Rule change request

Expanding the transmission ring-fencing framework to include negotiated transmission services

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AUSTRALIAN ENERGY REGULATOR

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Shortened forms

Shortened Form	Extended Form
ACCC	Australian Competition and Consumer Commission
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AEO	Australian Energy Operations
AER	Australian Energy Regulator
AusNet	AusNet Transmission Group Pty Ltd
CitiPower	CitiPower, Powercor and United Energy (joint submission)
DNSP	Distribution Network Service Provider
ENA	Energy Networks Australia
Guideline	Ring-fencing guideline – Electricity Transmission (Version 4), March 2023
NEM	National Electricity Market
NEO	National Electricity Objective
NER or the rules	National Electricity Rules
NSW DNSPs	Ausgrid, Endeavour Energy, Essential Energy (joint submission)
RESP	related electricity service provider
REZ	Renewable Energy Zone(s)
TNSP	Transmission Network Service Provider

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Summary

The Australian Energy Regulator (AER) is proposing an amendment to the National Electricity Rules (NER) relating to the inclusion of negotiated transmission services within the scope of the Transmission Ring-fencing Guideline. The AER requests this rule change proposal be "fast tracked" under Division 3 of the National Electricity Law (NEL) following extensive consultation already undertaken with stakeholders on the nature of the problem and the proposal forming the basis of this rule change request.

The proposed amendment would address a concern that negotiated transmission services, which are provided on an exclusive basis by electricity Transmission Network Service Providers (TNSPs), are not subject to the Transmission Ring-fencing Guidelines. The potential harm arising from this gap is the potential for TNSPs to discriminate in favour of themselves or an affiliate when providing non-regulated transmission services as a result of their monopoly provision of negotiated transmission services. Including negotiated transmission services within the scope of the Transmission Ring-fencing Guideline would provide the AER with additional regulatory tools to manage the potential harms associated with possible discriminatory behaviour, and would provide greater transparency for connection applicants and third party service providers.

This issue came to light during the AER's substantive review of the transmission ring-fencing arrangements in 2022-23. During the review, a significant number of stakeholders raised concerns about the ability of TNSPs to discriminate against competitors in providing contestable connection services (which are non-regulated transmission services) due to their monopoly role in providing the non-contestable elements of a connection (which are provided as negotiated transmission services). We heard concerns about potential harm occurring in two instances:

1. In generator connections, where a connecting party is seeking both contestable and non-contestable connection services and the TNSP has the ability to discriminate in favour of generators completing all services with the TNSP (including with its related affiliates).
2. In distribution network connections, where an electricity distribution network service provider (DNSP) receives a connection application which requires upstream augmentation works on the shared transmission network, then the TNSP may use the information about the new potential connection to its advantage.

Even the potential ability of TNSPs to discriminate can cause harm by dampening competition in the market for contestable services. This arises where potential competitors consider they are not able to compete on an equal footing with TNSPs. Where any restraint from competition is not credible, TNSPs can potentially increase costs, delay services, or

otherwise behave in a way that is harmful to the market. Ultimately, this would lead to higher costs for consumers.

Ring-fencing is typically used to address concerns about discriminatory behaviour by requiring greater transparency, imposing information access and disclosure obligations, and potentially requiring separation of the contestable and non-contestable components of a TNSP's services. However, the AER was not able to consider this issue in the context of our review of the ring-fencing guideline because the NER limit the scope of ring-fencing to separating prescribed transmission services from other services provided by TNSPs. The NER does not allow for ring-fencing of negotiated transmission services, the most common of which is the non-contestable component of connections. As such, we signalled that we would further consider the issue with a view to potentially submitting a rule change request.

AER consultation paper

On 12 May 2023 the AER published a consultation paper seeking stakeholders views on the evidence for and materiality of the problem and two options for addressing the issues identified by stakeholders during the review of the Transmission Ring-fencing Guideline. We also requested connection applicants participate in a survey relating to their experience in connecting to the transmission network. The options we presented were:

1. Option 1: Introduce compliance reporting requirements within Chapter 5 of the NER to improve transparency in how TNSPs are meeting existing obligations embedded within the connections framework in the NER.
2. Option 2: Expand the ring-fencing framework in clause 6A.21.2(a) of the NER to include the ability to ring-fence negotiated transmission services, in addition to prescribed transmission services.

In response, TNSPs submitted there is insufficient evidence that a change to the regulatory framework is warranted. As such, they did not support either option. Some TNSPs also raised specific concerns with the two options presented. In particular, they considered there was a risk that Option 2 could lead to TNSPs no longer providing contestable connection services, as well as the risk of increased cost and time required to perform connections.

Of those stakeholders that considered there is an issue to be addressed, Option 2 was almost unanimously supported. Most of these stakeholders considered that Option 2 would be more effective than Option 1 in addressing the potential for discriminatory behaviour by TNSPs. Other reasons given for supporting Option 2 were that it would appropriately allow monopoly services to be ring-fenced from contestable services, correcting a possible regulatory oversight, and would apply equally across all jurisdictions in the National Electricity Market (NEM).

The rule change proposal

After carefully reviewing stakeholder submissions and the responses to the survey, the AER considers that amendment of the NER is warranted. The AER submits that it is appropriate to seek a change to the NER for three reasons:

- The potential exists for TNSPs to discriminate in favour of themselves or an affiliate in providing connection services. While there are existing frameworks that might mitigate

against the associated harms, these are not fit-for-purpose or sufficiently tailored to provide third parties with confidence that they are competing on a level playing field.

- Even if market power is not actually misused, the potential for such behaviour may be enough to deter new entry into, or limit competition in, contestable markets. Ultimately, inefficiencies in connecting new generation to the grid due to market power will result in higher prices for consumers.
- Significant new generation capacity is required over coming years as the industry transitions away from fossil-fuel generation. Any inefficiencies in the connection framework due to market power will delay, and increase the cost of, the transition.

We submit that the best way to address these concerns is to amend clause 6A.21.2(a) of the NER to allow for the accounting and functional separation of the provision of negotiated transmission services, as well as prescribed transmission services, from the provision of other services by TNSPs. The AER considers this approach is preferable to introducing compliance reporting requirements within Chapter 5 of the NER because ring-fencing will provide the AER with more effective tools to directly address and mitigate discrimination. It should be noted, however, that this rule change request does not affect or amend any existing compliance obligations under Chapter 5. TNSPs are still required to comply with connection obligations, including those that relate to the timing and form of responses to connection applicants, and behavioural obligations around not preventing or hindering access to prescribed or negotiated transmission services, negotiating in good faith and ensuring pricing transparency. This rule change request only relates to the ability of the AER to impose ring-fencing requirements on negotiated transmission services. The manner in which ring-fencing requirements would be implemented, such as whether functional separation should be imposed, would need to be considered as part of a review of the Transmission Ring-fencing Guideline.

Even if few ring-fencing measures were ultimately imposed, we consider the proposed rule change has merit. Simply having the powers in place would provide a disincentive for TNSPs to engage in potential discriminatory behaviour and provide greater confidence to other market participants that the AER has the necessary tools to act, if required.

It is submitted that the proposed rule change contributes to the achievement of the National Electricity Objective (NEO) by promoting:

- Efficient investment in, and operation of, transmission infrastructure with respect to connection services by providing greater transparency and reducing the potential for TNSPs to discriminate in the provision of connection services. This should improve contestability in connection services and so reduce costs and improve services.
- 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. AEMO's ISP forecasts the withdrawal of 14 GW of coal capacity by 2030 and 23 GW by 2050.[1] This will require the introduction of over 125 GW of additional variable renewable energy by 2050 (including 48 GW by 2030) and over 60 GW of firming capacity (e.g.

[1] AEMO, *2022 Integrated System Plan*, June 2022, p. 48.

dispatchable storage, hydro and gas-fired generation) to be connected by 2050.[2] Ensuring that connections happen at efficient cost will be critical to ensuring the energy transition occurs at the lowest possible cost to consumers.

- Supporting reliability in the supply of electricity by increasing efficiency in generator connections to the transmission network, helping to ensure sufficient generation is installed quickly as aging coal-fired generators retire and the industry transitions towards net zero emissions.
- As a result of the above, promotion of the achievement of emissions reduction targets by facilitating more efficient and cost-effective connection of variable renewable energy sources and dispatchable firming capacity to the transmission network.[3]

[2] AEMO, *2022 Integrated System Plan*, June 2022, p. 48.

