9 June 2023

Mark Feather

General Manager, Strategic Policy & Energy Systems Innovation

Australian Energy Regulator (**AER**)

[redacted]

Cc: AERringfencing@aer.gov.au

Dear Mr Feather,

Ausgrid, Endeavour Energy and Essential Energy (together, the **NSW DNSPs**) welcome the AER's consultation on options to address possible gaps in the transmission ring fencing framework.

The NSW DNSPs broadly support the options recommended by the AER to address the risk that transmission network service providers (**TNSPs**) are able to take advantage of their monopoly position in providing connection works to large, sophisticated commercial customers as negotiated transmission services as discussed in the Consultation Paper.

However, we do not recommend increasing the level of ring fencing controls applicable to TNSPs so that they align with the current electricity distribution ring fencing guideline (**Distribution Guideline**). Rather, we consider that it is more appropriate to reduce regulatory constraints on DNSPs in circumstances where they compete (or have to potential to compete) with TNSPs for connection works to large, sophisticated commercial customers.

Such a change would be consistent with the objectives of ring fencing, and can ultimately improve competition for connections and drive better outcomes for electricity consumers.

There is a need for this approach given the electricity supply chain is currently undergoing a fundamental transformation and improved delivery of network services is critical to the transformation being managed as seamlessly as possible. The Consultation Paper recognises the clear benefits of promoting competition for the high demand in new grid connections. In many cases, DNSPs are a potential source of competition to TNSPs for the connection of large loads and/or generation that are adjacent to both distribution and transmission infrastructure. The key rationale for considering increased contestability is to drive efficiencies and lower the costs of network investment and operations for consumers. Enabling a greater role for DNSPs with deep connections experience (including in high voltage assets) will drive efficiencies relative to stand-alone providers. Ultimately, with the expected high demand for new grid connections over the coming decade, it is critical that these connections are delivered efficiently and at lowest cost.

As raised in our submission to the AER's Transmission ring-fencing draft guideline review, the NSW DNSPs support measures to provide a more level playing field between TNSPs and DNSPs for the delivery of large contestable connection projects. Accordingly, any changes to the transmission ring fencing framework should recognise the need for consistent regulatory treatment of DNSPs and TNSPs in circumstances where there is potential for competition between them.

As recognised by the AER in the Consultation Paper, the threat of competition must exist in practice, and not just in theory, to be an effective curb on the monopoly power of TNSPs and to deliver timely and cost effective connections.1 While the potential for inter-network competition exists, inconsistencies in ring fencing obligations constrain DNSPs from effectively competing with TNSPs in practice in relation to some connection works.

[1] AER, *Consultation Paper: Options to address gaps in transmission ringfencing framework*, May 2023, p 23.

These inconsistencies include:

- As discussed in the Consultation Paper, all negotiated transmission services sit outside the ring fence, meaning that a TNSP (unlike a DNSP providing an equivalent service) could potentially use information acquired or generated in the provision of non-ring fenced non-contestable negotiated services to gain an unfair advantage in the provision of other contestable services (or in any tender process for other contestable services); and
- Even where ring-fencing controls do apply to TNSPs under the transmission ring fencing guideline (**Transmission Guideline**), these are much more malleable than the ring fencing controls that apply to DNSPs. For example, TNSPs are not required to use separate branding for any contestable services, meaning that they can effectively offer a 'one stop shop' for contestable and non-contestable aspects of a large connection. Such offerings are highly desirable to prospective connection applicants, however, due to the stricter distribution ring-fencing rules, DNSPs cannot put forward an equivalent service offering.

The NSW DNSPs are of the view that, left unaddressed, the above regulatory inconsistencies risk limiting contestability and potentially creating delays for the large amount of connection works forecast to be required in the near term. This would run counter to several State and Federal Government policies, in particular those aimed at increasing load connections within or nearby Renewable Energy Zones (REZs).

Accordingly, any changes to the transmission ring fencing framework should recognise the need for consistent regulatory treatment of DNSPs and TNSPs in circumstances where there is potential for competition between them. It is the NSW DNSPs' strong view that it would be in the long-term interests of consumers for the rules and regulatory guidelines to apply agnostically across transmission and distribution in this regard.

