

9 June 2023

Mark Feather
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Australian Energy Regulator
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Canberra ACT 2601

Dear Mark

AusNet appreciates the opportunity to make a submission in response to the Australian Energy Regulator's (**AER's**) consultation paper, *Options to address gaps in transmission ring-fencing framework* (**Consultation Paper**).

The purpose of the Consultation Paper is to "explore whether there is any ability for, or evidence of, TNSPs discriminating in favour of themselves or an affiliate in providing [contestable] connection services" and the "potential options to address any concerns."¹ Two such options are presented in the Consultation Paper: a rule change to introduce mandatory compliance reporting for TNSPs in Chapter 5 of the National Electricity Rules (**NER**), and expanding the scope of the AER's existing powers to permit it to make guidelines ring-fencing negotiated transmission services from contestable transmission services.

AusNet continues to support the use of ring-fencing guidelines and similar instruments where there is a real, material and evidence-based risk that market participants are distorting market competition. Therefore, we commend the AER's move to gather information to assess whether TNSP behaviour in respect of negotiated transmission services is detrimentally affecting the market for contestable services. However, we are concerned by the AER's decision to propose solutions to address market distortions before it completes its evidence-gathering, and we urge the AER to consider a further period of information gathering and investigation to determine whether there is, in fact, a need to ring-fence negotiated transmission services.

By its design, Victoria's contestability framework promotes competition

The Consultation Paper notes that Victoria has a unique framework for providing contestable transmission services and acknowledges AusNet's position that the framework has a number of features that obviate the need for additional ring-fencing obligations.² AusNet discussed these features in detail in our submissions throughout the transmission ring-fencing consultation process in 2022.³

It is our position that the features that promote competition for contestable services also limit the ability of a Declared Transmission System Operator (**DTSO**) (including AusNet) to discriminate in favour of itself or an affiliate. As the Consultation Paper notes, these features are the Australian Energy Market Operator's (**AEMO's**) role as the party that conducts the tenders for contestable projects and the party that determines the technical

¹ AER, *Consultation paper – Options to address gaps in transmission ring-fencing framework*, May 2023, 5-6.

² *Ibid*, 21.

³ AusNet, 'Response to Tx Ring-fencing Issues Paper, 22 July 2022', 'AusNet Response to Questions from the Ring-fencing Guideline Electricity Transmission Issues Paper, 22 July 2022' and 'Response to Tx Ring-fencing Draft Decision, 16 Dec 2022' all available at: <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/ring-fencing-guideline-electricity-transmission-2023/initiation#step-82010> (accessed 07/06/2023).

specifications for each project⁴, as well as the volume of information that must be disclosed by the DTSO to the market. The efficacy of these features is a matter which the Consultation Paper expressly seeks to test.⁵

To supplement the evidence gathered through this process, we would be happy to meet with the AER to deepen its understanding of the structure and dynamics of the contestable services market, and how the competitive tension it creates also disciplines DTSO behaviour in the market for negotiated transmission services.

There is clear evidence of strong competition in Victoria

The contestability framework in Victoria is delivering effective competition for contestable transmission services. Our review indicates that since 2012, no fewer than 17 contestable projects for the construction and operation of terminal stations and high voltage assets have been awarded. As the figure below shows, these projects have been awarded to a diverse range of bidders.

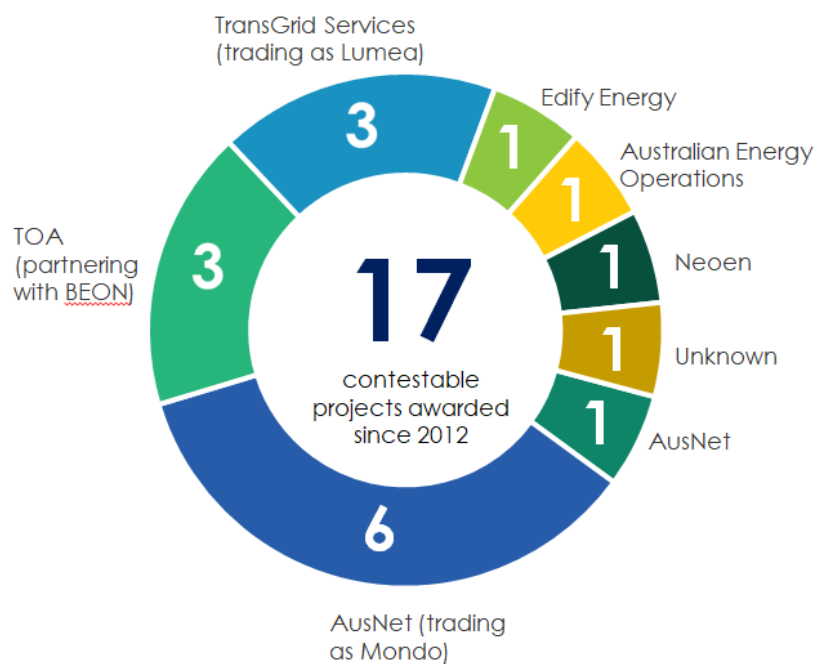


Figure 1: Transmission projects awarded in Victoria (2012-present)