[3] While emissions reductions are not formally part of the NEO yet and the proposed amendments to the National Electricity Law have not been finalised, it is possible that the NEO will be amended before the end of the year.

1 Nature and scope of the problem

Currently the scope of the matters that the Transmission Ring-fencing Guideline are permitted to deal with, as provided for in the NER, only encompasses the accounting and functional separation of prescribed transmission services from the provision of other transmission services.[4] It does not extend to the accounting and functional separation of negotiated transmission services from other services, despite these services being provided exclusively by TNSPs.

There are two harms that ring-fencing seeks to prevent:

- cross-subsidisation, where a TNSP uses revenue that it earns from providing a service to subsidise activities in other, contestable markets; and
- discrimination, where a TNSP can favour itself or an affiliate, or discriminate against a competitor, as a result of providing a monopoly service in a related market.

Both cross-subsidisation and discrimination can have the effect of undermining or damaging competition and innovation in related contestable markets.

The AER's primary concern relates to the potential for TNSPs to discriminate when providing negotiated transmission services. We have fewer concerns about cross-subsidisation, which we consider is addressed through TNSPs' Cost Allocation Methodologies (CAMs). CAMs require TNSPs to allocate their costs across different types of transmission services in accordance with an agreed methodology and have their accounts audited. We acknowledge that some stakeholders were concerned about the potential for TNSPs to cross-subsidise contestable services by inflating charges for negotiated transmission services.[5] However, our primary concern remains related to the potential for discrimination.

The remainder of this chapter sets out:

- why we consider there is a tangible risk that TNSPs could discriminate in favour of themselves or an affiliate in providing connection services;
- available evidence of discriminatory behaviour and why we consider that even the perception of discrimination could cause harm to the market; and
- the materiality of the problem.

We also discuss submissions received on these issues, where relevant.

1.1 The risk of discrimination in connection services

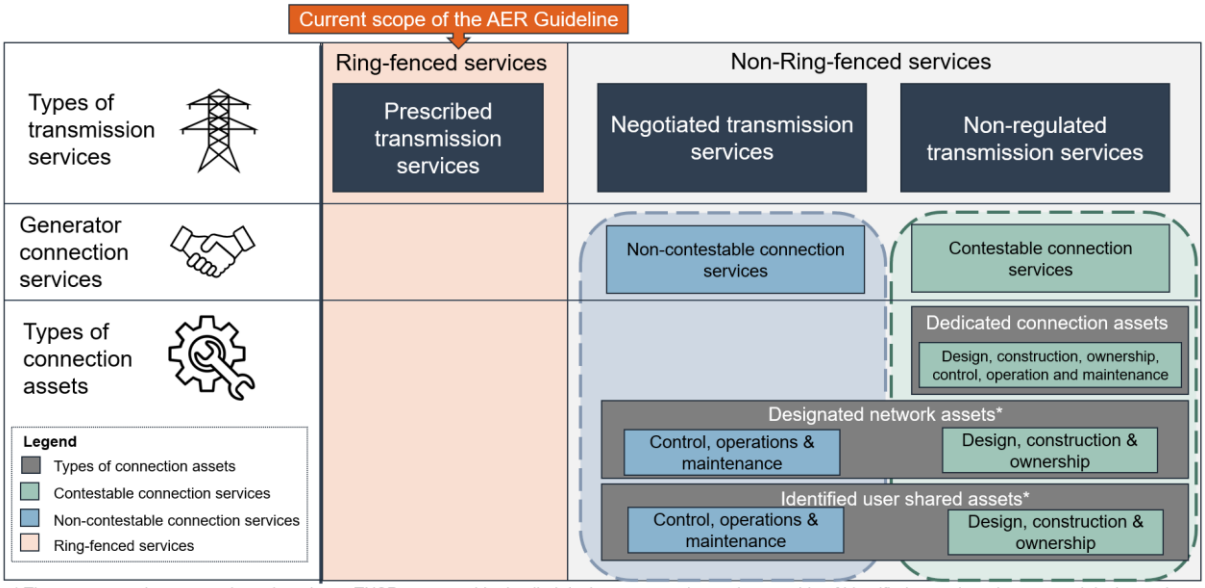
1.1.1 The potential for discriminatory behaviour to occur

The main type of service where the potential for discrimination in the provision of negotiated transmission services arises is in providing connection services. TNSPs currently provide non-contestable connection services as a negotiated transmission service on an exclusive

[4] See clause 6A.21.2 of the NER.

[5] See the following submissions to AER, *Consultation Paper – Options to address gaps in transmission ring-fencing framework*, March 2023: AEO, p. 3; Citiower/Powercor/United Energy, p. 2 and 3; Snowy Hydro, p. 2.

basis. TNSPs can also provide contestable connection services as a non-regulated transmission service. Further background on the different types of transmission and connection services is provided in our Consultation Paper on this issue.[6] The way in which these services are related and are linked to transmission ring-fencing is summarised in the diagram below.



* There are some instances where the primary TNSP must provide detailed design, construction and ownership of identified user shared assets and designated network assets as non-contestable transmission services.

Wherever a single entity provides both monopoly and contestable services in the same or related markets, there is a risk that discriminatory behaviour could occur. It is for this reason that ring-fencing controls often apply in these circumstances: to clearly separate out the two sets of services for transparency, helping to enforce non-discrimination obligations. Indeed, Flow Power and Engie submitted that the omission of negotiated transmission services from the ring-fencing framework appears to be a regulatory oversight that should be corrected.[7]

In the case of transmission connections, we consider there is a risk that TNSPs could use their monopoly provision of non-contestable connection services to discriminate in favour of themselves or an affiliate in the contestable connections market. This could include, for example, increasing costs for connecting parties that choose a third-party provider, delaying connections, or otherwise providing non-contestable connections services on less favourable terms and conditions than for connecting parties that complete the full connection with the TNSP. There is also a risk of the TNSP sharing confidential information obtained as a result of providing negotiated transmission services with an affiliate, or using confidential information to its own advantage.

In its Transmission Connection and Planning Arrangements (TCAPA) Final Determination, the AEMC noted that since negotiated transmission services must be provided on an exclusive basis by the TNSP, that ring-fencing controls should be applied between a TNSP's

[6] AER, *Consultation Paper – Options to address gaps in transmission ring-fencing framework*, March 2023, pp. pages 10-13.

[7] See the following submissions to AER, *Consultation Paper – Options to address gaps in transmission ring-fencing framework*, March 2023: Flow Power, pp. 2-3; and Engie, p. 1.

provision of prescribed transmission services and negotiated transmission services, and its non-transmission or other contestable transmission services.[8] The AEMC also noted that the final rule did not amend aspects of the NER relating to ring-fencing, which were out of scope.

The AEMC also drew a comparison with services provided by Distribution Network Service Providers (DNSPs), commenting that negotiated transmission services are more comparable to alternative control services provided by DNSPs, since both these services are required to be provided by the relevant network service provider. We note that alternative control services are subject to ring-fencing under the Distribution Ring-fencing Guideline.

1.1.2 Mitigating factors that may limit discriminatory behaviour

There are some rules and legislation in place that help mitigate potential discriminatory behaviour, including:

- The connections framework in chapter 5 of the NER. The connections framework includes several obligations that are similar to the types of obligations included in the ring-fencing guideline to prevent discriminatory behaviour, primarily around information access and disclosure.
- The Competition and Consumer Act 2010 (Cth) (CCA) is the principal consumer protection and fair trading law in Australia, whose objects include the promotion of competition and fair trading and provision for consumer protection. This legislation is not, however, the principal framework for regulation of the electricity industry.

During the review of the Transmission Ring-fencing Guideline, the ENA engaged Incenta Economic Consulting (Incenta) to, among other things, consider the harms that could potentially eventuate from having a monopoly TNSP provide contestable connection services and identify the elements of the connections framework that it considers mitigates these harms. A summary of their analysis was provided in the Consultation Paper on this rule change request.[9]

We consider that there are limitations to existing frameworks in ensuring third parties can compete with TNSPs in providing connection services.