We provide more detailed views and case studies at Attachment A below. The NSW DNSPs would be happy to discuss any aspect of this submission with the AER. Please contact the following with any questions:

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

Yours sincerely,

[redacted]

Alex McPherson	Colin Crisafulli	Natalie Lindsay
Acting Chief Customer Officer	Head of Network Regulation	Head of Regulatory Affairs
Ausgrid	**Endeavour Energy**	**Essential Energy**

ATTACHMENT A:

1 Effective competition between TNSPs and DNSPs will drive better outcomes for consumers

As TNSPs provide a number of contestable connection services, there is in theory a number of circumstances where TNSPs could be constrained by third parties providing these contestable services. As noted by the AER in the Consultation Paper, it is not enough for these competitive constraints to be merely theoretical, as such constraint is required in practice to be an 'effective curb on monopoly power and to deliver timely and cost-effective connections'.[2] However, the Consultation Paper described that there is little evidence of this competitive constraint occurring in practice with 'very few' connection services being provided by third parties.[3]

As described in our December 2022 submission, DNSPs can compete with TNSPs in a range of contexts, including in relation to the provision of connection services to large customers and for contestable services associated with connection of large-scale energy-intensive facilities (e.g., airports, data centres).[4] A recent example of where NSW DNSPs have competed with TNSPs for these connection services is set out in **Box 1** below.

The presence of a DNSP alternative to TNSP connections can provide a number of significant benefits. Most obviously, customers have the choice of options for their connection, which can lead to better outcomes for the connecting party in the form of lower connection costs and improved service offerings that are more tailored to the customer's requirements. This should ultimately drive better outcomes for electricity consumers who will benefit as these lower connection costs and improved service offerings are passed on in the form of lower prices for electricity. The presence of a DNSP alternative to TNSP connections also creates competitive tension and a competitive constraint on the monopoly power of TNSPs that would not otherwise exist.

However, for the reasons outlined in section 2 of this submission, TNSPs currently have a regulatory advantage over DNSPs that hinders DNSPs from effectively competing with TNSPs in relation to some connection works. This is holding back the benefits of competition between network service providers that would otherwise be flowing to electricity consumers in NSW.

[2] AER, *Consultation Paper: Options to address gaps in transmission ringfencing framework*, May 2023, p 23.

[3] AER, *Consultation Paper: Options to address gaps in transmission ringfencing framework*, May 2023, p 23.

[4] NSW DNSPs, *Joint Submission to AER's Transmission Ring-fencing Draft Guideline*, 16 December 2022, p 3, 7.

Box 1: Example of recent scenarios where NSW DNSPs have competed with TNSPs for connection services

Connection Applicant A approached a NSW DNSP and TNSP to tender for the connection of a multi-use site with forecast demand in excess of 10MW per annum growing to over 100MW per annum over several years. The applicant also planned to include on-site generation forecast to export over 90MW at its peak. This would allow the applicant to operate its own 'microgrid' and supply other customers at the site and potentially surrounding areas in the future.

The Applicant desired an integrated solution where the network would provide a design that would achieve its aims/forecasts and a solution to build, operate and maintain the network infrastructure. Noting the site would involve a private, and in parts embedded, network below the supply points from the network.

Relatedly, there were at least two other connection applicants in neighbouring locations that also had significant forecast demand requirements and, for one, aspirations for a large amount of on-site generation.

The ability of the NSW DNSP to offer a competitive solution to the connection applicant, relative to the TNSP, was restricted by the operation of the Distribution Ring-Fencing Guideline. Specifically, the NSW DNSP could not (in the absence of a ring-fencing waiver):

- Provide energy advisory services to the Applicant.
- Provide network design services to the Applicant.
- Provide the Applicant an integrated build, operate (i.e. network control) and maintain solution for the private microgrid and/or embedded network components of the solution or other innovative elements such as EV charging stations.
- Provide an ongoing service to the Applicant to manage the onsite generation to maximise its commercial use (i.e. beyond network support)
- Refer the Applicant to their unregulated affiliate for any of the above services.
- Offer all three Applicants / prospective Applicants in the area an integrated solution by sharing information with their unregulated affiliate.

We note there are natural advantages and efficiencies to connecting at higher voltages / the Transmission network in certain circumstances. For instance, less network infrastructure with fewer transformation steps can reduce costs. It is appropriate for the customer to benefit from these potential advantages in securing an efficient connection to a network. It would not be appropriate for this decision to instead be driven by differing ring-fencing obligations that allow a TNSP to offer a better customer experience and/or integrated solution to connection applications.

