

**Draft rule determination**

# National Electricity Amendment (Expanding the transmission ring- fencing framework) Rule 2024

**Proponent**

Australian Energy Regulator

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## About the AEMC

The AEMC reports to the energy ministers. We have two functions. We make and amend the national electricity, gas and energy retail rules and conduct independent reviews for the energy ministers.

## Acknowledgement of Country

The AEMC acknowledges and shows respect for the traditional custodians of the many different lands across Australia on which we all live and work. We pay respect to all Elders past and present and the continuing connection of Aboriginal and Torres Strait Islander peoples to Country. The AEMC office is located on the land traditionally owned by the Gadigal people of the Eora nation.

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To cite this document, please use the following:

AEMC, Expanding the transmission ring-fencing framework, Draft rule determination, 22 February 2024

## Summary

- 1 The Commission has made a more preferable draft rule to empower the AER to impose ring-fencing obligations on transmission network service providers (TNSPs) in respect of negotiated transmission services through its Transmission Ring-Fencing Guidelines (the Guidelines).
- 2 The draft rule addresses the AER's concerns about a gap in the scope of the Guidelines that prevent the AER from addressing the risk of discriminatory conduct associated with the provision of negotiated transmission services and non-regulated transmission services.
- 3 The AER and a variety of stakeholders (except for TNSPs) have identified this risk for discrimination in the context of new connections to the transmission network. This risk is a result of a primary TNSP's exclusive right to provide negotiated connection services (which is one category of negotiated transmission services) and the TNSP's ability (or its affiliate) to also participate in the market for contestable connection services (which is one category of non-regulated transmission services).
- 4 The Commission considers that it is beneficial to make a rule change now to provide the AER with the tools to address the risk of discrimination. This will support effective competition in the market for contestable connection services to meet the substantial increase in demand for connection services from renewable and storage developments, driven by the energy transition.
- 5 The rule change request has been fast tracked, reflecting the consultation already undertaken by the AER on the nature and content of its proposal. In March 2023, the AER published a consultation paper seeking stakeholder views on two options to address the risk that TNSPs may engage in discriminatory behaviour. One option, which received stakeholder support (except from TNSPs), reflects the proposed solution in the rule change request.
- 6 While our draft rule would enable the AER to extend the scope of the Guidelines to include the provision of all negotiated transmission services, the Commission notes that the primary area of concern for stakeholders and the focus of this draft rule determination is the provision of connection services. These comprise non-contestable elements (provided exclusively by the TNSP as a negotiated transmission service, and which we refer to as non-contestable connection services) and contestable elements (which are non-regulated transmission services that can be provided by any party, including the primary TNSP, which we refer to as contestable connection services).
- 7 We are seeking feedback on our draft determination and rule by 4 April 2024.

## Our draft rule seeks to support effective competition in the market for contestable connections

- 8 In line with the AER's rule change request, we consider there is a risk that a primary TNSP relies on their monopoly position over the provision of non-contestable connection services to discriminate in favour of themselves or an affiliate in the contestable connections market. However, as the current scope of the Guidelines is restricted to prescribed transmission services, the AER does not enable the AER to address this risk through specific obligations for the ring-fencing of TNSP's provision of non-contestable connection services from contestable connection services. We acknowledge that existing legislation and rules may deter certain conduct that could hinder competition, but we consider that the existing arrangements do not prevent more subtle forms of discrimination.
- 9 The risk that TNSPs may discriminate in the market for contestable connections services, and the

lack of appropriate powers for the AER to address this risk, may hinder effective competition in the market for contestable connection services by discouraging potential competitors from participating in the market. Effective competition can improve the efficiency of the connection process for renewable and storage developments to connect to the grid, with savings passed through to consumers via lower wholesale electricity prices.

- 10 The Commission’s draft rule supports competition in the market for contestable connection services. It does so by enabling the AER to specify obligations (if necessary) that would improve the confidence of potential competitors and connecting parties that there is limited risk for a primary TNSP to discriminate in favour of themselves or an affiliate when providing contestable connection services.

## Stakeholder concerns about the risk of discriminatory conduct shaped our draft rule

- 11 The Commission considers that there is a need for change. There is broad support for making this draft rule from a range of stakeholders, with the exception of TNSPs.
- 12 In submissions to the AER’s consultation paper, a variety of stakeholders, including retailers, generators, gentailers, consumer advocacy groups, distribution network service providers, transmission developers and peak industry bodies, expressed the view that the risk of discrimination during the connections process is a material problem that should be addressed urgently, due to the expected substantial increase in new transmission connections in the context of the energy transition.
- 13 TNSPs considered that changes to the transmission ring-fencing framework are unwarranted because of a lack of evidence of discriminatory conduct and would be unnecessarily burdensome. TNSPs support timely and efficient connections and consider that ring-fencing negotiated transmission services could be costly and may slow the connections process.
- 14 The Commission considers that it is not necessary to establish that TNSPs have engaged, or are engaging, in discriminatory conduct to justify enabling the AER to specify obligations on TNSPs for the ring-fencing of non-contestable connection services. We note that there are legitimate reasons why connecting parties may be reluctant to provide direct evidence of discriminatory conduct and that proving discrimination would be difficult, particularly when the conduct is subtle and less obvious. While the Commission has not seen direct evidence of discrimination, the concerns held by stakeholders demonstrate a broader market concern that should be addressed. We consider that the risk that TNSPs could discriminate reduces confidence in the effective competitiveness of the market for contestable connection services and that the AER should be provided with all necessary tools to address this issue.
- 15 We consider that despite potential implementation costs for TNSPs (which will ultimately depend on the extent of any obligations specified by the AER through its Guidelines), there is an opportunity to derive significant benefits from supporting a competitive market for contestable connection services as demand for connection services from renewable and storage developments is expected to increase substantially under the energy transition.

## Our draft rule would complement recent and ongoing reforms to improve the connections process

- 16 The substantial increase in demand for new connections is driven by the transition from fossil fuels to renewable energy, as new and existing participants seek to connect renewable generation

and storage capacity, and the development of renewable energy zones. Given the increasing size of the market, it is important that competition in the market for contestable connection services is effective.

- 17 Our draft rule would complement the Commission's [Transmission connections and planning arrangements](#) and [Connection to dedicated connection assets](#) rule changes which established and further developed the existing transmission connection arrangements. These rule changes did not make any amendments to the transmission ring-fencing arrangements because it was out of scope. However, both rule changes emphasised the importance of competition in the provision of contestable connection services while recognising that it is essential for the primary TNSP to be the clear, single point of accountability for shared network outcomes.
- 18 The draft rule would also complement ongoing reforms to improve the transmission connections process including the [Connections reform initiative](#) and the Commission's [Enhancing investment certainty in the R1 process](#) rule change.

## The draft rule would contribute to the national electricity objective

- 19 **Principles of market efficiency:** The Commission's draft rule would contribute to market efficiency by supporting effective competition in the market for contestable connection services. An effectively competitive market for contestable connection services should ultimately reduce the system costs of the energy transition which ultimately means lower costs passed onto consumers.
- 20 **Principles of good regulatory practice:** The Commission's draft rule would maintain the current principles-based approach to ring-fencing, rather than prescribing specific obligations in the NER that the AER should impose on TNSPs. We consider that a principles-based rule allows the AER to further develop the ring-fencing framework for negotiated transmission services on an as needs-basis and flexibly respond to market developments over time. Our more preferable draft rule better contributes to the NEO because it provides the AER with greater flexibility than the proposed rule.
- 21 Our draft rule would also provide for regulatory consistency by empowering the AER to address the risk of discriminatory conduct in the provision of negotiated transmission services in a way that is consistent with the current regulatory approach for addressing similar risks in the provision of prescribed transmission services and distribution services.
- 22 **Implementation considerations:** The Commission's draft rule supports timely implementation of any changes to the AER's Guidelines to provide stakeholders and the market with regulatory certainty as to the obligations on TNSPs to ring-fence their provision of non-contestable connection services from contestable connection services as soon as practicable.