In the TCAPA Final Determination, the AEMC acknowledged that chapter 5 would operate in conjunction with ring-fencing, and TNSPs would need to continue to comply with "the requirements of its cost allocation methodology and transmission ring-fencing guideline".[10]

In respect of chapter 5 of the NER, there are three potential gaps:

- There is no requirement for TNSPs to explain how they are complying with their obligations. This lack of transparency makes it difficult for competitors to know how strictly TNSPs are complying with their obligations and therefore the extent to which they are competing on a level playing field. For example, while there are restrictions on the use and disclosure of information, it is not clear whether TNSPs are imposing some form

[8] Ibid, p. 168.

[9] AER, *Consultation Paper – Options to address gaps in transmission ring-fencing framework*, March 2023, pp. pages 19-21.

[10] AEMC, *Transmission Connection and Planning Arrangements*, *Rule Determination*, 23 May 2017, p. 151

of staff separation, office separation, or whether staff are simply told they should not disclose or use certain information. Each of these options could lead to very different compliance outcomes. Compliance outcomes will also depend on the incentive structures for staff, such as whether incentives are linked to sales that could be facilitated through disclosure or use of confidential information, how comprehensively staff are informed of their obligations, and how comprehensively staff compliance is monitored and enforced by TNSPs.

- There is limited monitoring and reporting which would provide information on whether TNSPs are behaving in a discriminatory way. The absence of a compulsory obligation on TNSPs to report on their compliance with relevant components of chapter 5 means compliance issues would not be immediately visible to the AER ahead of voluntary reporting or proactive compliance measures by the AER. As discussed further below, there are also limited incentives for connecting parties to report discriminatory behaviour.
- Many of the clauses in chapter 5 relating to the connections framework are disapplied in Victoria due to the role that AEMO plays in connections. As such, some of the existing clauses in chapter 5 that may help prevent discriminatory behaviour do not apply in Victoria, unlike the Transmission Ring-fencing Guideline which applies to all NEM jurisdictions.

We also note AGL's view that the existing connections framework "is a long complex highly detailed process" and that "it would be difficult for the AER to effectively monitor and therefore enforce the regulatory regime".[11]

The CCA covers general competition laws and, as such, provides general requirements for businesses not to discriminate against suppliers or competitors. In contrast, ring-fencing is industry-specific and is designed and enforced by us specifically to promote the national electricity objective. Under the ring-fencing framework, the AER would be able to set out specific obligations in the ring-fencing guideline to mitigate the risk of TNSPs favouring their own contestable services or their affiliates over other providers. The AER would also be able to require TNSPs to report on what processes they have in place to comply with specific ring-fencing obligations, allowing for greater visibility of potential discrimination or information sharing.

A significant shortcoming of relying on either the CCA or the chapter 5 provisions of the NER is that it requires a connecting party to identify non-compliance and report it to the relevant regulatory entity or take legal action. However, connecting parties are unlikely to feel comfortable to do so because of the need to maintain a commercial relationship with a TNSP. Further, there would be a significant cost and time delay associated with taking action under the CCA. Timing is critical, as delays can cause significant additional costs and ultimately foregone income until the connection can be completed. Delays may also impact timing commitments for financing arrangements, which can jeopardise the connection project. This risk is somewhat mitigated under chapter 5 of the NER which requires commercial arbitrations entered into under Rule 5.5 to be resolved within 30 days.[12]

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[11] AGL submission to AER, *Consultation Paper – Options to address gaps in transmission ring-fencing framework*, March 2023, p. 2.

[12] See NER clause 5.5.6(a).

1.1.3 Summary

In summary, the AER considers there is a material potential for TNSPs to discriminate in favour of themselves or an affiliate in providing connection services. While there are existing frameworks that might mitigate against the associated harms, these are not fit-for-purpose or sufficiently tailored to provide third parties with confidence that they are competing on a level playing field. Therefore these frameworks are not a replacement for, but rather complementary to, fit-for-purpose ring-fencing arrangements tailored to negotiated transmission services.

1.2 Evidence of discriminatory behaviour

It is difficult to know how well the connections framework is working in practice to prevent any potential discrimination by TNSPs for two reasons:

1. Those most impacted by discriminatory behaviour – connection applicants – may not feel comfortable to report such behaviour or challenge TNSPs because of their need to have an ongoing relationship with TNSPs.
2. There is limited publicly available information on connections completed by third party providers which might demonstrate the contestable connections framework was effective.

1.2.1 Reluctance to raise concerns

Connecting parties may be reluctant to raise concerns about a TNSP's behaviour given the need for an ongoing working relationship with the TNSP as the only entity that can facilitate a connection to their network. There may be a perception that raising concerns will harm current or future connections with TNSPs. This has two implications. First, where TNSPs can exert monopoly power, there may be a reluctance for connecting parties to make use of existing elements of the NER that are intended to benefit them such as dispute resolution procedures. Second, we have concerns that connecting parties have been reluctant to provide specific evidence of their interactions with TNSPs through both the transmission ring-fencing review and the consultation to develop this rule change request.

TransGrid did not agree with the view that connecting parties may be reluctant to raise disputes, noting that they could raise concerns with the ACCC or through the dispute resolution process without prejudice.[13] On the other hand, the CEC agreed that concerns about reprisals were a potential barrier to obtaining evidence, and AGL considered "it will often not be in the interest of a connecting party to challenge perceived discriminatory behaviour".[14] Alinta Energy suggested that some parties may not be able to provide evidence due to confidentiality agreements.[15] PIAC suggested an additional mechanism should be

[13] Transgrid, submission to AER, *Consultation Paper – Options to address gaps in transmission ring-fencing framework*, March 2023, p. 5.

[14] See the following submissions to AER, *Consultation Paper – Options to address gaps in transmission ring-fencing framework*, March 2023: CEC, p. 2; AGL, p. 2.

[15] Alinta Energy submission to AER, *Consultation Paper – Options to address gaps in transmission ring-fencing framework*, March 2023, p. 2.

added to the NER to allow market participants to raise allegations of discriminatory behaviour confidentially.[16]

1.2.2 Evidence of third-party connections

There is limited publicly available information on the number of connections completed by parties other than the incumbent TNSP. Further, the AER has very limited oversight of negotiated transmission services. The information that is available suggests that very few connection services are provided by third parties.

When the AEMC reviewed the connection framework in 2021 via its Dedicated Connection Asset rule change, submissions suggested that very few, if any, connection assets were being provided contestably.[17] Submissions to the Transmission Ring-fencing Guideline Review also suggested there are few contestable connections being constructed by parties other than the Primary TNSP, yet there appears to be appetite for appointing, or at least exploring, alternative providers.

TNSPs have suggested that the framework was deliberately designed so that most contestable connections would continue to be delivered by the Primary TNSP. Rather, the threat of competition would be sufficient to promote competitive outcomes. For this reason, the absence of third-party providers may be viewed as an outcome of the design of the framework, rather than a sign of anti-competitive outcomes.

Even if the framework was designed this way, we must be confident that the threat of competition exists in practice, not just in theory, to be an effective curb on monopoly power and so deliver timely and cost-effective connections. In this case, the absence of third-party providers could be a result of TNSPs still being able to discriminate in favour of itself or an affiliate, meaning there may not be effective competitive pressure.

Similarly, even if market power is not actually misused, the potential for such behaviour may be enough to deter new entry into, or limit competition in, contestable markets.

In Victoria, where AEMO procures many transmission services, including for the shared network, on a contestable basis, the incumbent TNSP owns and operates 99% of the transmission system.[18] Of the 15-20 transmission augmentations that have been delivered under the contestable framework, three were delivered by a party other than the incumbent.[19] These were all relatively small augmentations, being the construction and operation of new terminal stations. However, in its submission to the consultation paper, AusNet advised that since 2012, only 7 of the 17 contestable projects for the construction and operation of terminal stations and high voltage assets in Victoria have been awarded to AusNet or its affiliate.[20]

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[16] PIAC submission to AER, *Consultation Paper – Options to address gaps in transmission ring-fencing framework*, March 2023, p. 2.

[17] See AEMC, Connection to Dedicated Connection Assets, Final Determination, 8 July 2021, p. 132.

[18] AusNet, *Ring-fencing Electricity Transmission Guideline Issues Paper* submission, May 2022, p. 1.

[19] AEMC, *Transmission planning and investment review – Contestability, Directions paper*, 24 November 2022, p. 18.

[20] AusNet, submission to AER, *Consultation Paper – Options to address gaps in transmission ring-fencing framework*, March 2023, p. 2.