2 TNSPs currently have a regulatory advantage over DNSPs

Inconsistent ring fencing obligations between DNSPs and TNSPs risk distorting competition for contestable connection services. There are two important differences between the ring fencing constraints that apply to TNSPs and DNSPs:

- **Position of the ring fence**. As recognised in the Consultation Paper, negotiated transmission services are not inside the ring fence under the Transmission Guideline, meaning some monopoly TNSP services are not ring fenced from the provision of other contestable connection services; and
- **Strength and burden of ring fencing controls**. TNSPs are subject to less burdensome ring fencing controls than DNSPs under the Transmission Guidelines.

These differences and their impact on competition between TNSPs and DNSPs are considered in detail below.

2.1 Position of the ring fence

As identified by the AER in the Consultation Paper, the National Electricity Rules (**NER**) do not currently allow for ring fencing of 'negotiated transmission services'. Consequently, not all monopoly services offered by TNSPs sit inside the ring fence under the Transmission Guideline, because certain negotiated transmission services are in fact non-contestable.

This means that there is still scope for discrimination in the supply of some monopoly negotiated services outside the ring fence. For example, a TNSP could potentially use information acquired or generated in the provision of these non-ring fenced monopoly services to provide an unfair advantage to a related entity service provider in the provision of contestable services (or in any tender process for contestable services).

This is in contrast to the ring fencing rules for DNSPs which (in combination with the AER's service classification) ensure that the ring fence is imposed between monopoly and contestable services, meaning that DNSPs have no opportunity to use information acquired in the provision of monopoly services to obtain any kind of advantage in contestable markets.

2.2 Strength and burden of ring fencing controls

Even where TNSPs are subject to ring fencing controls, these are much less burdensome than those that apply to DNSPs. This means that TNSPs have much greater flexibility in how they offer services to large customers and tailor their service offerings to the needs of the project.

The Distribution Guideline imposes strict functional separation requirements on DNSPs. These include:

- Requiring separate offices and staff to be used in the provision of any contestable services; and
- Requiring separate and independent branding for and contestable services, and restricting the advertisement and cross promotion of monopoly and contested services.[5]

The Transmission Guideline imposes much lighter functional restrictions on TNSPs. There are no office separation requirements for TNSPs, and only limited staff separation requirements (applying only to 'marketing staff'). There are no branding or cross-promotion restrictions in the Transmission Guideline, meaning that a TNSP can offer contestable and non-contestable services under the same brand.[6]

The NSW DNSPs understand that part of the reason for these differences is due to the nature of TNSPs' customers. The AER notes in its explanatory materials that TNSPs' customers are typically large, sophisticated commercial entities, and that in this context the benefits of additional functional separation would likely outweigh the costs.[7]

The NSW DNSPs agree that it is appropriate for less functional separation constraints to be imposed when dealing with larger customers. As discussed below, our concern is not that a lesser constraint has been imposed on TNSPs. Rather, our concern is that DNSPs continue to face stricter ring fencing constraints when seeking to compete with TNSPs for these large customers.

2.3 Inconsistent ring fencing obligations risk distorting competition

The inconsistencies in the ring fencing obligations imposed on TNSPs and DNSPs can hinder effective competition between network service providers in respect of some connection works. In particular, the absence of branding restrictions and limited staff sharing controls mean that TNSPs can

[5] AER, *Distribution Guideline Version 3*, November 2021, clause 4.

[6] AER, *Transmission Guideline Version 4*, March 2023, clause 4.

[7] AER, *Explanatory Statement to the Transmission Guideline Version 4*, March 2023, p ix.

effectively offer a 'one stop shop' for monopoly and contestable services associated with grid connection. This is something that DNSPs are simply unable to offer.

There are obvious benefits to a connecting party using the same entity that is supplying monopoly connection services to also supply the related contestable connection services for a project. Engaging a single provider is likely to mean a simpler and easier connection process, and potentially some cost efficiencies.

However, the functional separation requirements on DNSPs mean that the same entity cannot provide both the monopoly and contested services to a connecting party, nor share information regarding that connecting party's requirements with a related entity. If the connecting party wishes to engage the DNSP for any aspects of the connection, it needs to separately engage an accredited service provider (**ASP**) of contestable services for any contestable components. A recent example of this separation needing to occur in the context of a large connection is set out in **Box 2** below.