Source: AusNet

Figure 1 underscores that AusNet faces strong competition for contestable projects. Due to low barriers to entry, including a clear and accessible pathway to obtaining a transmission licence or licence exemption for intending DTSOs⁶, and the market's confidence in the integrity of the competitive procurement process AEMO runs, a number of new entrants are successfully competing to provide contestable services. These include entities associated with Victorian distribution network service providers (DNSPs)⁷ and interstate TNSPs⁸, as well as international energy players with strong generator affiliations seeking to build a presence in the Australian renewables sector.

⁴ AER, *Consultation Paper*, 28.

⁵ *Ibid*, 22.

⁶ As at 8 June 2023, the Essential Services Commission's website shows 7 transmission licences have been issued to 5 entities.

⁷ Both the TOA entities and Beon are part of the Victorian Power Networks group, which also owns Victorian DNSPs CitiPower, Powercor, and which is itself an affiliate for United Energy.

⁸ TransGrid Services Pty Ltd, which trades as Lumea, is an affiliate of NSW TNSP, TransGrid.

The recent announcement that a consortia featuring NSW DNSP Essential Energy is the preferred bidder to operate the Central West Orana Renewable Energy Zone⁹ in NSW demonstrates that DNSPs are capable of providing contestable transmission services. Similarly, generators can build, own and operate their own connection assets as part of their generation systems pursuant to a licence or appropriate exemption. The obvious strength of current and prospective levels of competition for contestable projects in Victoria must necessarily dispel concerns that AusNet, as the provider of negotiated transmission services, can confer advantage on itself or an affiliate, or otherwise distort competition in the market for contestable transmission services.

AusNet notes the comments made by Jemena, CitiPower/Powercor and Iberdrola about our incentives to engage in discriminatory conduct.¹⁰ AusNet refutes, in the strongest possible terms, any suggestion that we would engage in any such behaviour and we challenge the complainants to produce evidence in support of their claims. In relation to the assertions that AusNet has an incentive to disclose information obtained from a connection applicant to an affiliate, AusNet notes the confidentiality obligations in Rule 8.6 of the NER. This rule imposes explicit and strict confidentiality obligations on AusNet in respect of information it receives from a party seeking negotiated transmission services. Indeed, these obligations apply to all registered participants in the NEM, including other DTSOs providing transmission services in Victoria. It is a tier 1 civil penalty provision for AusNet to disclose such information other than in accordance with the NER. We take our obligations under rule 8.6 seriously and have appropriate mechanisms in place to ensure compliance.

It has not escaped AusNet's attention that these theoretical misbehaviours and associated calls for greater regulatory intervention come from parties who are, or whose own affiliates are, in direct competition with AusNet, or otherwise have close working relationships with AusNet's competitors.

The complaints cited in the Consultation Paper also fail to account for the commercial realities AusNet faces in providing negotiated transmission services. Our connections team invests significant time and effort working with prospective customers to develop the most appropriate and cost-effective connection for both the contestable and negotiated service components of a project. Sometimes, the customer appoints a competitor of AusNet to build the contestable components using, on occasion, the design ideas and inputs developed by AusNet. This problem squarely illustrates the competitive discipline that all DTSOs face in Victoria.

Similarly, we reject suggestions that AusNet deliberately slows down the connection process for those customers who do not appoint us to provide contestable transmission services. We apply the same approach to all our customers, irrespective of whether we are providing only the non-contestable component of a connection service or both the contestable and non-contestable components. The NER is clear regarding the requirements we must follow when providing these services and the consequences of not doing so, which creates a very strong incentive for us to adhere to those requirements. While we recognise connection delays do occur, these can be caused by many factors, including delays on the customer side (e.g. in obtaining internal approvals, changing project requirements, failing to obtain finance). The AER must consider these issues more thoroughly and holistically before allowing delays to be the basis for introducing additional ring-fencing obligations.