1.2.3 Submissions to the Consultation Paper

Concerns about the ability for TNSPs to favour themselves or an affiliate in providing connection services came to light during the AER's substantive review of the transmission ring-fencing arrangements in 2022-23. We heard concerns from stakeholders about potential harm occurring in two instances:

1. In generator connections, where a connecting party is seeking both contestable and non-contestable connection services and the TNSP has the ability to discriminate in favour of generators completing all services with the TNSP (including with its related affiliates).
2. In distribution network connections, where an electricity distribution network service provider (DNSP) receives a connection application which requires upstream augmentation works on the shared transmission network, then the TNSP may use the information about the new potential connection to its advantage.

These concerns have been reiterated by some stakeholders in response to the Consultation Paper.

As noted above, we are concerned that there has been a reluctance by some stakeholders to engage on their interactions with TNSPs in seeking transmission connections. Despite this, there has been significant support from stakeholders for amendments to the regulatory framework to address potential discriminatory TNSP behaviour by a range of parties, several of whom noted that simply the perception of discrimination would harm market outcomes irrespective of whether there was tangible evidence of such behaviour. For example:

- The Clean Energy Council (CEC) stated that, while there is no definitive evidence of harm to date, "[W]ithout ring-fencing, there is a non-zero risk that a TNSP might favour a generator purchasing contestable services from its related entity". The CEC went on to note that real harms could arise simply from the perception of discriminatory behaviour, a concern shared by AGL.[21]
- The Energy Users' Association of Australia (EUAA) noted it is "aware of apparent discrimination in providing network services by TNSPs across the NEM", such as asymmetric information provision, discounts from TNSP-affiliated tenders and overly onerous requirements for third party works. The EUAA suggests that, consequently, "third parties able to perform the works will not "waste their time" developing a tender".[22]
- The Public Interest Advocacy Centre (PIAC) "consider[s] it prudent to act to curtail the potential for discriminatory behaviour, regardless of whether such behaviour has actually occurred or not".[23]

[21] See the following submissions to AER, *Consultation Paper – Options to address gaps in transmission ring-fencing framework*, March 2023: CEC, pp. 1-2; AGL, p. 3.

[22] EUAA, submission to AER, *Consultation Paper – Options to address gaps in transmission ring-fencing framework*, March 2023, pp. 1-2.

[23] PIAC, submission to AER, *Consultation Paper – Options to address gaps in transmission ring-fencing framework*, March 2023, pp. 1.

Other submissions that explicitly supported action being taken to address the perception of discrimination even without definitive evidence included Alinta Energy, ENGIE, Flow Power and Snowy Hydro.[24] These stakeholders considered that even the perception of harm could be detrimental to the market.

On the other hand, AusNet, the ENA, TasNetworks and Transgrid considered there is insufficient evidence to justify amending the regulatory framework.[25]

The ENA raised concerns that the AER had not identified any concrete gaps in the current framework and that "reliance on unsubstantiated claims made by motivated stakeholders does not meet the threshold of evidence required for a rule change request to be made in the interests of customers".[26] They considered that the AER should use its existing powers to obtain further information and assess compliance with the NER and discuss any findings with TNSPs before considering whether to submit a rule change.[27]

The ENA and Transgrid pointed to TNSP expertise and ability to complete connections quickly and at low cost as reasons for being preferred suppliers of connections services. Similarly, TasNetworks noted Tasmania is experiencing a surge in connection inquiries and that allowing customers to have the option of choosing the experienced local TNSP is in their best interests. [28]

The ENA noted that elements of the connections framework permit TNSPs to take advantage of economies of scope and scale in providing contestable connection services. They also state they can provide a quicker connection process because when third party providers are involved, additional steps are required so the TNSP can ensure there are no risks to the shared network that they have responsibility for. This means that choosing a TNSP or its affiliate to provide connection services can result in a quicker connection.[29]

For these reasons, TNSPs cautioned that, in their view, onerous ring-fencing requirements could have the unintended effect of increasing costs and timeframes for connections by reducing their incentives to provide contestable connection services.

Other matters raised included:

- Transgrid pointed to the CEC's Connection Reform Initiative as demonstrating that the results of the connections process are not because of biased or discriminatory behaviour.[30]

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[24] See the following submissions to AER, *Consultation Paper – Options to address gaps in transmission ring-fencing framework*, March 2023: Alinta Energy, p. 2; Flow Power, p. 2; Snowy Hydro, pp. 1-2.

[25] See the following submissions to AER, *Consultation Paper – Options to address gaps in transmission ring-fencing framework*, March 2023: AusNet, p. 3; ENA, p. 6; TasNetworks, p. 1; Transgrid, p. 1.

[26] ENA, submission to AER, *Consultation Paper – Options to address gaps in transmission ring-fencing framework*, March 2023, p. 6.

[27] Ibid, p. 7.

[28] See the following submissions to AER, *Consultation Paper – Options to address gaps in transmission ring-fencing framework*, March 2023: ENA, p. 5; Tasnetworks, p. 1; Transgrid, p. 8.

[29] ENA, submission to AER, *Consultation Paper – Options to address gaps in transmission ring-fencing framework*, March 2023, p. 4.

[30] Transgrid, submission to AER, *Consultation Paper – Options to address gaps in transmission ring-fencing framework*, March 2023, p. 5.

- The ENA stated that they are not aware of any instances where TNSPs have used information to encourage a connection to the transmission network and AusNet refuted any suggestion that they would engage in such behaviour, citing the confidentiality obligations contained in Rule 8.6 of the NER and noting it is a civil penalty provision.[31]
- Both the ENA and AusNet suggested that the competitive framework in Victoria has resulted in entry by new participants and that additional separation requirements would have the opposite effect of intended by reducing competition.[32]

1.2.4 Summary

As noted in our Explanatory Statement accompanying the final Transmission Ring-fencing Guideline:[33]

> A critical purpose of ring-fencing is to address competition concerns where access to a monopoly service is essential to facilitate effective competition in another market. This is the case for transmission connections, where generators and others must engage with a TNSP for the non-contestable elements of a connection, but in theory have access to multiple providers for the contestable elements of a connection. Allowing TNSPs to operate in the contestable market raises concerns about their ability to misuse their market power by tying the provision of non-contestable services to the provision of contestable services. Even if market power is not actually misused, the potential for such behaviour may be enough to deter new entry into, or limit competition in, contestable markets.

We continue to consider that the harms associated with the potential for TNSPs to discriminate in favour of themselves or an affiliate are tangible, irrespective of whether there is evidence of such behaviour in practice. TNSPs are already playing a critical role in connecting hundreds of megawatts of new capacity as the industry transitions away from fossil fuel generation. Connection applicants must have confidence that they are able to connect on terms and conditions that provide them with value for money and a fast connection process.

We acknowledge the concerns raised by TNSPs about the potential for functional separation to inhibit their ability to provide costly and timely connections. However, as discussed further in section 4.2 below, the proposed rule change in and of itself does not seek to directly impose functional separation requirements. Rather, this would be a matter for implementation in the Transmission Ring-fencing Guideline, following a review.

1.3 Materiality of the problem

The nature of transmission connections has evolved significantly over the past decade. These changes are increasing opportunities for contestability in the transmission connections

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[31] See the following submissions to AER, *Consultation Paper – Options to address gaps in transmission ring-fencing framework*, March 2023: ENA, p. 9; AusNet, p. 3.

[32] See the following submissions to AER, *Consultation Paper – Options to address gaps in transmission ring-fencing framework*, March 2023: ENA, p. 9; AusNet, p. 2.

[33] AER, *Electricity transmission Ring-fencing Guideline, Explanatory Statement – Version 4*, March 2023. pp. 59-60.

market, suggesting any costs associated with inefficiencies in the connections process will only increase in coming years. Key contributing factors include:

- Regulatory changes to promote contestability. The framework for connecting to the transmission network was substantially reformed in 2017,[34] in part to clarify the elements of a connection that could be provided contestably. Chapter 5 of the NER now identifies elements of connections that must be provided by the TNSP as negotiated transmission services, and the elements that may be provided by third parties, as well as obligations on all parties to facilitate the connection process. Victoria's connection framework remains separate, where AEMO has a role in the process.
- The development of Renewable Energy Zones (REZs). REZs are being developed in New South Wales, Victoria, Queensland and Tasmania, with the NSW framework most progressed.[35] The purpose of REZs is to cluster new wind and solar projects in renewable hubs so that transmission investment can be made efficiently – in terms of time and cost. There is potential for the connections process (including the construction of the connections assets) for REZs to be contestable. As REZs continue to be developed across NEM jurisdictions, there may be increasing opportunities for third parties to provide connection services within these REZs.
- The entry of new players seeking to connect smaller generation systems to the transmission network. When the NER was developed, parties seeking connection to the transmission network were typically large, incumbent generators. However, the number of players in the generation market has increased. Over the last decade we have seen new entrants, including smaller players, seeking to connect that are less familiar with the regulatory framework. They are also connecting smaller generating systems. As a consequence, these parties may have less bargaining power than the parties historically seeking connection.
- The transition from fossil fuel-based generation to renewable generation driving an increase in connections activity. There is significant investment required over coming years to connect sufficient new renewable generation as fossil fuel generators retire. It is critical that this be done quickly and at low cost. Approximately 52 renewable power projects are either committed or being commissioned at present, while over 500 projects have been publicly announced.[36] TNSPs will play a critical role in facilitating these connections in their role as the monopoly operator of the transmission network.