## The draft rule would empower the AER to flexibly address the risk of discriminatory conduct that hinders effective competition

- 23 The Commission's draft determination is to make a more preferable draft rule that explicitly clarifies that the AER has flexibility when deciding whether or not to specify obligations for the ring-fencing of negotiated transmission services from non-regulated transmission services (to address the risks of discriminatory conduct in the provision of connection services).
- 24 We acknowledge that the provision of prescribed transmission services is distinct from the provision of negotiated transmission services and that the transmission connections framework already mitigates, to some extent, the risk of discriminatory conduct in the provision of connection services. Our more preferable draft rule enables the AER to specify obligations to manage any

residual risks depending on prevailing market conditions.

- 25 As a result, the ring-fencing framework for the provision of negotiated transmission services under our draft rule may differ from the current ring-fencing framework for prescribed transmission services and from the draft rule proposed by the AER because:
- The AER could decide *not* to specify any new obligations for TNSPs to ring-fence negotiated transmission services from non-regulated transmission services.
  - The AER could *exclude* specific categories of negotiated transmission services from the application of such obligations.

### The AER would be required to update its Guidelines within twelve months from the rule commencement date

- 26 The Commission's draft determination is to require the AER to review and publish its updated Guidelines within twelve months from the commencement date of any final rule (if made).

## How to make a submission

### We encourage you to make a submission

Stakeholders can help shape the solution by participating in the rule change process. Engaging with stakeholders helps us understand the potential impacts of our decisions and contributes to well-informed, high quality rule changes.

### How to make a written submission

**Due date:** Written submissions responding to this draft determination and draft rule must be lodged with Commission by **4 April 2024**.

**How to make a submission:** Go to the Commission's website, [www.aemc.gov.au](http://www.aemc.gov.au), find the "lodge a submission" function under the "Contact Us" tab, and select the project reference code **ERC0371**.<sup>1</sup>

Tips for making submissions on rule change requests are available on our website.<sup>2</sup>

**Publication:** The Commission publishes submissions on its website. However, we will not publish parts of a submission that we agree are confidential, or that we consider inappropriate (for example offensive or defamatory content, or content that is likely to infringe intellectual property rights).<sup>3</sup>

### Next steps and opportunities for engagement

We will hold a virtual public forum on 11 March 2024. The forum will provide an overview of the draft determination. Stakeholders will have the opportunity to ask questions. To register for this forum please visit our registrations page.

There are other opportunities for you to engage with us, such as one-on-one discussions or industry briefing sessions.

You can also request the Commission to hold a public hearing in relation to this draft rule determination.<sup>4</sup>

**Due date:** Requests for a hearing must be lodged with the Commission by 29 February 2024.

**How to request a hearing:** Go to the Commission's website, [www.aemc.gov.au](http://www.aemc.gov.au), find the "lodge a submission" function under the "Contact Us" tab, and select the project reference code **ERC0371**. Specify in the comment field that you are requesting a hearing rather than making a submission.<sup>5</sup>

### For more information, you can contact us

Please contact the project leader with questions or feedback at any stage.

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Telephone:	02 8296 7800

1 If you are not able to lodge a submission online, please contact us and we will provide instructions for alternative methods to lodge the submission

2 See: <https://www.aemc.gov.au/our-work/changing-energy-rules-unique-process/making-rule-change-request/our-work-3>

3 Further information about publication of submissions and our privacy policy can be found here: <https://www.aemc.gov.au/contact-us/lodge-submission>

4 Section 101(1a) of the NEL.

5 If you are not able to lodge a request online, please contact us and we will provide instructions for alternative methods to lodge the request.

## Contents

<b>1</b>	<b>The Commission has made a draft determination</b>	<b>1</b>
1.1	Our draft rule seeks to support effective competition in the market for contestable connections	1
1.2	Stakeholder concerns about the risk of discriminatory conduct shaped our draft determination	5
1.3	Our draft determination would complement recent and ongoing reforms to improve the connection process	7
<b>2</b>	<b>The draft rule would contribute to the energy objectives</b>	<b>10</b>
2.1	The Commission must act in the long-term interests of energy consumers	10
2.2	We must also take these factors into account	10
2.3	How we have applied the legal framework to our decision	10
<b>3</b>	<b>How our rule would operate</b>	<b>15</b>
3.1	The AER would have the power to specify ring-fencing obligations on TNSPs in relation to negotiated transmission services	15
3.2	The draft rule would provide flexibility to the AER	20
3.3	The AER would be required to update the Guidelines within twelve months of the rule commencement date	23
<b>Appendices</b>		
<b>A</b>	<b>Rule making process</b>	<b>24</b>
A.1	The process to date	24
<b>B</b>	<b>Regulatory impact analysis</b>	<b>25</b>
B.1	Our regulatory impact analysis methodology	25
<b>C</b>	<b>Legal requirements to make a rule</b>	<b>27</b>
C.1	Draft rule determination and draft rule	27
C.2	Power to make the rule	27
C.3	Commission's considerations	27
C.4	Civil penalty provisions and conduct provisions	27
<b>Abbreviations and defined terms</b>		
<b>29</b>		
<b>Tables</b>		
Table B.1:	Regulatory impact analysis methodology	26
<b>Figures</b>		
Figure 1.1:	Current arrangements and changes under the draft rule: scope of the AER's Guidelines	2



# 1 The Commission has made a draft determination

This draft determination is to make a more preferable draft rule to address the AER's concern that a gap in the scope of the AER's Transmission Ring-Fencing Guidelines (the Guidelines) prevents the AER from addressing the risk of discriminatory conduct associated with the provision of negotiated transmission services.<sup>6</sup> The AER's rule change request considers that there is a risk that the primary TNSP could use its exclusive right to provide non-contestable connection services (a category of negotiated transmission services) to discriminate to favour themselves or an affiliate in the market for contestable connection services.<sup>7</sup> The risk of discrimination may hinder effective competition in the market for contestable connection services in a way that reduces the efficiency of the connection process and may result in higher connection costs that are ultimately passed onto consumers.

The AER proposed to amend the NER to expand the scope of the Guidelines to include negotiated transmission services.<sup>8</sup> This would provide the AER with the necessary tools to address discrimination by enabling it to impose obligations that would require TNSPs to ring-fence their provision of negotiated transmission services from other transmission services which can be provided contestably, i.e. can be provided by any party, including by the primary TNSP.

The Commission considers that it is beneficial to make a rule change now to provide the AER with the tools to support effective competition in the market of contestable connection services given the substantial increase in demand for connection services in the context of the energy transition.<sup>9</sup>

We are seeking stakeholder feedback on this more preferable draft rule. The more preferable draft rule is referred to as 'the draft rule' in this draft determination.

## 1.1 Our draft rule seeks to support effective competition in the market for contestable connections

The Commission's draft determination is to empower the AER to impose obligations on a primary TNSP in respect of ring-fencing negotiated transmission services from non-regulated transmission services through its Guidelines as illustrated in Figure 1.1. Currently, the AER can only develop and impose obligations on TNSPs to ring-fence prescribed transmission services from other services through the Guidelines.