Box 2: Example of a major connection requiring strict separation between DNSP and contestable services

Snowy Hydro is constructing a 660MW Open Cycle Gas Turbine (OCGT) power station, known as the Hunter Power Project, on the decommissioned Kurri Kurri aluminium smelter site. The Hunter Power Project will supplement Snowy Hydro's generation portfolio with critical dispatchable capacity. Snowy Hydro estimates that, by providing firmed energy, the Hunter Power Project will facilitate an estimated 1.5 to 2GW of renewables, or the equivalent of 160,000 household solar installations.

The Hunter Power Project requires a connection to the Ausgrid network as well as contestable works related to the connection. A new 132kV Switching Station (Kurri North) will connect the power station to the Ausgrid network by way of three existing 132kV feeders. This involves reconfiguration of existing Ausgrid infrastructure at the site so that it can connect the generator instead of supplying an aluminium smelter. However various elements of the connection work (including delivery of the Switching Station) are deemed contestable and therefore not able to be delivered by Ausgrid.

Consequently, Snowy Hydro needed to separately procure contestable and non-contestable elements of the connection work, potentially adding to the cost and time required to operationalise the project.

Inconsistent ring fencing obligations have the potential to constrain DNSPs from effectively competing with TNSPs in relation to some connection works. This is likely to in turn reduce competitive constraints on TNSPs, potentially increasing the cost to connecting parties.

As the AER notes in the Consultation Paper, substantial investment in transmission and generation is likely to be required as Australia transitions to its net zero carbon emissions targets.[8] Indeed, as highlighted by the AER, the AEMO estimates that at least 10,000 kilometres of new transmission lines will be required to accommodate the anticipated growth in renewable generation over the next 30 years, at an estimated cost of around $12.7 billion.[9]

The timely and cost effective provision of connection works is key to bringing on new generation capacity to the market to support this transition. Connection costs are significant, being approximately 10% of a new project's total costs.[10] Effective competition for new grid connections can assist in facilitating timely and cost effective connection works, and can result in lower connection costs and

[8] AER, *Consultation Paper: Options to address gaps in transmission ringfencing framework*, May 2023, p 38.

[9] AER, *Explanatory Statement to the Transmission Guideline Version 4*, March 2023, p 2.

[10] AER, *Consultation Paper: Options to address gaps in transmission ringfencing framework*, May 2023, p 15.

improved service offerings – the benefits of which can ultimately be passed onto end customers in the form of lower prices for electricity. A recent example of the uneven regulatory treatment occurring at network connections on the distribution level is outlined in **Box 3** below.

Box 3: Example of unequal treatment in transmission and distribution ring-fencing

A Local Government Area has established a designated special activation precinct offering investment and business development opportunities for new and existing industries. The precinct builds on already-planned private and government investments, creating up to 3,000 jobs across a range of industries.

The precinct's development would require a new contestable distribution level connection including a required cut in of the existing 132kV transmission network feeder. The customer sought the connection through the local DNSP as a reliable service provider capable of delivering a large load connection in a timely and cost-effective manner. However, as the connection would be deemed a contestable Dedicated Connection Asset under the National Electricity Rules, the DNSP is unable to do the works under the Distribution Ring-fencing Guideline except through a fully-functionally separated entity. Conversely, the TNSP is able to undertake the same contestable connection without the need to be functionally separated provided cost allocation is appropriately applied.

This example demonstrates that large developments are seeking connection into the distribution network. However, due to the uneven application of ring-fencing obligations at the distribution and transmission levels, customers are being inadvertently required to connect at the transmission level as DNSPs are unable to undertake these large load connections. This is a particularly concerning outcome given timely and cost-effective access to network infrastructure is paramount for both economic development as well as supporting the broader energy transformation underway.

3 Proposed solution: levelling the playing field

The NSW DNSPs support efforts to ensure that there is effective competition for new grid connections, including measures aimed at providing a more level playing field for the delivery of contestable connection works. *This should include competitively neutral application of ring fencing rules between DNSPs and TNSPs, in circumstances where there is scope for inter-network competition*.

3.1 The need for consistent regulatory treatment of DNSPs and TNSPs to ensure effective competition

The objective of ring fencing, as described by the AER, is to 'provide a regulatory framework that promotes competitive markets, generally by seeking to ensure a level playing field for providers in markets for contestable services while promoting the long-term interests of consumers'.[11]

Consistent with this objective, the AER should aim for consistent regulatory treatment of DNSPs and TNSPs in circumstances where there is potential for competition between them.[12] This does not necessarily mean aligning the level of TNSP ring fencing controls with those currently applicable to DNSPs. Rather, in circumstances where DNSPs potentially compete with TNSPs for connection of large customers, for the reasons described below, it is likely to be more appropriate for DNSP ring-fencing controls to be aligned with the current Transmission Guideline.