Without the ability to ring-fence negotiated transmission services, there may be potential for TNSPs to use their monopoly power in the provision of these services to discriminate in favour themselves or an affiliate and so hinder the competitiveness of the contestable connections market.

The market for contestable transmission connections is still nascent and should be supported where possible. The development and implementation of each generation project may cost several hundred million dollars to complete. Each project is likely to require a new connection

[34] See AEMC, *Transmission Connection and Planning Arrangements*, *Rule Determination*, 23 May 2017.

[35] For a discussion of REZs, see AER, State of the Energy Market Report, 2021, p 58.

[36] See AEMO, NEM Generation information, January 2023. 'Renewables' includes solar and wind farms, hydro power stations, and batteries.

the cost of which is likely to be approximately 10% of the overall project cost.[37] If TNSPs are acting in a manner which undermines customers procuring third party providers to deliver contestable works, this would negatively impact the cost of connections, increasing the cost of, and potentially delaying, the energy transition.

[37] See AEMC, *Transmission Connection and Planning Arrangements*, *Rule Determination*, 23 May 2017, p ii.

2 Application for fast track approval

2.1 Fast tracking applications

The AER requests that this application be progressed as a 'fast track' rule change. The requirements for fast track consideration are:[38]

a) An electricity market regulatory body has made a rule change request and has consulted with the public on the nature and content of the request; and

b) The AEMC is of the opinion that the consultation was adequate, having regard to the nature and content of that request and the kind of consultation conducted by the electricity market regulatory body.

2.2 AER consultation overview and process

The AER has conducted extensive consultation on the nature and scope of the issue this rule change request seeks to address, and has also consulted on two possible solutions to the issue. On that basis, the AER submits that this rule change request satisfies the requirements under the NEL for this rule change to be fast tracked by the AEMC.

The AER's consultation process was in two parts. First, we discussed the issue as part of our recent review of the Transmission Ring-fencing Guideline. The Explanatory Statement that accompanied the draft guideline canvassed the following:[39]

- Potential harms raised by stakeholders in respect of TNSPs' potential ability to discriminate in favour of themselves or an affiliate in the market for contestable connections services. Stakeholders were concerned about both information sharing and the potential for TNSPs to use their position to favour themselves or an affiliate when providing contestable connections.[40]
- The scope of the AER's ring-fencing powers and the fact that the NER limits the ring-fencing guideline to the accounting and functional separation of prescribed transmission services provided by TNSPs from other services. The ring-fencing guideline currently cannot provide for the accounting and functional separation of negotiated transmission services from other services, which were the source of concern raised by stakeholders in respect of connections.[41]
- Stakeholders were invited to provide feedback on whether they would support a change to the NER that would expand the ring-fencing framework to include negotiated transmission services.[42]

[38] See the National Electricity Law clause 96A.

[39] AER, Electricity transmission Ring-fencing Guideline, Explanatory Statement – Version 4, Draft, November 2022.

[40] See AER, Electricity transmission Ring-fencing Guideline, Explanatory Statement – Version 4, Draft, November 2022, pp. 25-26.

[41] Ibid, pp. 26-27.

[42] Ibid, p. 27.

In the Explanatory Statement that accompanied the final guideline, we summarised further submissions on these issues and indicated our intention to consult further on the need for a rule change request.

The second part of the consultation process commenced with the publication of a Consultation Paper on 12 May 2023 and a request for connection applicants to participate in a survey relating to their experience in connecting to the transmission network. The Consultation Paper included:

- A description of the nature and scope of the problem, including a summary of the relevant points raised in submissions received during the Transmission Ring-fencing Review.
- Two options for addressing the problem for stakeholder feedback and an invitation for stakeholders to submit alternative solutions.
- How the options presented would contribute to the achievement of the NEO and their expected benefits, costs and impacts.

Prior to publishing the Consultation Paper, the AER met with:

- The Clean Energy Council's Market Investment and Grid Directorate on 8 May 2023 to provide a summary of the Consultation Paper and request responses to the survey.
- The Energy Networks Association (ENA) on 10 May 2023 to provide a summary of the Consultation Paper.

The AER also requested connection applicants participate in an online survey relating to their experience in connecting to the transmission network. We note that AusNet, the ENA and Transgrid raised some concerns with the survey, including that some of the questions assumed there was a problem and so could lead to biased answers, and that the survey did not include large load customers.[43] While we consider the survey was a valuable exercise, the survey was just one of many aspects of our consultation. Our decision to submit this rule change request has also been informed by the other, more extensive consultation activities noted above.

The Consultation Paper and survey questions are attached to this proposal. A list of stakeholders who provided submissions are documented in Appendix A.

2.3 Submissions in response to AER papers

The AER received 24 submissions in response to the Explanatory Statement to the draft Transmission Ring-fencing Guideline.[44] The proposed rule change was supported by the Australian Energy Council, Australian Energy Operations, Clean Energy Investor Group, Clean Energy Finance Corporation (CEFC), CitiPower/Powercor/United Energy (CitiPower),

[43] See the following submissions to AER, *Consultation Paper – Options to address gaps in transmission ring-fencing framework*, March 2023: AusNet, pp. 5-6; ENA, p. 8; Transgrid, p. 4.

[44] https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/ring-fencing-guideline-electricity-transmission-2023/draft.

Iberdrola, Snowy Hydro, Squadron Energy and Tilt Renewables. The proposed rule change was not supported by ENA, AusNet, Transgrid or TasNetworks.

The AER received 19 submissions in response to the Consultation Paper which were published on the AER website in June 2023.[45] The proposed rule change was supported by Alinta Energy, AGL, Clean Energy Council (CEC), Snowy Hydro Group, Flow Power, Energy Users Association of Australia (EUAA), CitiPower Australian Energy Operations, Public Interest Advocacy Centre (PIAC), CEFC, ENGIE, Iberdrola and Tilt Renewables. The proposed rule change was not supported by ENA, AusNet, Ausgrid, Endeavour Energy and Essential Energy, Transgrid or TasNetworks.

[45] https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/review-of-options-to-address-gaps-in-transmission-ring-fencing-framework/initiation.

3 Stakeholder views on the options

As discussed above, AusNet, the ENA, TasNetworks and Transgrid considered there to be insufficient evidence of a problem to warrant any changes to the rules. In addition, Transgrid pointed to general competition law as providing sufficient protections from any potential harms. On this basis, theses stakeholders did not support introducing either option presented in the Consultation Paper.

The remainder of this chapter sets out views specific to each option.

3.1 Option 1: Introduce compliance reporting

Option 1 proposed to improve transparency in providing connection services by introducing new reporting requirements in chapter 5 of the NER that would allow the AER to monitor more closely the provision of negotiated transmission services and compliance with chapter 5 of the NER.

While there was some support for this option, this was in the context of providing additional transparency above and beyond Option 2. There was no support for Option 1 being implemented on its own on the basis that Option 1 alone would not be sufficient to mitigate the identified potential harms. Increased reporting and transparency, while beneficial, were seen as ineffective without greater ability for the AER to ensure compliance and provide additional regulatory tools to prevent discriminatory behaviour should it be identified.[46]

While supporting Option 2, the CEC acknowledged that Option 1 would impose fewer administrative costs and would have a lesser regulatory burden.[47]

Transgrid explicitly did not support Option 1. They considered that added reporting or compliance requirements would affect the way that a TNSP conducts negotiated or contestable work, and that they already have rigorous processes in place to ensure a clear and transparent connection process.[48]

3.2 Option 2: Expand the ring-fencing framework

Option 2 proposed expanding the ring-fencing framework to include negotiated transmission services.

