers faced by non-incumbent network developers without ignoring the real advantages of incumbent network service providers and encouraging innovative solutions to network needs that provide lower costs/higher value without unfairly shifting risk to consumers or regulated incumbents'.²⁹
- providing an important early example of implementing a competitive framework for the construction and operation of new transmission infrastructure.

Further, we consider that DNSPs participating in the competitive procurement process for the Central-West Orana REZ, or indeed, being selected as the REZ Network Operator would not be at the detriment of the DNSPs' provision of safe, reliable and secure supply of distribution services under the national framework. As we outline below, we do not consider that participation in the competitive process or ultimately providing REZ network services gives rise to the risk of cross-subsidisation or discrimination.

3.3 Potential for cross-subsidisation

In deciding whether to grant a class waiver, we must consider the potential for cross-subsidisation if the waiver is granted or refused. That is, consider whether there is potential for a DNSP to use revenues from provision of direct control services to cross-subsidise provision of other services.³⁰ We may waive legal separation obligations, but we cannot waive cost allocation and attribution obligations under clause 3.2.2(d) of the Guideline.

We consider there to be limited risk that a DNSP may cross-subsidise provision of REZ network services for the Central-West Orana REZ in granting a class waiver of legal separation obligations under the Guideline. This is because:

- provision of both distribution services and REZ network services will be subject to separate and robust regulatory frameworks of the NER and EII Act, and
- we will require any DNSP that is successful in EnergyCo's procurement process to amend its cost allocation methodology to incorporate REZ network services.³¹

²⁷ Essential Energy, *CWO REZ class waiver to distribution ring-fencing guideline*; 14 March 2022, p. 3.

²⁸ AER, *AER submission to the AEMC's Transmission Planning and Investment Review consultation paper*, p. 3.

²⁹ NSW Department of Planning, Industry and Environment, *Network Infrastructure Projects (Part 5 of the Electricity Infrastructure Investment Act 2020)*, *Policy paper*, October 2021, p. 24.

³⁰ AER, *Ring-fencing Electricity Distribution Guideline (Version 3)*, October 2021, cl. 5.3.2(a)(iii).

³¹ NER, cl. 6.15.4.

3.3.1 Robust regulatory frameworks

EnergyCo is running a competitive procurement process to select a Network Operator for the Central-West Orana REZ network project, however once the Network Operator is selected EnergyCo will enter a project deed with the successful DNSP for the term of the concession period. This concludes the competitive stage of the process and the successful DNSP becomes the monopoly provider of REZ network services for the Central-West Orana REZ, subject to AER revenue determinations. We observe the DNSP providing REZ network services will continue to be bound by Guideline obligations under clause 3.2 to maintain separate accounts and allocate costs, which cannot be waived.

Further, under the EII Act the Network Operator will be required to submit five-yearly revenue proposals to us. We therefore consider that requiring a DNSP that is successful in the procurement to update its cost allocation methodology will adequately manage the risk of cross-subsidy in the construction and operations phase.

3.3.2 Cost allocation and attribution

In reaching our decision to grant a class waiver for the provision of REZ network services for the planned Central-West Orana REZ should EnergyCo select a DNSP as a Network Operator we considered whether the DNSP may be incentivised to under-allocate future shared costs to REZ network services (and over-allocate shared costs to direct control services provided under the NER), to provide a more competitive bid into the procurement process. Again, we consider this risk to be low, as it would require consistent and ongoing misallocation of shared costs over the term of the concession period, substantially increasing the likelihood that we would detect this behaviour.

We considered whether a DNSP, as Network Operator for the Central-West Orana REZ, may be incentivised to under-allocate shared costs to REZ network services (and over-allocate shared costs to direct control services) at the construction and operations phase of the REZ. This incentive may exist if there is a difference in how the EII Act and NER framework treat any cost savings achieved by the DNSP. Under the NER, a portion of any underspend below a DNSP's annual revenue requirement must be returned to consumers under the Capital Expenditure Sharing Scheme and the Efficiency Benefit Sharing Scheme.³² We understand that treatment of any underspend below an annual amount payable agreed between EnergyCo and the Network Operator may be different under the framework for contestable network infrastructure projects. A DNSP that is also a Network Operator may be incentivised to mis-allocate costs that are shared between provision of direct control services and REZ network services.

In our Explanatory Statement to version 1 of the Guideline, we noted that we may grant a waiver from legal separation if a DNSP offers a non-distribution service that is regulated and where its cost allocation methodology is inclusive of the non-distribution service.³³ We allowed this on the basis that the risk of cross-subsidy is limited where adequate transparency is provided through the cost allocation methodology and if the DNSP is offering services that are not contestable. Once a service is included in the cost allocation methodology, it is subject to auditing as part of our annual auditing process under the NER. We consider this mechanism provides the necessary transparency to minimise the risk of misallocation of any shared costs between direct control services and REZ network services.

3.4 Potential for discrimination

We consider there is limited risk that a DNSP would discriminate in favour of itself in competing to provide REZ network services for the Central-West Orana REZ, for the following reasons:

- We understand that the Central-West Orana REZ will connect to TransGrid's transmission network. Therefore, a DNSP will not have access to ring-fenced information about the transmission network that the Central-West Orana REZ will connect to.

³² AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013, cl. 1.3; AER, *Capital expenditure incentive guideline for electricity network service providers*, November 2013, cl. 2.3.2.

³³ AER, *AER Ring-fencing Guideline – Explanatory Statement*, 30 November 2016, p. 57.

- Ausgrid submitted that the regulated nature of REZ network services once a successful tenderer has been selected means the risk of discrimination does not arise, and that the provision of REZ network services do not rely on access to a DNSP's direct control services.³⁴ For these reasons, Ausgrid submitted that functional separation obligations (office, staff and branding separation) in the Guideline should be waived.³⁵ We agree with Ausgrid on this point. For example:
 - the risk of discriminatory access to the NER regulated distribution network or associated customer information, is does not arise. Therefore, we have decided to include Guideline obligations relating to staff and office sharing³⁶ in the class waiver.
 - the rationale for the Guideline's branding obligations does not apply in the context of the Central-West Orana REZ. REZ network services are not contestable services being marketed to consumers, where there is potential for branding or cross-promotion to influence consumer choice.³⁷ Hence, we have decided to also waive the Guideline obligation for branding³⁸ and cross-promotion.
- In our role as regulator, we will be monitoring the competitive procurement process undertaken by EnergyCo, including how potential conflicts have been identified and addressed, and the process used to ensure incumbent network businesses are not unduly advantaged in the procurement process.³⁹ We understand that standard probity arrangements will also be in place during the competitive procurement process.
- The class waiver is granted for provision of REZ network services only for the planned Central-West Orana REZ. A DNSP that is selected to be the Network Operator for the Central-West Orana REZ will still be restricted from providing services in competitive markets under the Guideline.
- The class waiver does not waive clauses 4.1 or 4.3 of the Guideline, which are a general obligation to not discriminate, and behaviours relating to the treatment of information access and disclosure respectively.
- Endeavour Energy stated that the natural advantages that an incumbent regulated business might normally have in competing to provide network services are lessened by EnergyCo undertaking a centralised approach to preparatory works, engagement and planning activities that would normally be under the transmission network's remit under the national framework.⁴⁰

More broadly, as Essential Energy submitted,⁴¹ a DNSP's independent audit will validate that the REZ network services associated with being the network owner and/or network operator of the Central-West Orana REZ are not being applied in a discriminatory manner. This could occur via an independent audit. We consider that as part of the annual ring-fencing compliance process, the ring-fencing auditor will be able to confirm that costs of REZ network services are being allocated and attributed in accordance with the condition of the class waiver and its approved cost allocation methodology. We and DNSPs are familiar and comfortable with these existing auditing processes, making them an effective monitoring tool to leverage with minimal additional administrative burden on either party.

³⁴ Ausgrid, *Consultation on class waiver under the distribution Ring-fencing Guideline – Central-West Orana Renewable Energy Zone*, 14 March 2022, p. 2.

³⁵ Ausgrid, *Consultation on class waiver under the distribution Ring-fencing Guideline – Central-West Orana Renewable Energy Zone*, 14 March 2022, p. 4.

³⁶ AER, *Ring-fencing Electricity Distribution Guideline (Version 3)*, October 2021, cll. 4.2.1(a) and 4.2.2(a).

³⁷ Ausgrid, *Consultation on class waiver under the distribution Ring-fencing Guideline – Central-West Orana Renewable Energy Zone*, 14 March 2022, p. 3.

³⁸ AER, *Ring-fencing Electricity Distribution Guideline (Version 3)*, October 2021, cl. 4.2.3(a).

³⁹ Further detail on our approach to reviewing the procurement process will be set out in our forthcoming guideline, which will detail our approach to: (1) reviewing the procurement process undertaken by the Infrastructure Planner to select a Network Operator, and (2) undertaking a transmission efficiency test and making a revenue determination for a Network Operator selected on a contestable basis.

⁴⁰ Endeavour Energy, *Consultation on class waiver to the distribution ring-fencing guideline*, 14 March 2022, p. 1.

⁴¹ Essential Energy, *CWO REZ class waiver to distribution ring-fencing guideline*; 14 March 2022, p. 4.

Finally, we have the ability under the Guideline to initiate an investigation into perceived cross-subsidisation or discriminatory behaviour at any time. In material circumstances this could lead to the revocation of the class waiver. The Guideline therefore provides for immediate recourse should discriminatory behaviour be identified,⁴² including the ability to revoke the class waiver.

3.5 Benefits and costs of DNSP complying with ring-fencing obligations

Overall, we consider that the benefit to NSW electricity consumers of granting the class waiver outweighs the costs of the DNSP complying with the obligations for legal and functional separation.⁴³ This is because there are unlikely to be benefits to consumers from a DNSP complying with ring-fencing obligations in the case of the Central-West Orana REZ. Specifically, we discuss above that:

- there is a negligible risk of discrimination where a DNSP competes to provide REZ network services for the Central-West Orana REZ. Therefore, NSW electricity consumers are unlikely to benefit by way of improved competition in markets for contestable electricity services.
- that there is a limited risk for cross-subsidisation between REZ network services and regulated direct control services, and this risk can be managed by a DNSP updating its cost allocation method.