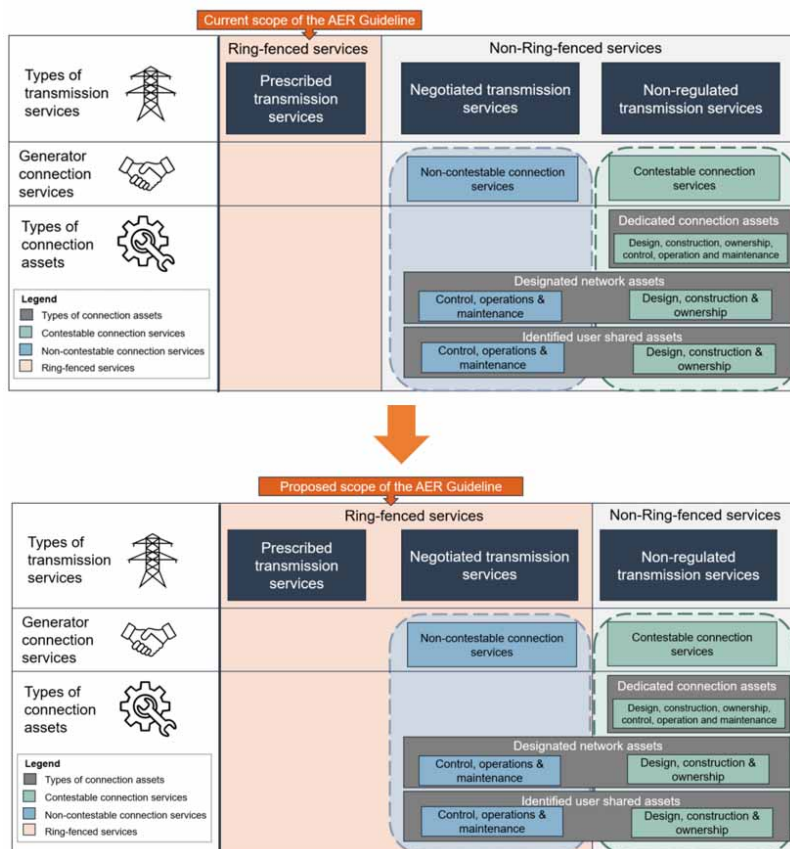
6 The Commission notes that the Transmission Ring-Fencing Guidelines is sometimes referred to as 'the Guideline' in the rule change request. In this draft determination we will refer to it as "the Guidelines" consistent with the language in the NER.

7 AER, rule change request - Expanding the transmission ring-fencing framework, p. 5.

8 Ibid, p. 25.

9 Section 1.3.1 discusses the substantial increase in the demand for connection services in more detail.

Figure 1.1: Current arrangements and changes under the draft rule: scope of the AER’s Guidelines



Source: AER, rule change request - Expanding the transmission ring-fencing framework, p. 10 & 25.

Our draft rule would not automatically impose any obligations on TNSPs. Instead, our draft rule would enable the AER to specify obligations on TNSPs and provide the AER with flexibility to:

- specify some or no obligations in respect of the provision of negotiated transmission services by a primary TNSP, and
- exclude specific categories of negotiated transmission services from the application of any obligations (see section 1.1.1 for further context on this in terms of the different categories of negotiated transmission services).

Chapter 3 discusses how our rule would operate in more detail, including the level of flexibility the AER would have under the draft rule to specify obligations on TNSPs to ring-fence negotiated transmission connection services from non-regulated transmission services.

### 1.1.1 A primary TNSP has an exclusive right to provide negotiated transmission services and can also provide non-regulated transmission services

There are three categories of transmission services defined under Chapter 10 of the NER:

- **Prescribed transmission services:** The costs of these services are recovered from all transmission network users. The AER regulates the revenue that a TNSP can recover for these services.
- **Negotiated transmission services:** The terms and conditions, including the prices, for the provision of these services are negotiated between the TNSP and another party in accordance

with Chapter 5 of the NER and are paid for by the user who needs them. The AER does not regulate the revenue that a TNSP can earn for the provision of negotiated transmission services. They consist of:

- shared network services that exceed network performance requirements (to meet jurisdictional requirements);
- non-contestable connection services provided to transmission network users (which are the focus of this rule change project);
- services specified to be negotiated services under clause 5.2A.4, for example, funded augmentations;
- undertaking system strength connection works.
- **Non-regulated transmission services:** These include contestable connection services. These services are not subject to any form of economic regulation under the NER.

Prescribed transmission services and negotiated transmission services can only be provided by the primary TNSP, whereas non-regulated transmission services are contestable.

### 1.1.2 There is a risk that TNSPs can use their exclusive right to provide non-contestable connection services to discriminate in the market for contestable connection services

The NER currently requires the AER to develop Guidelines for the accounting and functional separation of the provision of prescribed transmission services by TNSPs from the provision of other services by TNSPs.<sup>10</sup>

Additionally, the Guidelines may provide for (but are not limited to) the following obligations:<sup>11</sup>

- legal separation of the entity through which a TNSP provides network services from any other entity through which it conducts business,
- the establishment and maintenance of consolidated and separate accounts for prescribed transmission services and other services provided by the TNSP,
- allocation of costs between prescribed transmission services and other services provided by the TNSP,
- limitations on the flow of information between the TNSP and any other person, and
- limitations on the flow of information where there is the potential for a competitive disadvantage between those parts of the TNSP's business which provide prescribed transmission services and parts of the provider's business which provide any other services.

Currently, in respect of prescribed transmission services, the AER imposes obligations that include:<sup>12</sup>

- a general obligation not to discriminate,<sup>13</sup>
- requiring functional separation, for example regarding marketing where a TNSP's marketing staff must not work for an affiliate 'associate' taking part in a 'related' business,<sup>14</sup>
- information access and disclosure obligations which for example, require a TNSP to keep information that is acquired by a when providing prescribed transmission services confidential, where it is not already publicly available,<sup>15</sup> and

<sup>10</sup> Clause 6A.21.2(a) of the NER.

<sup>11</sup> Clause 6A.21.2(b) of the NER.

<sup>12</sup> See, AER, *Ring-fencing guideline for electricity transmission*, March 2023.

<sup>13</sup> Clause 4.1 of the Guidelines.

<sup>14</sup> Clause 4.3 of the Guidelines.

<sup>15</sup> Clause 4.2 of the Guidelines.

- compliance and reporting obligations which, for example, require a TNSP's compliance with its obligations to be independently verified by a suitably qualified auditor and then reported to the AER annually.<sup>16</sup>

These obligations, which require TNSPs to ring-fence prescribed transmission services from other services, seek to ensure that TNSPs do not leverage their exclusive right to provide prescribed services to discriminate in the market for other services.

In line with the AER's rule change request, we consider there is a risk that TNSPs use their exclusive right to provide non-contestable connection services to discriminate in favour of themselves or an affiliate in the contestable connections market. However, because the current scope of the Guidelines is restricted to prescribed transmission services, the AER does not empower the AER to address this risk by enabling the AER to specify any obligations in respect of negotiated transmission services (including non-contestable connection services). Existing legislation and rules may restrict blatant discrimination in some cases, but do not prevent more subtle forms of discrimination.<sup>17</sup>

### 1.1.3 Our draft rule would empower the AER to address the risk of TNSPs discriminating in the market for contestable connection services

The risk that a primary TNSP may discriminate in the market for connection services, and the lack of appropriate powers for the AER to address this risk, may hinder effective competition in the market for contestable connection services by discouraging:

- potential competitors from participating in the market for contestable connection services, where potential competitors perceive that the primary TNSP may use its exclusive right to provide non-contestable connection services to obtain a competitive advantage in the market for contestable connections, and
- connecting parties from seeking offers from parties other than the primary TNSP to provide contestable connection services.