This option received near unanimous support from stakeholders that considered that a change to the rules is warranted.[49] Reasons given for supporting Option 2 included that it would:

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[46] See the following submissions to AER, *Consultation Paper – Options to address gaps in transmission ring-fencing framework*, March 2023: CEC, p. 2; Flow Power, p. 3; EUAA, p. 2; Alinta Energy, p. 3; and PIAC, p. 2.

[47] CEC, submission to AER, *Consultation Paper – Options to address gaps in transmission ring-fencing framework*, March 2023, p. 2.

[48] See Transgrid, submission to AER, *Consultation Paper – Options to address gaps in transmission ring-fencing framework*, March 2023, pp. 7, 9.

[49] Stakeholders supporting Option 2 were: AGL, Alinta Energy, AEO, CEC, CEFC, CitiPower, Engie, EUAA, Flow Power, Iberdrola, PIAC, Snowy Hydro and Tilt Renewables.

- appropriately separate regulated monopoly services from contestable services and address an apparent oversight in the regulatory framework;
- allow the AER to take direct action to mitigate any potential discriminatory behaviour;
- better address potential uncompetitive behaviour by TNSPs than Option 1 and in doing so would promote competition in the market for connections;
- increase confidence in investors and developers that they can connect at an efficient cost;
- level the playing field between TNSPs and DNSPs;
- provide greater transparency and accountability than under the existing framework;
- provide greater flexibility to respond to changes in the market over time; and
- create a consistent approach across all NEM jurisdictions, including Victoria.

The CEC's support was conditional on ensuring that this approach would not have the effect of slowing down the connection process, which was a concern raised by some of their TNSP members (although disputed by other members).[50]

While the NSW DNSPs (Ausgrid, Endeavour Energy and Essential Energy) supported levelling the playing field between TNSPs and DNSPs, they considered this should be done by reducing regulatory constraints on DNSPs rather than increasing them on TNSPs.[51]

AusNet, TasNetworks and Transgrid explicitly did not support Option 2.[52] In addition to the lack of evidence and view that general competition laws should address any potential discriminatory behaviour, these stakeholders raised concerns that a more restrictive approach to ring-fencing may affect the ability and incentives for TNSPs to provide contestable connections. In turn, they considered this could have the effect of:

- removing the most experienced parties from the market
- preventing TNSPs from taking advantage of scale and scope efficiencies, increasing costs and the time taken to perform connections
- adversely impacting competition.

AusNet also considered that ring-fencing is not the appropriate mechanism to improve competition in connections. Rather, they considered significant changes are required to chapter 5 of the NER to improve the overall contestability framework.[53]

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[50] CEC, submission to AER, *Consultation Paper – Options to address gaps in transmission ring-fencing framework*, March 2023, p. 2.

[51] NSW DNSPs, submission to AER, *Consultation Paper – Options to address gaps in transmission ring-fencing framework*, March 2023, pp. 1 & 8.

[52] See the following submissions to AER, *Consultation Paper – Options to address gaps in transmission ring-fencing framework*, March 2023: AusNet, pp. 2, 4 & 5; TasNetworks, p. 2; and Transgrid, pp. 1 & 10.

[53] AusNet, submission to AER, *Consultation Paper – Options to address gaps in transmission ring-fencing framework*, March 2023, p. 4.

4 AER proposal

4.1 Description

After carefully assessing the views of all stakeholders, the AER considers and submits that the NER should be amended to extend the ring-fencing framework to incorporate negotiated transmission services. This would allow the AER to make Transmission Ring-fencing Guidelines that govern the behaviour of TNSPs in respect of the provision of negotiated transmission services, as well as prescribed transmission services.

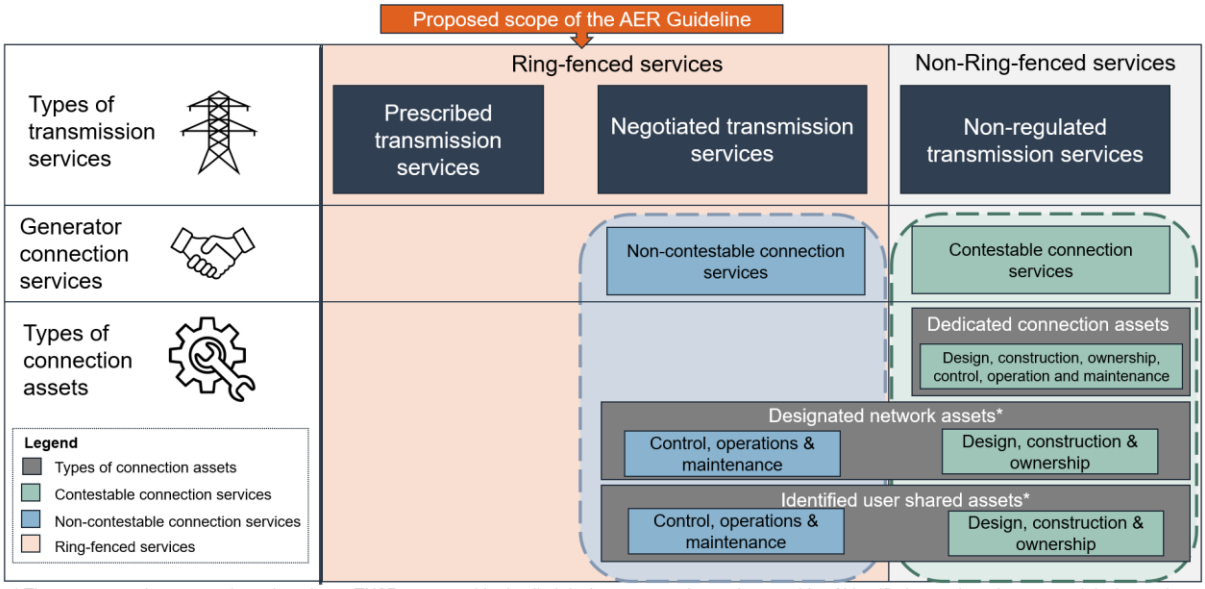
Currently, clause 6A.21.2(a) of the NER requires that:

> Transmission ring-fencing guidelines must be developed by the *AER* in consultation with each *participating jurisdiction* for the accounting and functional separation of the provision of *prescribed transmission services* by *Transmission Network Service Providers* from the provision of other services by *Transmission Network Service Providers* (the *Transmission Ring-fencing Guidelines*).

We propose this clause be extended and clarified to provide for:

> …the accounting and functional separation of the provision of *prescribed transmission services* and *negotiated transmission services* by *Transmission Network Service Providers* from the provision of other services by *Transmission Network Service Providers*…

The diagram below demonstrates the proposed expanded scope of the ring-fencing framework compared to the diagram in section 1.1.



* There are some instances where the primary TNSP must provide detailed design, construction and ownership of identified user shared assets and designated network assets as non-contestable transmission services.

For completeness, we propose that references in clause 6A.21.2(b) to prescribed transmission services also be extended to include references to negotiated transmission services. This clause sets out the matters that the Transmission Ring-fencing Guideline may include (without limitation). The affected sub-clauses are:

- 6A.21.2(b)(1)(ii), which would allow the Guideline to require the establishment and maintenance of consolidated and separate accounts for negotiated transmission services, as well as prescribed transmission services.
- 6A.21.2(b)(1)(iii), which would allow the Guideline to require the allocation of costs between negotiated transmission services and non-regulated transmission services, as well as between prescribed transmission services and other services.
- 6A.21.2(b)(1)(v), which would allow the Guideline to limit the flow of information where there is the potential for a competitive disadvantage between those parts of the TNSP's business which provide negotiated transmission services and parts of the TNSP's business which provide any other services.

It is not the policy intent that legal and/or functional separation would be permitted between prescribed transmission services and negotiated transmission services. Both services are required to be provided on a monopoly basis by the primary TNSP and, as such, we do not consider it appropriate or desirable to be able to legally separate provision of prescribed transmission services from provision of negotiated transmission services.

The rule as proposed would allow for different ring-fencing approaches to be taken between prescribed transmission services and negotiated transmission services, given the nature of these services and the potential discrimination issues are different. For example, it may be appropriate to require different functional separation requirements between prescribed transmission services and non-regulated transmission services and between negotiated transmission services and non-regulated transmission services, depending on the nature of the potential harms and the cost of imposing functional separation.