[11] AER, *Explanatory Statement to the Transmission Guideline Version 4*, March 2023, p 4.

[12] We note this position is shared by other DNSPs: see e.g., Jemena Electricity Networks, *Submission to AER's electricity transmission ring-fencing guideline review*, July 2022.

The NSW DNSPs recognise that stronger ring-fencing controls may be necessary where contestable services are being supplied to smaller customers. However, it needs to be recognised that DNSPs are not always dealing with smaller customers. In some cases (including in the examples described above), DNSPs are dealing with the same large, sophisticated customers as Transgrid, and often are competing with TNSPs to secure those customers.

As recognised by the AER, the same considerations in relation to the separation of staff and restrictions on branding and cross promotion do not necessarily apply when dealing with different customer groups. When dealing with smaller customers there may be greater benefit in requiring separation of brands, staff and offices. However when dealing wither larger, sophisticated commercial customers, the cost of these restrictions is likely to outweigh any benefit.[13]

Currently, the Distribution Guideline does not distinguish the application of these regulatory obligations between the different types of services offered by DNSPs and their affiliates (i.e., between those supplied to household or small business customers, and those supplied to large customers with large loads and/or generation).

In order to align the regulatory constraints on DNSPs with those applying to TNSPs, it may be necessary to distinguish between the different types of contestable services offered by DNSP affiliates – i.e. between:

- Services that are supplied to small customers i.e. household or small business customers; and
- Services that are supplied potentially in competition with TNSPs to large loads and/or generation.

Some options for introducing greater consistency in regulatory constraints applying to the latter category of services are outlined below.

3.2 Options for reform

The NSW DNSPs recognise that there are likely to be several options open to the AER for addressing this inconsistency in ring fencing obligations between TNSPs and DNSPs, including amendments to the Distribution Guideline.

However, the simplest and most practical option to address the inconsistency would seem to be a class waiver for DNSPs to apply in defined situations where, for example, DNSPs compete with TNSPs for certain large-scale connection works.

The class waiver mechanism has been used before to address similar issues. The AER has granted a class waiver of certain ring fencing obligations under the Distribution Guideline to all DNSPs in the National Electricity Market to allow them to participate in a tender process for a specific transmission project for the Central-West Orana (**CWO**) REZ.[14] In granting this class waiver the AER noted that there would be little benefit to consumers from requiring DNSPs to comply with ring-fencing obligations in connection with this large transmission project, and potentially significant cost. The AER noted:[15]

> *…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 Centra lWest 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.*

[13] AER, *Explanatory Statement to the Transmission Guideline Version 4*, March 2023, p ix.

[14] AER, *Distribution ring-fencing class waiver for the Central-West Orana Renewable Energy Zone*, March 2022.

[15] AER, *Distribution ring-fencing class waiver for the Central-West Orana Renewable Energy Zone*, March 2022, p 10.

- *reduce the number of competitors with experience in reliably and safely managing network infrastructure in Australia, potentially impacting the overall quality of the bids that EnergyCo receives.*

- *potentially lose the opportunity to realise efficiencies in leveraging existing supply chain relationships.*

Under the EII Act, all NSW electricity consumers will pay for the cost of the NSW Roadmap. 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.

The NSW DNSPs consider that many of the AER's reasons for granting the CWO REZ class waiver would be similarly applicable to any class waiver for DNSPs to compete with TNSPs more broadly for large scale connection works. A class waiver to compete for contestable transmission works would similarly create more competitive tension, which in turn would promote more efficient pricing, quality, safety and reliability for the relevant network services.[16] All of these benefits would ultimately drive better outcomes for electricity consumers in the form of improved services and lower electricity prices.

The NSW DNSPs acknowledge that a class waiver would not entirely resolve the issues raised by the AER in the Consultation Paper. A class waiver would principally be directed at resolving inconsistency in the strength and burden of ring-fencing controls imposed on DNSPs and TNSPs. The issue relating to positioning of the ring fence for TNSPs would potentially remain, and may need to be addressed through a separate rule change.

Nonetheless, promoting consistency of ring-fencing controls between TNSPs and DNSPs would be an important step towards enhancing competition for contestable transmission projects and thus assist in driving better outcomes for electricity consumers.

[16] AER, *Distribution ring-fencing class waiver for the Central-West Orana Renewable Energy Zone*, March 2022, p 7.