The AER notes in its rule change request that examples of discrimination could include: increasing costs for connecting parties that choose a third-party provider, delaying connections, or otherwise providing negotiated connection services on less favourable terms compared to connecting parties that complete the full connection with the primary TNSP.<sup>18</sup>

The Commission acknowledges that these examples, in themselves, are not evidence of discriminatory behaviour. There may be legitimate reasons for differences in the cost and timelines between the connection processes where a third party provides contestable connection services and where the primary TNSP provides these services. For example, network assets like designated network assets (DNA) or identified user shared assets (IUSA) allow for contestable ownership, but the primary TNSP must provide for control, operation and maintenance of these assets as a negotiated service. Where a third party owns a DNA or IUSA, the primary TNSP and the third party owner are required to enter into a network operating agreement<sup>19</sup> (NOA) whereas a NOA is not required where the primary TNSP is to own the asset. Establishing a NOA would reasonably take time and involve additional costs.

As discussed in section 2.3 in more detail, the draft rule is in the long term interest of consumers because it seeks to improve the efficiency of the transmission connection process by supporting

<sup>16</sup> Clause 6.2 of the Guidelines.

<sup>17</sup> Section 3.1.1 discusses the limitations of existing arrangements to address the risk of all forms of discrimination in more detail.

<sup>18</sup> AER, rule change request, p. 10.

<sup>19</sup> Clause 5.3.7(a) of the AER.

competition in the market for contestable connection services. It does so by empowering the AER to impose obligations (if necessary) that would improve the confidence of potential competitors and connecting parties that there is limited risk that the primary TNSP would discriminate in favour of itself or an affiliate when providing contestable connection services. Even if the AER would not specify any obligations, simply empowering the AER to do so would support competition in the market for connection services by assuring the market that the AER has access to the full suite of regulatory tools to address the risk of discrimination.

## 1.2 Stakeholder concerns about the risk of discriminatory conduct shaped our draft determination

The Commission considers that there is a need for change. Stakeholders (except for TNSPs) raised concerns about the risk of discriminatory conduct during the TCAPA rule change, and more recently during consultation undertaken by the AER. The AER's recent consultation occurred in two parts:

- During the AER's recent review of its Guidelines, the AER's Explanatory Statement accompanying its draft Guidelines canvassed the potential harms associated with the risks of discriminatory conduct, the scope of the AER's ring-fencing powers, and whether a change to the NER to expand the ring-fencing framework to include negotiated transmission services would be supported. The AER received 24 submissions in response to its draft Guidelines.<sup>20</sup> During the AER's review of its Guidelines, stakeholders raised concerns about the risk that primary TNSPs may discriminate in favour of themselves or an affiliate when providing connection services.<sup>21</sup> The AER was unable to address these concerns during the review as the NER only authorises the AER to develop Guidelines for the provision of prescribed transmission services.
- Subsequently, the AER published a consultation paper seeking stakeholder views on two options to address the risk that primary TNSPs may engage in discriminatory behaviour. Both options would require amendments to the NER.<sup>22</sup>

The AER received 19 submissions in response to its consultation paper from a variety of stakeholders, including retailers, generators, gentailers, consumer advocacy groups, distribution network service providers (DNSPs), transmission developers and peak industry bodies. These stakeholders expressed the view that the risk of discrimination is a material problem that should be addressed urgently, due to the expected substantial increase in demand for new transmission connections from renewable energy and storage developments driven by the energy transition.<sup>23</sup> Stakeholders supported option 2, to empower the AER to specify obligations for TNSPs to ring-fence negotiated transmission services, as the most appropriate solution because it gives the AER a sufficiently broad set of tools to effectively mitigate the risk for primary TNSPs to engage in discriminatory conduct.<sup>24</sup> Stakeholders further noted that the AER may not necessarily need to use these powers or impose more onerous obligations on TNSPs because the 'threat' of ring-fencing may be sufficient, in itself, to mitigate the risk for discriminatory conduct.<sup>25</sup>

20 The AER's draft Guidelines, accompanying Explanatory Statement, and stakeholder submissions can be viewed here <https://www.aer.gov.au/industry/register/resources/guidelines/ring-fencing-guideline-electricity-transmission-2023/draft>

21 AER, rule change request, p. 5.

22 See AER, consultation paper - Review of options to address gaps in transmission ring-fencing framework, 1 March 2023, [here](#).

23 Submissions to the AER consultation paper: Flow Power, pp. 2-3; Iberdrola, p. 2; PIAC, pp. 1-2; Snowy Hydro Ltd, p. 2; Tilt Renewables, pp. 1-2; EUAA, pp. 1-2; ENGIE, p. 1; CitiPower, Powercor and United Energy, p. 1; CEFC, pp. 2-3; CEC, p. 3; Alinta, p. 1, AEO, p. 1; Ausgrid, Endeavour Energy and Essential Energy, p. 1 & AGL, p. 3.

24 Ibid.

25 For example see, Flow Power submission to the AER consultation paper, pp. 2-3.

In contrast, TNSPs considered that changes to the transmission ring-fencing framework are unwarranted because of a lack of evidence of discriminatory conduct and changes would be unnecessarily burdensome. TNSPs support timely and efficient connections and consider that ring-fencing negotiated transmission services could be costly and may slow the connections process.<sup>26</sup> The Clean Energy Council (CEC) also recognised the potential for ring-fencing to slow down the connection process, noting that any potential future obligations should not slow down the connection process.<sup>27</sup>

Stakeholders (except TNSPs) considered that it is not necessary to prove discrimination because even the potential for such behaviour can cause harm by creating uncertainty in the market and deterring new entry to, or limiting competition in, the market for contestable connection services.<sup>28</sup>

The AER's rule change request seeks to address the *risk* of primary TNSPs engaging in discriminatory behaviour in favour of themselves or an affiliate when providing contestable connection services. On this basis, the Commission considers that it is not necessary to establish that TNSPs have engaged or are engaging in discriminatory conduct to justify empowering the AER to impose obligations for the ring-fencing of a primary TNSP's provision of negotiated transmission services. We note that there are legitimate reasons why connecting parties may be reluctant to provide direct evidence of discriminatory conduct and that proving discrimination would be difficult, particularly when the conduct is subtle and less obvious.<sup>29</sup> While the Commission has not seen direct evidence of discrimination, the concerns held by stakeholders demonstrate a broader market concern that should be addressed. We consider that the risk that primary TNSPs may discriminate can reduce confidence in the competitiveness of the market for contestable connection services and that the AER should be provided with the necessary tools to address this issue.

Our draft rule is consistent with option 2 in the AER's consultation paper. We consider this option to be the most appropriate solution to addressing the risk of discriminatory conduct. However, we have made a more preferable draft rule that explicitly provides that the AER may decide:

- not to specify obligations, and
- to exclude specific categories of negotiated transmission services from any obligations imposed by the AER.

The Commission notes that it is not the policy intent that accounting and functional separation would be required between prescribed transmission services and negotiated transmission services.<sup>30</sup> 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 separate the provision of prescribed transmission services from the provision of negotiated transmission services. The intent of this rule change is to allow the AER to specify obligations for the accounting and functional separation of activities where there is a risk of discriminatory conduct in the provision of non-contestable and contestable services.

26 Submissions to the AER consultation paper: AusNet, p. 3; ENA, p. 6; TasNetworks, p. 1; Transgrid, p. 1.

27 CEC submission to AER consultation paper, p. 2.

28 Submissions to AER consultation paper: Alinta Energy, p. 3; Flow Power, p. 2; Snowy Hydro, pp. 1-2, PIAC, pp. 1-2.

29 We discuss this further in section 3.

30 AER rule change request, p. 26.

The Commission acknowledges that TNSPs would face some costs depending on the extent of obligations (if any) imposed by the AER. A more restrictive approach to ring-fencing<sup>31</sup> could significantly increase costs on TNSPs to provide contestable connection services. We acknowledge, that under specific circumstances, the costs of extensive ring-fencing obligations may outweigh any benefits derived from it.