The proposed rule is not intended to change the commercial negotiation of connection services. The existing framework for agreeing price and other terms and conditions would remain unchanged. Rather, the proposed rule is intended to provide greater transparency and accountability for TNSPs in how they engage in the negotiation process to provide greater confidence that TNSPs are not discriminating in favour of themselves or an affiliated entity.

While several stakeholders considered that Option 1 should be implemented in tandem with Option 2, we consider that Option 2 alone will achieve many of the same outcomes as Option 1. For this reason we are not proposing any new reporting requirements be introduced in Chapter 5 of the NER.

In response to ENA's suggestion that the AER should obtain further information and assess compliance with the NER before submitting a rule change, the AER considers that the concerns raised by other stakeholders are material enough to pursue this rule change request. For reasons discussed in chapter 1, our view is that existing frameworks are not sufficient to provide market participants with confidence that the risk of discriminatory behaviour by TNSPs is sufficiently mitigated. This lack of confidence has a real risk of reducing the competitiveness of the connections market and resulting in unfair and inefficient outcomes for connecting parties. Consequently, assessing compliance with the current frameworks will not be sufficient to address the associated potential harms to the market. As is discussed further in section 4.2, the proposed rule change will provide greater tools for addressing the potential for discrimination beyond reporting on compliance. Furthermore, we disagree with the ENA that support for this rule change is from "motivated stakeholders".

Rather, it is from connecting parties seeking to increase competition and reduce costs in the connections market. Contestable connection works do not require the local knowledge of a TNSP and should not require additional steps where a third party provider is involved.

4.2 How the proposal would address the identified issue

The proposed rule change would provide the AER with the full suite of regulatory tools available under the ring-fencing framework to address potential discriminatory behaviour in the provision of negotiated transmission services. The specific ways in which the proposed rule would address the identified issue will depend on how the Transmission Ring-fencing Guideline is amended to reflect the expanded scope. Any amendments to the Guideline would be subject to consultation via the Transmission Consultation Procedures, and we do not intend to pre-empt the type of measures that we may impose to ring-fence negotiated transmission services from non-regulated transmission services if the scope of ring-fencing is expanded.

However, if a review of the Guideline found that additional measures were warranted, examples of how this power could be exercised to address the identified issue include:

- Requiring additional reporting on relevant aspects of TNSP delivery of negotiated transmission services to assist with understanding whether discriminatory behaviour was occurring. This could include information on, for example:
  - how many connection enquiries were received;
  - how many connection applicants tendered for the contestable connection elements (if known);
  - how many connections proceeded with a non-incumbent provider; and
  - connection timeframes and costs.
- Extending the current obligation not to discriminate under clause 4.1 of the Guideline to include prohibiting discrimination between a Related Electricity Service Provider (RESP) and competitor of a RESP in connection with the provision of negotiated transmission services. Without limitation, the general non-discrimination obligations are targeted at preventing a TNSP from:
  - giving itself or its RESP a financial benefit that is not available to its competitors;
  - giving customers of its RESP a financial or non-financial benefit that would not be available to them if they were customers of a competitor of the RESP; or
  - using its position as a TNSP to advantage its RESP in competing to provide contestable services.

  The general non-discrimination obligation also prohibits a TNSP from providing recommendations or providing information in favour of a RESP.
- Extending the definition of “ring-fenced information” under the current Guideline to include electricity information acquired or generated by a TNSP in connection with its provision of negotiated transmission services. In effect, this would extend the current information access and disclosure requirements under clause 4.2 of the Guideline that place requirements on TNSPs to keep ring-fenced information confidential and only use it for the purpose for which it was acquired or generated.

These information requirements would reduce any competitive advantage TNSPs or their affiliates derive from their possession, or acquisition, of such information, particularly as a result of the TNSP being the exclusive provider of non-contestable transmission services.

- Extending the current obligation in respect of marketing staff separation. Currently, the obligation under clause 4.3 of the Guideline only requires separation of marketing staff involved in the provision of prescribed transmission services from the provision of other services. This could be extended to: (1) separate marketing staff involved in the provision of negotiated transmission services from staff involved in the provision of contestable electricity services; and/or (2) widen the scope of staff separation beyond marketing staff.

  This requirement would help enforce limitations on the flow of information where individual staff members are involved in the provision of both monopoly and contestable services. Similarly, office separation can also be appropriate where there is a risk of sensitive information being passed between staff members, whether intentionally or otherwise.

- Introducing restrictions on cross-branding and promotions. Such restrictions can assist where there is a concern that customers are likely to be susceptible to, or confused by, shared branding and cross-promotions to the advantage of the TNSP.

We stress, however, that if the ring-fencing framework under the NER is extended to include negotiated transmission services, the application of the expanded framework in terms of how that translates to specific obligations and requirements will be considered as part of a review of the Transmission Ring-fencing Guideline. The rule change, in and of itself, would not impose any additional reporting obligations, general requirement not to discriminate, or any form of functional separation.

We acknowledge the concerns raised by TNSPs in respect of the potential for functional separation to inhibit the provision by TNSPs of connection services altogether. We also note that other stakeholders have suggested that complete functional separation is required to provide the market with confidence that TNSPs are not using their monopoly advantage. Ultimately these are issue that would be carefully weighed in updating the Transmission Ring-fencing Guideline. Furthermore, we note that if any of the measures in an updated guideline were likely to inhibit the provision of connection services by certain TNSPs altogether, then those TNSPs could apply for a waiver from the Transmission Ring-fencing Guideline. Waiver applications are assessed by the AER on a case-by-case basis and may be granted where the benefit to consumers of the TNSP complying with the obligations would be outweighed by the cost to the TNSP of complying with that obligation.[54]

Even if few ring-fencing measures were ultimately imposed on the provision of negotiated transmission services under the Transmission Ring-fencing Guideline, we consider there would still be merit in amending the rules. Simply having the above tools in the regulatory toolkit would help curb potential discriminatory behaviour by TNSPs and promote competition in contestable connections services. Knowing that more costly measures could be imposed

[54] AER, *Electricity transmission Ring-fencing Guideline – Version 4*, March 2023, clause 5.3.2.

would provide an incentive for TNSPs to avoid operating in a way that could be viewed as discriminatory.

In July 2023, Tier 1 civil penalties were introduced for breaches of the Transmission Ring-fencing Guideline. Civil penalties provide a strong motivator for complying with regulatory obligations. As such, we consider amending the rules to allow the imposition of ring-fencing measures, combined with civil penalties for non-compliance, will provide strong incentives for TNSPs ensure they are treating competitors on an equal footing.

As noted in Chapter 1, the AER is less concerned about the potential for cross-subsidisation because of the requirement for TNSPs to allocate their costs according to their CAMs and have their accounts audited. However, we acknowledge concerns raised by some stakeholders about the potential ability for TNSPs to inflate the cost of negotiated transmission services. The proposed rule change would provide us with tools to require additional transparency and focus on cost separation were evidence of cross-subsidisation to arise.

4.3 Transition to the new rules

If made, we propose the rule come into effect immediately and include a requirement for the AER to complete a review of the electricity Transmission Ring-fencing Guideline within 18 months of commencement of the rule.

5 Achieving the National Electricity Objective

The National Electricity Objective (NEO) is:

> 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:
>
> a) Price, quality, safety, reliability and security of supply of electricity; and
>
> b) The reliability, safety and security of the national electricity system.

Energy Ministers have also agreed to introduce an emissions reduction objective into the NEO.[55] This amendment is expected to take effect by September 2023.[56] Therefore, the AER considers it is appropriate to also consider the potential impact the proposed options might have on achieving targets for reducing Australia's greenhouse gas emissions.

The proposed rule change is likely to contribute to the achievement of the NEO compared to the status quo. While there may be a limited number of connections at the moment, there will be increasing connections to facilitate the 125 GW of additional variable renewable energy required by 2050 to replace retiring coal generators.[57] It is therefore important that the framework is fit for purpose and connecting generators have confidence that they can use third party providers that may offer better value for money than incumbent TNSPs, without concern about having non-contestable connection services delayed or completed on unfavourable terms and conditions.