Conversely, we consider there are potentially significant benefits NSW electricity consumers may lose in the long-term if DNSPs are prohibited from competing to provide REZ network services for the Central-West Orana REZ. Prohibiting DNSPs from competing would:

- narrow the field of eligible participants in EnergyCo's competitive procurement process, potentially resulting in a less competitive outcome.
- reduce the number of competitors with experience in reliably and safely managing network infrastructure in Australia,⁴⁴ potentially impacting the overall quality of the bids that EnergyCo receives.
- potentially lose the opportunity to realise efficiencies in leveraging existing supply chain relationships.⁴⁵

Under the EII Act, all NSW electricity consumers will pay for the cost of the NSW Roadmap.⁴⁶ Should DNSPs be restricted from participating in EnergyCo's procurement process and this results in a less competitive outcome, NSW electricity consumers may pay more for Central-West Orana REZ network infrastructure in the long-term than might otherwise have been the case.

3.6 Conclusion

We consider that the benefit or likely benefit to NSW electricity consumers of permitting DNSPs to bid to build and operate the Central-West Orana REZ network infrastructure outweighs the costs to the DNSP of complying with legal and functional separation ring-fencing obligations. We recognise the potential for a DNSP to cross-subsidise provision of REZ network services from regulated revenues that it earns providing direct control services under the NER. However, we consider that this risk can be managed by requiring any DNSP that wins the right to build and/or operate the Central-West Orana REZ to update their NER cost allocation methodology to explicitly take account of cost allocation between provision of REZ network services and regulated direct control services provided under the NER. We consider the risk of discrimination is very limited.

⁴² Essential Energy, *CWO REZ class waiver to distribution ring-fencing guideline*; 14 March 2022, p. 4.

⁴³ Specifically, AER, *Ring-fencing Electricity Distribution Guideline (Version 3)*, October 2021, cl. 3.1(b), 4.2.1(a), 4.2.2(a) and 4.2.3(a)

⁴⁴ Ausgrid, *Consultation on class waiver under the distribution Ring-fencing Guideline – Central-West Orana Renewable Energy Zone*, 14 March 2022, p. 3; Essential Energy, *CWO REZ class waiver to distribution ring-fencing guideline*; 14 March 2022, p. 4

⁴⁵ Essential Energy, *CWO REZ class waiver to distribution ring-fencing guideline*; 14 March 2022, p. 5.

⁴⁶ EII Act, s. 58.

Overall, we consider that granting a class waiver promotes the NEO by supporting greater competition in the provision of electricity services.

4 Decision

Our decision is to grant a class waiver to all DNSPs in the NEM. Specifically, we grant a class waiver of DNSPs' ring-fencing obligations in respect of the following clauses of the Guideline:

- 3.1(b) (legal separation)
- 4.2.1(a) (physical separation/co-location)
- 4.2.2(a) (staff sharing)
- 4.2.3(a) (branding).

This class waiver applies to the provision of REZ network services for the planned Central-West Orana REZ only, should Energy Co select a DNSP as a Network Operator for the Central-West Orana REZ network project. The class waiver expires at the end of the concession period⁴⁷ agreed in the project deed⁴⁸ signed between EnergyCo and the successful participant in EnergyCo's procurement process.

Further, the class waiver is granted on the condition that:

- Any DNSP that is selected by EnergyCo to be the Network Operator for the Central-West Orana REZ must amend its cost allocation methodology made under Chapter 6, Part F of the NER to include REZ network services for the Central-West Orana REZ. Under the NER, the AER must approve any amendments to a DNSP's CAM.
- The AER must be notified in writing by a DNSP that is selected by EnergyCo to be the Network Operator for the Central-West Orana REZ of the length of the concession period within 30 business days of signing a project deed. The AER must also be notified of any variations to the length of the concession period within 30 business days of any such variation.

For the avoidance of doubt, in circumstances where a DNSP (or DNSPs) participated in the competitive procurement process to build and operate network infrastructure for the planned Central-West Orana REZ, the class waiver will no longer apply to a DNSP (or those DNSPs) that are not selected to build, own or operate the Central-West Orana REZ, from the point in time when EnergyCo has concluded the procurement process by signing a project deed with the successful participant.

For the avoidance of doubt, the class waiver is granted to the following DNSPs:

- Ausgrid
- AusNet Services
- CitiPower
- Endeavour Energy
- Energex
- Essential Energy
- Ergon Energy
- Jemena Electricity Networks
- Power and Water Corporation
- Powercor
- SA Power Networks
- TasNetworks
- United Energy.

⁴⁷ The concession period refers to the term of the Project Deed signed between the Infrastructure Planner and the Network Operator selected to build and maintain network infrastructure under the EII Act.

⁴⁸ A project deed refers to a contract entered by the Infrastructure Planner with the Network Operator to construct and maintain network infrastructure projects under s.63(4)(a) of the EII Act.