Despite these implementation costs, the Commission considers that there is an opportunity to derive significant benefits from supporting a competitive market for contestable connection services as demand for connection services is expected to increase substantially. The Commission notes that the AER, in developing its Guidelines, should consider the costs and benefits of ring-fencing in line with its general obligation to make decisions that promote the NEO. The AER is well positioned to assess the costs and benefits of ring-fencing.<sup>32</sup> Moreover, the AER may grant waivers to exempt a TNSP from specific ring-fencing obligations if the TNSP can demonstrate that the cost of compliance would outweigh the benefits to the market.<sup>33</sup> Our more preferable draft rule provides flexibility for the AER to factor in these considerations when deciding whether to specify any obligations for primary TNSPs to ring-fence negotiated transmission services from non-regulated transmission services.

## 1.3 Our draft determination would complement recent and ongoing reforms to improve the connection process

### 1.3.1 The market for connection services is expected to grow substantially in the context of the energy transition

As noted by the AER, the market for contestable connection services is expected to grow, driven by a substantial increase in demand for new connections from renewable energy developers. The demand is a result of factors including:<sup>34</sup>

- **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. 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 connection 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, smaller players seeking to connect generation systems to the transmission network:** When the NER was developed, parties seeking to connect to the transmission network were typically large, incumbent generators. However, the number of players in the generation market has increased. Over the last decade, new entrants, including smaller players, have sought to connect that are less familiar with the regulatory framework. 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 demand for connections:** Meeting legislated decarbonisation targets as part of the energy

31 For example, strict functional separation that requires TNSPs to separate all staff involved in the provision of negotiated transmission services from staff involved in the provision of unregulated transmission services in circumstances where there are very limited resources available and few connections.

32 The AER may use its statutory information gathering powers to further investigate the costs and benefits of ring-fencing.

33 For example, the costs of staff separation may be proportionately higher for a smaller TNSP where demand for transmission connections is infrequent and lumpy. A TNSP may manage its costs by deploying specialist staff on other (i.e. regulated) activities when they are not required for connection activities.

34 AER, rule change request, p. 18.

transition will require the connection of an unprecedented amount of generation capacity at an unprecedented rate. The ISP forecasts that variable renewable energy resource generation capacity will need to triple between now and 2030. This significant growth in generation capacity is evidenced by the number of new projects seeking to connect, with an increase in the size of the connection queue from 389 projects in July 2022 to 524 projects in May 2023.<sup>35</sup>

### 1.3.2 The draft rule complements recent and ongoing regulatory reform

The Commission established and further developed the existing transmission connection arrangements through the following previous rule changes:

- **Transmission connections and planning arrangements (TCAPA):** The final rule introduced a clear distinction between contestable and non-contestable transmission services relating to assets relevant to the connection of a connecting party. The Commission acknowledged that these changes had implications for a TNSP's compliance with the AER's Guidelines.<sup>36</sup> The Commission acknowledged that a restrictive approach to ring-fencing may affect the ability and incentives for primary TNSPs to participate in a market for the provision of contestable connection services.<sup>37</sup>
- **Connection to dedicated connection assets (DCA):** The final rule introduced a new category of network asset called a DNA.<sup>38</sup>
  - A DNA is a material addition to the transmission system (i.e. those including transmission lines with a total route length of 30km or more), which is used exclusively by an identified user group and is not used to provide prescribed services. DNAs replaced the concept of 'large DCAs' (which had been introduced under TCAPA).
  - 'Small DCAs' (i.e. transmission lines with a total route length of less than 30km) continue to be treated as connection assets unless they voluntarily choose to opt into the DNA framework. Whereas all aspects of DCAs can be provided contestably, DNAs form part of the transmission network and the primary TNSP must control, operate and maintain the DNA and provide the functional specification as a negotiated service. Only design, construction, and ownership are contestable.

The DCA rule change thus reduced contestability by preventing third parties from controlling, operating, and maintaining as well as providing the functional specification for powerlines 30km or more. The Commission recognised the rule limited contestability but considered that the greatest benefits from allowing competition in the provision of transmission network services are likely to arise during construction, which remained contestable. Classifying DNA control, operation, maintenance and providing functional specification for DNAs as negotiated services increased the scope of negotiated services compared to under the previous arrangements for large DCAs.

These rule changes did not make any amendments to the transmission ring-fencing arrangements because it was out of the scope of these rule changes. However, both rule changes emphasised the importance of competition in the provision of contestable connection services while recognising that it is essential for TNSPs to be the clear, single point of accountability for shared network outcomes. This draft rule would complement these previous rule changes by empowering the AER to support a competitive market for the provision of contestable connection services.

35 See network connections scorecard [here](#).

36 AEMC, Transmission Connection and Planning Arrangements final determination. 23 May 2017, p. 167.

37 Ibid.

38 AEMC, Connection to dedicated connection assets final determination. 8 July 2021.



In addition to this draft rule, other current reforms to improve the transmission connection process include:

- **Connections reform initiative (CRI)** - The CEC, AEMO, TNSPs and renewable energy developers have collaborated through the CRI to develop solutions to address the most pressing systemic concerns with the NEM's transmission connection process.<sup>39</sup>
- **The *Enhancing investment certainty in the R1 process rule change*** - The CEC submitted a rule change request seeking to provide greater clarity in the NER on the requirements, process steps, and responsibilities associated with assessing and approving the connection of new generation to the NEM. The Commission seeks to publish a draft determination in March 2024.<sup>40</sup>

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39 See [here](#) for more information about the CRI.

40 Please visit the [project page](#) for more information about the rule change.

## 2 The draft rule would contribute to the energy objectives

The draft rule would contribute to the NEO by empowering the AER to develop fit for purpose Guidelines that support market efficiency in the provision of contestable connection services.

### 2.1 The Commission must act in the long-term interests of energy consumers

The Commission can only make a rule if it is satisfied that the rule will or is likely to contribute to the achievement of the relevant energy objectives.<sup>41</sup> For this rule change, the relevant energy objective is the NEO. The NEO is:<sup>42</sup>

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; and
- (c) the achievement of targets set by a participating jurisdiction—
  - (i) for reducing Australia’s greenhouse gas emissions; or
  - (ii) that are likely to contribute to reducing Australia’s greenhouse gas emissions.

The targets statement, available on the AEMC website, lists the emissions reduction targets to be considered, as a minimum, in having regard to the NEO.<sup>43</sup>

### 2.2 We must also take these factors into account

#### 2.2.1 We have considered whether to make a more preferable rule

The Commission may make a rule that is different, including materially different, to a proposed rule (a more preferable rule) if it is satisfied that, having regard to the issue or issues raised in the rule change request, the more preferable rule is likely to better contribute to the achievement of the NEO.<sup>44</sup>

For this rule change, the Commission has made a more preferable draft rule. The reasons are set out in section 2.3 below.

### 2.3 How we have applied the legal framework to our decision

The Commission must consider how to address the risk that TNSPs discriminate in favour of themselves or an affiliate when providing contestable connection services due to their exclusive right to provide non-contestable connection services against the legal framework.

41 Section 88(1) of the NEL.

42 Section 7 of the NEL.

43 Section 32A(5) of the NEL.

44 Section 91A of the NEL.

We have identified the following criteria to assess whether the proposed rule change, no change to the rules (business-as-usual), or other viable, rule-based options are likely to better contribute to achieving the NEO:

- **Principles of market efficiency:** does the draft rule empower the AER to support effective competition in the market for contestable connection services?
- **Principles of good regulatory practice:** does the draft rule promote flexibility and consistency within the regulatory framework?
- **Implementation considerations:** does the draft rule provide for timely implementation of any updated AER Guidelines?

These assessment criteria reflect the key potential impacts – costs and benefits – of the rule change, for impacts within the scope of the NEO.

The Commission has undertaken regulatory impact analysis to evaluate the impacts of the various policy options against the assessment criteria. Appendix B outlines the methodology of the regulatory impact analysis.