The proposed rule change will improve transparency in the way in which TNSPs comply with aspects of the connection framework that are intended to encourage TNSPs to act fairly and transparently and minimise the potential for TNSPs to exercise their market power to the detriment of connecting parties and competitors in related markets. This should provide third party providers with greater confidence that they are competing on a level playing field, enhancing competition. At the very least, increased reporting requirements and transparency will provide an increased degree of scrutiny on the connection process.

The proposed rule change would provide the AER with a broad set of tools to take direct action to mitigate discriminatory behaviour in respect of negotiated transmission services, such as through functional separation. While the benefits of imposing functional separation would need to outweigh the costs for the guideline to require such separation, we consider that the threat of additional regulatory measures would also help curb the potential for any discriminatory behaviour.

Specific elements of the NEO that may be enhanced are:

- Efficient investment in, and operation of, electricity services. The proposed rule change is likely to provide connecting parties with greater negotiating power in the transmission

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[55] Department of Climate Change, Energy, the Environment and Water, *Consultation on proposed legislative changes to incorporate an emissions reduction objective into the national energy objectives,* 20 December 2022: https://www.energy.gov.au/government-priorities/energy-and-climate-change-ministerial-council/priorities/national-energy-transformation-partnership/consultation-proposed-legislative-changes-incorporate-emissions-reduction-objective-national-energy-objectives.

[56] Energy and Climate Change Ministerial Council – Energy Ministers Sub-Group, Meeting Communique, Friday 19 May 2023.

[57] AEMO, *2022 Integrated System Plan*, June 2022, p. 48.

connections market through increased accountability of TNSPs, and transparency in the provision of negotiated connection services. This in turn will provide connecting parties with a greater ability to manage the timing and cost of their connection, improving competition in the provision of contestable connection services which should, in turn, drive efficiencies and reduced costs, benefiting consumers.

- Improved competition for connections will also support reliability in the supply of electricity in light of the retirement of coal-fired generators during the transition towards net zero emissions, particularly if there are risks that connections are currently being delayed to suit the circumstances of the incumbent TNSPs. Ensuring that connections of new generation and firming capacity happen as quickly as possible, without unnecessary delay, will help shore up supply as coal-fired generation becomes increasingly unreliable due to age and ultimately retires.
- Downward pressure on wholesale electricity prices reflecting lower connection costs. As noted in section 1.3, the connection costs can be 10% of a project's overall costs. Lower connection costs could therefore lead to reduced costs for consumers where connection costs savings are passed through via lower wholesale prices. This is likely to be particularly beneficial given the level of investment required in transmission and generation for the energy transition. AEMO's ISP forecasts the withdrawal of 14 GW of coal capacity by 2030 and 23 GW by 2050.[58] This will require the introduction of over 125 GW of additional variable renewable energy by 2050 (including 48 GW by 2030) and over 60 GW of firming capacity (e.g. dispatchable storage, hydro and gas-fired generation) to be connected by 2050.[59] Ensuring that connections happen at efficient cost will be critical to ensuring the energy transition occurs at the lowest possible cost to consumers.
- Promote the achievement of emissions reduction targets. As mentioned above, significant new variable renewable energy and firming capacity are required to replace coal-fired generation. Facilitating more efficient and cost-effective connection of these energy sources to the transmission network will assist with Australia's transition away from coal-fired generation and consequently promote the achievement of emissions reduction targets.

[58] AEMO, *2022 Integrated System Plan*, June 2022, p. 48.

[59] AEMO, *2022 Integrated System Plan*, June 2022, p. 48.

6 Expected costs, benefits and impacts of amending the NER

6.1 Benefits

The key stakeholders that would benefit from the proposed rule are connecting generators, third-party service providers of contestable connections services and consumers.

6.1.1 Connecting generators

Generators looking to connect to the transmission network may benefit from more competition in the provision of contestable connection services because the proposed rule provides the potential for stronger regulatory action, enforcement and compliance to prevent discrimination. Increased competition could lead to more efficient service delivery from service providers, less risk of delays to connections, lower costs of contestable connection services and more transparency over the cost of negotiated transmission services. Greater competition will also provide connecting generators with greater negotiating power with TNSPs.

6.1.2 Third party service providers

Service providers that can provide contestable connection services will also benefit from increased transparency in the connections market. The proposed rule will remove barriers to entry to the contestable transmission connections market because there will be less risk, or less perceived risk, of TNSPs using their monopoly power to influence connecting generators' decisions about choosing contestable connection service providers. Third party service providers will be in a better position to compete with TNSPs in the provision of contestable connection services and more likely to obtain work from connecting generators.

6.1.3 Consumers

Consumers may benefit from potential increased competition in the connections market leading to downward pressure on connection costs. This may flow through to lower wholesale electricity prices**.**

6.2 Costs

6.2.1 TNSPs

The costs incurred by TNSPs under the proposed rule will depend on the ring-fencing arrangements under any revised transmission ring-fencing guideline. These costs would be assessed as part of a review of the Guideline that would need to occur if the ring-fencing head of power is extended.

There is potential for TNSPs' costs to increase if ring-fencing measures are required between negotiated transmission services and contestable transmission services.

6.3 Expected impacts

6.3.1 TNSPs

Costs and impacts of the rule change proposal are limited, as the rule change itself does not impose additional obligations on TNSPs. The expected impacts of the proposed rule on

TNSPs will depend on any future amendments to the Transmission Ring-fencing Guideline, but could potentially include increased regulatory burden and some uncertainty to business operations due to an increased scope of regulation. The AER would undertake a rigorous consultation process to determine the costs and benefits of any specific amendments to the Guideline at that time.

TNSPs noted in submissions to the Consultation Paper that requiring functional separation between negotiated transmission services and other services would reduce incentives for TNSPs to provide contestable connection services, potentially resulting in some TNSPs exiting the market. As noted above, the AER would consider this as part of consultation on any changes to the Guideline should the rule change be adopted.

6.3.2 Connecting generators

The proposed rule, if made, would be expected to positively impact outcomes for generators connecting to the transmission network, including through:

- Increased confidence and bargaining power in negotiating for connection services with incumbent TNSPs and third-party providers as a result of increased transparency in the transmission connections market.
- Potentially cheaper connections through improved competition.
- Less risk of delays in the connection process, reducing risks associated with finalising project financing and planning approvals.

We also note TNSP's views that strict functional separation could result in higher costs and less timely connections. The AER would need to carefully weigh up the costs and benefits of any ring-fencing requirements through a full review of the Guideline.

6.3.3 DNSPs

We expect that the proposed rule would level the playing field for contestable connection services between TNSPs and DNSPs. As noted in chapter 1, several DNSPs raised concerns that TNSPs have an opportunity to leverage information acquired in the provision of negotiated transmission services to provide an unfair advantage in the provision of other contestable services, including where TNSPs and DNSPs compete to connect customers.

The proposed rule could address this issue, if required, by imposing staff and office separation if the benefits of doing so were found to outweigh the costs.

6.3.4 AER

The proposed rule would require increased monitoring and compliance from the AER. The implementation of the proposed rule would also require resources to prepare and consult on potential amendments to the transmission ring-fencing guideline and any subsequent enforcement or compliance activities. However, having additional information via compliance reporting would assist the AER in the effective regulation of TNSPs.

Appendix A – List of submissions received

Submissions in response to consultation paper[60]

1. Australian Energy Operations
2. Ausgrid, Endeavour Energy and Essential Energy
3. AGL
4. Alinta Energy
5. AusNet
6. Clean Energy Council
7. Clean Energy Finance Corporation
8. CitiPower/Powercor/United Energy
9. Energy Networks Australia
10. ENGIE
11. Energy Users Association of Australia
12. Flow Power
13. Iberdrola Australia
14. Jemena
15. Public Interest Advocacy Centre
16. Snowy Hydro
17. TasNetworks
18. Tilt Renewables
19. Transgrid

Submissions to explanatory statement to draft ring-fencing guideline responding to potential rule change request[61]

1. Australian Energy Council
2. Australian Energy Operations
3. AusNet
4. Clean Energy Investor Group
5. Energy Networks Australia
6. Clean Energy Finance Corporation
7. CitiPower/Powercor/United Energy
8. Iberdrola Australia
9. Powerlink
10. Snowy Hydro
11. Squadron Energy
12. Tilt Renewables
13. TasNetworks
14. Transgrid

[60] https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/review-of-options-to-address-gaps-in-transmission-ring-fencing-framework/initiation.

[61] https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/ring-fencing-guideline-electricity-transmission-2023/draft.