We are also concerned by the AER's comment that:

*...it **does not require evidence** that TNSPs have engaged in discriminatory conduct. Rather, it is **sufficient for the AER to have concerns** that in the absence of regulatory change there is the **potential** for that conduct to occur and damage competition.¹¹*

(emphasis added)

While the risk of adverse behaviour can be sufficient to warrant intervention in limited cases, we strongly encourage the AER to reconsider the merits of taking such a theoretical approach to economic regulation. In an environment where cost of living pressures are already acute, additional obligations that will increase the regulatory and administrative burdens (costs) on all providers of connection services, including those who have

⁹ *Australian Financial Review*, 'NSW picks Endeavour Energy consortium as preferred bidder for REZ', 27 April 2023.

¹⁰ AER, *Consultation paper*, 18.

¹¹ *Ibid*, 7.

raised concerns with the current approach to connection services, without any commensurate benefit to consumers or reduction in risk should be avoided.

AusNet has previously observed that Chapter 5 of the NER is limited in its ability to foster competition. Indeed, the NSW Government established a separate contestability framework for its REZ projects. To the extent that the AER's concern with competition for contestable transmission services is more accurately characterised as being with the structural impediments imposed by Chapter 5, we encourage the AER to consider that the appropriate course is to advocate for reforms to the NER. Any attempt to use ring-fencing to promote competition is unlikely to succeed unless accompanied by changes to Chapter 5, and is more likely to damage existing levels of competition, especially in Victoria.

Restrictions may limit competition, resulting in poorer outcomes for consumers

Before deciding to impose additional ring-fencing measures, the AER must be mindful of the cooling effect that such obligations may have on competition, particularly where intervention is justified only by reference to theoretical concerns of market misconduct. Efforts to counter incumbent TNSPs' perceived advantages may be too intrusive and ultimately restrict competition. Clearly, this would be contrary to the long-term interests of end users and inconsistent with the AER's obligation to promote the achievement of the National Electricity Objective (NEO).

The Consultation Paper invites stakeholders to comment on whether non-discrimination obligations are required in Victoria.¹² We urge the AER to consider very carefully the potential impacts of any such changes before proceeding so as not to damage the very market dynamics that have enabled competition to flourish.

One specific area of concern is that unnecessary or asymmetric regulation may have a negative impact on the scale and scope efficiencies TNSPs can achieve by providing the full suite of transmission services. As all providers of contestable connection services are likely to be benefiting from economies of scale and scope, we would be concerned if any new restrictions resulted in our loss of that benefit while our competitors – be it another TNSP, a DNSP or other entity – could continue to benefit from their economies of scale and scope. Indeed, if the AER were to propose such reforms, it would distort competition, create an uneven playing field, and have negative consequences for all Victorians, which is the antithesis of what the AER is aiming to do.

However, our concern is also broader: new ring-fencing obligations may adversely affect the ability of any current or intending DTSO to provide their most competitive contestable transmission service offering. The Victorian licensing framework exemplifies this. All intending DTSOs must demonstrate they have the requisite financial, technical and corporate capacity. As noted above, there are several licensees accessing the necessary expertise through affiliations with an existing TNSP and/or other entity within their corporate group. Without access to the savings that economies of scale and scope allow, the connection costs in Victoria increase for all connection applicants, not just our own.

If new obligations are introduced, they must be crafted carefully to ensure the current level of deep, active competition in the market for contestable transmission services is preserved and remains robust. This will enable all DTSOs to continue to present connection customers with the most competitive solutions.

Broad non-discrimination obligations are too blunt and are likely to fail. Simply extending the current non-discrimination obligation to negotiated services or merely replicating the obligation from the Electricity Distribution Ring-Fencing Guideline will be problematic without further detailed consideration and resolution of these issues to determine if, and the nature of, any further ring-fencing obligations that may be required.

Separating contestable and non-contestable services is bad for customers

The second of the options proposed in the Consultation Paper is to extend the existing ring-fencing framework to incorporate negotiated transmission services, thereby allowing these services to be legally and/or functionally separated from contestable and unregulated transmission services.¹³

¹² Ibid, 28-29.

Requiring AusNet to separate the provision of contestable and non-contestable services would require internal teams to be duplicated. However, significant legal and operational costs would be incurred if full functional separation was required. Any functional separation of DTSOs could reduce or eliminate our participation in contestable processes. Services currently provided by the DTSO may be reduced or withdrawn due to the additional costs incurred in providing those services because of the loss of economies of scope and the inability to access capital on as favourable terms (as this would be a smaller company, potentially exposed to greater levels of risk). That is, the depth of competition for transmission connection services could be reduced to the detriment of customers.