The rest of this section explains why the draft rule, which is a more preferable draft rule, best promotes the long-term interest of consumers assessed against the criteria.

### 2.3.1 Empowering the AER to address the risk of discrimination supports market efficiency through effective competition

The Commission's draft rule would support market efficiency by supporting effective competition in the provision of contestable connection services. In the market for contestable connection services, greater competition would support three forms of efficiency:

- productive efficiency would be enhanced by firms competing to provide timely connection services at the lowest cost,
- allocative efficiency would be enhanced by connecting parties having greater choice in the trade-offs they can make between timelines, costs and methods of construction, while firms competing to provide the work will have less ability to charge above the marginal costs of providing the service, and
- dynamic efficiency would be enhanced as TNSPs and potential competitors innovate and find new ways to deliver more timely and less costly connection services.

An effectively competitive market for contestable connection services should ultimately reduce the system costs of the energy transition which ultimately means lower costs passed onto consumers.

The risk that primary TNSPs may discriminate could hinder effective competition in the market for contestable connection services, e.g. by discouraging connecting parties from seeking offers from potential competitors (i.e. third party service providers) if the connecting party believes that the primary TNSP would treat their connection application on less favourable terms than when the primary TNSP is engaged to provide the contestable connection services. This in turn would discourage potential competitors from participating in the market if they consider that connecting parties are less likely to tender their services.

The draft rule would provide potential competitors and connection applicants with greater confidence in the competitiveness of the market for contestable connection services as the AER would have the regulatory tools to address the risk of discriminatory conduct. Ultimately, even if minimal, or no, obligations were specified by the AER, the ability for the AER to do so may sufficiently mitigate the risk of discriminatory conduct.

We acknowledge TNSPs' concerns that enabling the AER to impose obligations in respect of non-contestable connection services may reduce the efficiency of the connection process. This is because any obligations the AER may impose, depending on the extent of these obligations, could slow down the connections process or could increase the costs to TNSPs to provide contestable connection services, which would ultimately be passed on to consumers.<sup>45</sup>

The Commission notes that there may be some natural efficiencies in having the TNSP perform all connection services. However, the Commission also notes the long-standing concerns raised by connecting parties about the timeliness and costs of the connection process due to TNSPs' monopoly power in negotiating connections and the lack of incentives to provide an efficient service. Against this background, and in contrast to TNSPs' concerns, we consider this draft rule could potentially promote efficiencies in TNSPs' provision of connection services in the context of a more competitive market for connection services.

The Commission considers that the potential benefits of effective competition, in the context of the substantial increase of demand for contestable connection services<sup>46</sup> would outweigh any potential implementation costs and supports the need for our draft rule. We also emphasise that the AER would need to undertake a rigorous consultation process to determine the costs and benefits of any specific amendments to the Guidelines as part of its review.<sup>47</sup>

### 2.3.2 Maintaining a principles-based approach aligns with good regulatory practice in terms of providing for flexibility and consistency

#### **The draft rule would maintain the current principles-based approach to ring-fencing under the NER**

The Commission's draft rule would maintain the current principles-based approach to ring-fencing, rather than prescribing specific obligations in the NER that the AER should impose on TNSPs.

Under the draft rule, the AER would have the flexibility to determine any obligations in respect of negotiated transmission services. As discussed in section 3.2, the more preferable rule clarifies that the AER would not be required to specify any obligations in respect of negotiated transmission services and that the AER may decide to impose obligations on some specific categories and not others. In developing the Guidelines, the AER must exercise its power in a manner that will or is likely to contribute to the NEO. In determining the need for and appropriateness of any ring-fencing obligation, the AER should be guided by the costs and benefits of its decisions.

The Commission considers that a principles-based rule allows the AER to further develop the ring-fencing framework for negotiated services on an as needs-basis and flexibly respond to evolving market developments over time based on stakeholder feedback received as part of the consultation process when the AER reviews and updates the Guidelines.

#### **The draft rule would provide a consistent approach in the way that the AER manages the risk of discriminatory conduct for prescribed transmission services and distribution services**

Our draft rule would create consistency in the current regulatory approach for managing the inherent risks of discriminatory conduct whenever a monopoly provider of an essential service (in this case access to the transmission network) is allowed to participate in competitive activities that depend on that service. Similar arrangements exist for managing these risks in the provision

<sup>45</sup> Submissions to the AER consultation paper: AusNet, p. 3; ENA, p. 6; TasNetworks, p. 1; Transgrid, p. 1.

<sup>46</sup> See the discussion in section 1.3

<sup>47</sup> AER, rule change request, p. 33.

of prescribed transmission services and distribution services under which the AER is empowered to specify obligations for the ring-fencing of the monopoly elements of those services.<sup>48</sup>

The Commission notes TNSPs concerns that the draft rule would simply result in an extension, or replication, of existing ring-fencing obligations for prescribed transmission services and distribution services to approaches to negotiated transmission services.<sup>49</sup> The Commission has previously acknowledged that a more restrictive approach to ring-fencing may also affect the ability and incentives for TNSPs to participate in a market for the provision of contestable connection services and may affect the degree of competition for contestable services.<sup>50</sup>

The Commission emphasises that the purpose of the draft rule is to ensure that the AER is properly authorised to carry out its regulatory responsibilities to address risks of discriminatory conduct (and more generally, anti-competitive behaviour) that may hinder effective competition. We consider that there is a gap in existing regulatory arrangements that prevent the AER from doing so. In empowering the AER accordingly, the Commission notes that the AER must exercise its power in a manner that will, or is likely to, contribute to the NEO and the AER has stated that it would conduct a rigorous consultation process to determine the cost and benefits of any amendments to the Guidelines before deciding whether to specify any obligations.<sup>51</sup> This would require it to consider the specific circumstances of the market for contestable connection services and evaluate the differences between the operating environments of distribution and transmission businesses, and not simply extend existing ring-fencing obligations to the provision of negotiated transmission services.

Our draft rule would also create a consistent approach across the NEM for managing the risks of discriminatory conduct in the provision of negotiated transmission services, as ring-fencing arrangements would apply in Victoria. While we understand the appeal of introducing further obligations in Chapter 5 of the NER relating to transmission connections, we note that not all provisions in Chapter 5 of the NER apply in Victoria. In contrast, the obligation on TSNPs to comply with the Guidelines applies universally across the NEM.<sup>52</sup>

### 2.3.3 Our draft rule would facilitate timely implementation of any updates to the AER's Guidelines

As discussed in section 3.3, the draft rule would require the AER to review and update the Guidelines within 12 months of the rule commencement date. The Commission acknowledges the significant work being undertaken across the industry over the next 12 months with the AER conducting several guideline updates and we recognise that the Guidelines update, required by our draft rule, would add to the workload of TNSPs, the AER, and other stakeholders.

However, we consider that it is important that stakeholders have regulatory certainty as soon as practicable about the need for, and detail of, specific obligations for the ring-fencing of negotiated transmission services given:

- ongoing stakeholder concerns for several years,
- the substantial increase in demand for new transmission connections from renewable energy and storage developments in the context of the energy transition, and

48 Clause 6.17.2 of the NER requires the AER to develop guidelines for the accounting and functional separation of the provision of direct control services by DNSPs from the provision of other services. Clause 6A.21.2 of the NER requires the AER to develop guidelines for the accounting and functional separation of the provision of prescribed transmission services by TNSPs from the provision of other services by TNSPs.

49 See for example AusNet's submission to the AER consultation paper, p. 4.

50 AEMC, *Transmission Connection and Planning Arrangements* final determination, 23 May 2017, p. 167.

51 AER, rule change request, p. 33.

52 Clause 6A.21.1 of the NER. The Commission notes that while Chapter 6A of the NER does not apply in the Northern Territory, network businesses in that jurisdiction are required to comply with Ring-fencing Guidelines Electricity Distribution under clause 6.17.1 of the NER.

- the additional time the AER must specify in the Guidelines for TNSPs to implement any changes to the Guidelines.

## 3 How our rule would operate

### 3.1 The AER would have the power to specify ring-fencing obligations on TNSPs in relation to negotiated transmission services

#### **Box 1: Draft determination - AER would have the power to specify ring-fencing obligations on TNSPs in relation to negotiated transmission services**

Our draft determination is to provide the AER with the power to specify (or not to specify) ring-fencing obligations in relation to negotiated transmission services in its Guidelines.

The draft rule only relates to the ability of the AER to specify ring-fencing obligations for negotiated transmission services. It does not, itself, impose any new ring-fencing obligations on TNSPs. The AER would, as part of a review of its Guidelines, consider the need for any obligations on TNSPs to ring-fence negotiated services from non-regulated transmission services. Stakeholders would be able to provide feedback in response to the AER's consultation on any changes to its Guidelines.

Section 3.1.1 provides a detailed discussion of the gap under the current arrangements.

Section 3.1.2 discusses the reasons for our draft rule in terms of why we consider that empowering the AER to expand the scope of the Guidelines is likely to improve effective competition in the market for contestable connection services.

Section 3.2 provides further detail on how our draft rule would provide the AER with flexibility to develop fit-for-purpose ring-fencing arrangements for the primary TNSP's provision of non-contestable connection services from its provision of contestable connection services. This flexibility recognises that there are existing measures in the transmission connections framework that mitigate the risk of discriminatory conduct in the provision of connection services and enables the AER to specify obligations to manage residual risks depending on prevailing market conditions.

#### **3.1.1 There is a potential for TNSPs to discriminate under the current arrangements, reducing the competitiveness of the connections market**

##### **Contestability in transmission connections and the risk of discrimination**

The Commission considers, in line with the majority of stakeholders (except for TNSPs), that the risk to discriminate exists for the connection of DNAs and/or IUSAs as these assets will form part of the shared network for which the TNSP ultimately remains responsible, and connection services for these assets will involve non-contestable (for example, operation and maintenance) and contestable (for example, design and construction) elements.

A similar risk exists for the connection of DCAs. Even though services for the design, construction, ownership, operation and maintenance of a DCA are fully contestable, a connecting party is still required to engage TNSPs to provide non-contestable connection services to connect a DCA to the shared network. This is because a DCA connects to the shared network through an IUSA or DNA.

Such discriminatory conduct could involve:<sup>53</sup>

<sup>53</sup> ENA engaged Incenta Economic Consulting to assist with an analysis of potential harms. See ENA's submission to the AER's consultation paper, p.8 and also *Competition issues for contestable transmission connection projects - ENergy Networks Australia*, Incenta Economic Consulting p.16

- Cost shifting to the regulated business to make a TNSP's competitive offer more competitive.
- Charging a price for operating and maintenance costs for a DNA and/or IUSA that is above the cost of supply with the aim of increasing the total cost of a competitor's offer.
- In the functional specification for a network asset, imposing technical obligations in a TNSP's favour.
- Using confidential information obtained under a TNSP's regulatory functions to give it an advantage in the provision of contestable connection services.
- The conduct of the TNSP during the connection process discriminates against competitors, for instance, by delaying processes.

TNSPs have noted in their submissions that their obligations under Chapter 5 of the NER restrict their ability to engage in discriminatory conduct and that there are legitimate reasons why there are differences in the costs and timeliness of the connections processes where a third party is engaged to provide contestable services.<sup>54</sup> For example:

- **Cost allocation obligations in the NER and the AER's Cost Allocation Guidelines**<sup>55</sup> prevent TNSPs from shifting costs between regulated and unregulated transmission services. For example, only costs which are directly attributable to the provision of a particular category of transmission service can be allocated to that service.<sup>56</sup>
- **General and specific negotiating principles that govern the behaviour of the TNSP and a connecting party** when agreeing the price, standard, conditions and timing of negotiated transmission services mitigate the risk of TNSPs setting inefficient prices for the operation and maintenance of third-party assets. For example, the NER requires that parties negotiate in good faith<sup>57</sup> and that the price for a negotiated transmission service should be based on the costs incurred in providing that service.<sup>58</sup>
- **The ability for a connecting party to seek the advice of an independent engineer on technical issues** in relation to negotiated transmission services<sup>59</sup> would address concerns that the TNSP is imposing unfavourable technical obligations in relation to a connection.
- **Restrictions around the use of confidential information**, including restricting TNSPs from using information received in relation to its provision of non-contestable services for the purpose of providing contestable services<sup>60</sup> would prevent the TNSP from using such information to its advantage when bidding for the contestable component of a connection.
- **Requirements on the TNSP to provide information to connecting parties and complete certain steps in the connection processes within set timeframes**<sup>61</sup> are intended to improve the efficiency of the connection process.

### **The Commission considers that the current arrangements do not fully mitigate the risk of discriminatory conduct**

The Commission considers that there remains a residual risk of TNSPs engaging in discriminatory conduct when providing contestable connection services despite the protections embedded in Chapter 5 of the NER because:

54 Ibid. See also the submissions from AusNet p.3, TasNetworks p.2, Transgrid p.2.

55 Clause 6A.19 of the NER.

56 Clause 6A.19.2(3)(i) of the NER.

57 Clause 5.3.6(f) of the NER.

58 Schedule 5.11(1) of the NER.

59 Rule 5.4 of the NER.

60 Clause 5.3.8(a1) of the NER.

61 See generally Rule 5.3 of the NER.



- Some types of discriminatory conduct would likely not be overt or obvious and clearly detectable but would instead likely be subtle and difficult to detect.
- Connecting parties, whether large or small, would be reluctant to raise concerns about a primary 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.

***Subtle and less obvious forms of discrimination are difficult to detect***

The Commission's TCAPA and DCA final rules established and confirmed that the primary TNSP is accountable for outcomes on the shared transmission network, which includes IUSAs and/or DNAs. Having a third party design, construct, and/or own the IUSA and/or DNA means that the TNSP must carry out additional steps to satisfy itself that the network asset will not adversely affect shared network outcomes. For example:

- Where a third party is responsible for providing the detailed design of the network asset, the TNSP would need to review the detailed design to assess its technical performance against the functional specification, and the connecting applicant must provide any additional information that the TNSP reasonably requires to undertake this assessment so that it can provide an offer to connect.<sup>62</sup>
- Third-party ownership of an IUSA or DNA, where the third-party owner (which can, for example, be the connecting party) must negotiate and enter into a NOA with the TNSP.<sup>63</sup> The NOA provides for the TNSP to control, operate and maintain the asset.

The Commission notes that these additional steps would legitimately add time to a connection process. As a result, a connecting party may choose to have the TNSP provide all aspects of the connection (including the contestable elements) providing for a more streamlined process.<sup>64</sup>

The risk, in these circumstances, is that there is the potential for the primary TNSP to use the cover of legitimate cost increases and/or delays to mask discriminatory conduct that would advantage its bid to provide contestable connection services, on the basis that the need for additional steps is avoided should the connecting party choose the primary TNSP to provide all connection services.

For example, a TNSP may delay the provision of an offer to connect where a third party provides detailed design of a network asset on the basis that it needs to assess the compliance of the design against the functional specification. While the services of an Independent Engineer can be used to assess compliance, the decision of the Independent Engineer is not binding on parties.<sup>65</sup> The Independent Engineer's advice is also limited to the technical aspects of the connection and does not include matters relating to the cost or commercial terms, or timing of the connection.<sup>66</sup> While the TNSP may be required to provide the offer to connect within the timeframes specified in the preliminary program,<sup>67</sup> the preliminary program can be modified from time to time by agreement of the parties, where such agreement must not be unreasonably withheld.<sup>68</sup> A connecting party that is seeking to use a third party to provide detailed design services cannot be confident that delays are a result of legitimate reasons or a result of discriminatory conduct.