While increased ring-fencing requirements could reduce the scope for DTSOs to provide contestable services, where DTSOs remain in the contestable market, the higher cost of providing negotiated transmission services will increase the cost of contestable service. While these higher prices could encourage contestable entry, it will come at the cost of efficiency. In addition, although we recognise that competition can drive innovation and improved service levels (including delivery times), we remain unconvinced that customers would automatically see any improvement in project delivery times under the AER's reforms. As we noted earlier, there are several factors that can drive delivery timetables, many of which rest with the party requesting the connection. Given this, we do not agree with the AER's assertion that its reforms will contribute to the achievement of the NEO. In particular, we do not consider that the AER's proposed reforms will:

- automatically result in efficient investment in, and operation of, transmission infrastructure with respect to connection services; or
- see reduced costs for generator connections, which should benefit customers where these lower costs are passed on to customers in the form of lower wholesale prices. Rather, we think that costs may increase.

We also do not consider that the AER's reforms will guarantee sufficient generation is installed quickly as aging coal-fired generators retire and the industry transitions towards net zero emissions. While this is an attractive theoretical argument, as we have highlighted above, the real-life context needs to be appropriately considered. For this reason, we again encourage the AER to collect the necessary evidence to support its reform agenda before proposing options for implementation.

Given all the above, AusNet cannot see what benefits accrue to customers that would offset the significant costs that will be incurred if DTSOs were required to implement further separation.⁸

Stakeholder survey should be supplemented by further information gathering activities

At the same time as it released of the Consultation Paper, the AER published a survey of market participants for those who have connected or are in the process of connecting to the transmission network.¹⁴ According to the AER, the survey's aim was to:

- identify any actual or potential discrimination by TNSPs during the connections process; and
- help it assess the materiality of the problem and inform next steps.

Evidence gathering is typically the first step in a policy making process. We are, therefore, concerned that the AER's call for evidence is accompanied by options for reform. At best, this may prejudice the responses; at worst, it implies that the AER has already decided what the survey will indicate.

Our primary concerns with the survey are as follows:

- **Target audience:** The questions asked are skewed to the experience of connecting generators. While generators provide a key perspective on these issues, other relevant stakeholders to the survey include large

¹³ Ibid, 32.

¹⁴ The AER's survey, which was to remain open until 9 June 2023 was available here: <https://www.aer.gov.au/communication/aer-releases-consultation-paper-on-transmission-ring-fencing-framework> (accessed 05/06/2023).

demand customers. The ability of these stakeholders to provide meaningful input to the survey may also be limited because of the form of the questions.

- **Leading questions:** Certain questions in the survey are leading, which may bias the responses. For example, question 29 assumes that the TNSP has used its advantage to influence the contestable portion of the connection, without providing an opportunity for respondents to express their own views on the matter.
- **Lack of clarity in the wording of the question:** Some questions (such as question 11) lack clarity and would have benefited from further explanation to ensure participants provided more accurate and insightful responses, thereby enhancing the quality of the data collected.

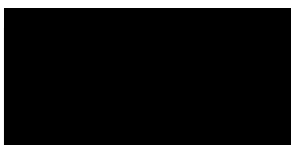
In light of the shortcomings of the survey, we encourage the AER to consider a dedicated period of information gathering during which time the AER issues information requests or, if necessary, uses its existing statutory information gathering powers, to collect information about actual market dynamics and behaviour. If the AER's analysis of this information demonstrates that further regulatory intervention is warranted, the AER can then design and consult on bespoke measures to address any shortcoming(s) it identifies. At present, we do not see either of the options outlined in the Consultation Paper as being appropriate next steps for the transmission sector.

Best practice is to complete the investigatory stage before recommending regulatory intervention

It is not usual practice to search for evidence of market failure and simultaneously propose solutions to address that market failure. Therefore, AusNet strongly urges the AER to pause its work developing further transmission ring-fencing obligations until it completes the data collection phase, and the analysis of that data reveals a clear and material risk or problem. Temporarily halting work to develop additional ring-fencing obligations will give the AER the opportunity to collect the necessary evidence to demonstrate the need for further reform, while allowing stakeholders to meaningfully engage with the AER on the issues. It will also allow the AER an opportunity to reconsider where its resources could be better focused, given the number of important reforms currently competing for resources.

We repeat our offer to meet with the AER to discuss the robust level of competition in the Victorian transmission sector and the specific features of the contestability regime that mean additional ring-fencing obligations are unnecessary in Victoria. If you would like to arrange this meeting, or you have any questions regarding this submission, please contact Justin Betlehem by email on [REDACTED].

Yours sincerely



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AusNet