62 Clause 5.3.5(a)(c) of the NER.

63 Clause 5.3.7(a)(2) of the NER.

64 ENA submission to the AER consultation paper, p. 4.

65 Clause 5.4.5(h) of the NER.

66 Clause 5.4.1(c) of the NER.

67 Clause 5.3.6(a)(1) of the NER.

68 Clause 5.3.2(b)(6) of the NER.

The potential for confidential information to be misused is another harm that is not adequately addressed under the current rules.

- The rules impose strict obligations as to the use of confidential information<sup>69</sup> and the Commission acknowledges that TNSPs are committed to fulfilling their obligations under the NER, with no exception in relation to obligations around confidentiality. However, we note that TNSPs are not required to explain how they are complying with these obligations and there is limited monitoring and reporting in this respect. We also note that while there are prohibitions against the disclosure of confidential information, it would be very difficult in circumstances where employees are permitted to participate in both the regulated and non-regulated activities of the TNSP to ensure that an employee in possession of confidential information (gained from the regulated business) is not using that information in a way that is advantageous to the TNSP. The Commission also notes that the obligations on TNSPs around the use of confidential information are not civil penalty provisions and as a result the prohibitions may not have a strong deterrence effect.

Consequently, the Commission considers there is a gap in the regulatory framework because:

- there is a risk of subtle and less obvious forms of discrimination to occur as a result of the primary TNSP having an exclusive right to provide non-contestable connection services, and being able to participate in the market for contestable connection services, and
- the AER does not currently have the power to address this risk of discrimination.

The Commission considers that it is appropriate to confer a power on the AER to develop obligations for the provision of non-contestable connection services. Even if TNSPs are not engaging in discriminatory conduct, the potential ability for them to do so would be harmful to the development of a competitive market for contestable connection services (as set out in more detail in Chapter 2).

### ***Reluctance by connecting parties to raise concerns***

Connecting parties may be reluctant to raise concerns about a primary TNSP's behaviour given the importance they would attach to maintaining an ongoing working relationship with the TNSP as the only entity that can facilitate a connection to the network. The consequence is that the connecting party would also be reluctant to avail itself of existing measures in the NER for resolving disputes, such as the commercial arbitration arrangements for negotiated transmission service disputes.<sup>70</sup> The connecting party's decision to make use of arbitration processes would be significantly influenced by the perception that its current (and future) connections would receive unfavourable treatment by the TNSP.

The reluctance to raise concerns and take action applies equally to both large and well-resourced entities as well as smaller players that are entering the market. These parties would be driven by the same commercial imperatives to achieve a fast and cost-efficient connection to the network as any delays could materially impact the economic viability of their projects. It is reasonable to assume that connecting parties, whether large or small, would seek to avoid actions that would therefore jeopardise their relationship with the only entity that controls access to the network. These parties would be even less inclined to report concerns in circumstances where the discriminatory conduct is less obvious and not easily detectable.

<sup>69</sup> Clause 5.3.8(a) and (a1) of the NER

<sup>70</sup> Rule 5.5 of the NER.

### 3.1.2 Alternatives to ring-fencing would either not adequately address the risks of discriminatory conduct or be too inflexible

The Commission has considered the following alternative options to the draft rule to mitigate the risk of discrimination in the provision of contestable connection services:

- Introducing compliance reporting obligations under Chapter 5 of the NER (as also considered by the AER in its consultation paper)
- Relying on existing regulatory measures, including the misuse of market power provision of the CCA
- Prescribing ring-fencing obligations under the NER.

#### ***Introducing compliance reporting obligations under Chapter 5 of the NER***

The AER consulted on the adequacy of introducing compliance reporting obligations in the NER as an alternative means of mitigating the risks of discriminatory conduct. Under this option, new obligations would be introduced into Chapter 5 of the NER to require TNSPs to report on how they are complying with their obligations under Chapter 5 of the NER. Introducing a compulsory obligation in the NER on TNSPs to report on their compliance with relevant provisions of Chapter 5 of the NER would provide the AER with more visibility about potential issues in the connections process.

The Commission notes that these obligations would not directly address the risk of discriminatory conduct and would not support market efficiency through effective competition.<sup>71</sup>

We further note that placing these obligations in the NER would create an inconsistent approach across the NEM as some provisions in Chapter 5 of the NER do not apply in Victoria. This does not align with good regulatory practice.<sup>72</sup>

We consider that these reporting obligations would be better placed in the Guidelines, which would have universal application across the NEM (noting that the decision to specify obligations on TNSPs (if any) in relation to negotiated services would ultimately be one for the AER to make). This approach would better align with principles of good regulatory practice by creating a consistent approach to addressing the risks of discrimination across jurisdictions. The AER's Guidelines 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. The AER would have the ability to monitor how TNSPs operate in the negotiated transmission space and this would provide more information about the efficiency of the connections process that would inform future rule changes or Guidelines reviews.

#### ***Relying on the arrangements under the CCA***

The Commission notes that connecting parties may bring claims under the *Competition and Consumer Act 2010* (Cth) in certain circumstances where they believe that the TNSP is engaging in discriminatory conduct (for example, if it involves a misuse of market power). We note that there is a high bar to proving such claims, making it a challenging, costly and prolonged process for investigating and taking legal action.

Another shortcoming of relying on the CCA is that it requires a connecting party to identify non-compliance and report it to the relevant regulatory entity or take legal action. As we have noted earlier, connecting parties, whether large or small, may be reluctant to raise concerns about a

<sup>71</sup> See our discussion in section 1.3.1

<sup>72</sup> See our discussion in section 1.3.2

TNSPs behaviour given the need for an ongoing working relationship with the TNSP as the only entity that can facilitate a connection to their network.

The Commission considers that empowering the AER to specify obligations in respect of TNSPs' provision of negotiated transmission services would allow the AER to create industry-specific obligations to address the risks of discriminatory conduct. This approach would better promote the NEO by targeting specific risks that would support effective competition in the market for contestable connection services.

### ***Prescribing ring-fencing obligations under the NER***

The Commission does not consider that it would be appropriate to set out obligations in respect of ring-fencing in the NER as this would significantly reduce the flexibility provided under a principles-based approach. A principles-based approach aligns with good regulatory practice and allows the AER to develop the ring-fencing framework for negotiated transmission services on an 'as-needs' basis to flexibly respond to market developments over time.

This option would also result in an inconsistent approach in how the risks of discriminatory conduct are managed for negotiated transmission services and for prescribed transmission services and distribution network services (which adopt a more flexible principles-based approach).

## **3.2 The draft rule would provide flexibility to the AER**

The Commission's draft determination is to make a more preferable draft rule that explicitly clarifies, for avoidance of doubt, that the AER has flexibility when deciding whether or not to specify obligations for TNSPs to ring-fence negotiated transmission services from contestable connection services.<sup>73</sup> This means that:

- The AER could decide *not* to specify any new obligations for TNSPs to ring-fence negotiated transmission services from non-regulated transmission services.
- The AER could *exclude* specific categories of negotiated transmission services from the application of such obligations.

This flexibility would enable the AER to respond to evolving market conditions and changing circumstances and manage TNSPs' concerns about the costs of ring-fencing negotiated transmission services.

We note that the current rules require the AER to consider the need for consistency between the Transmission Ring-Fencing Guidelines and the Distribution Ring-Fencing Guidelines. In the Commission's view, consideration of the specific operating environments of transmission businesses (relative to distribution businesses) would support the AER in developing bespoke fit-for-purpose obligations for the provision of negotiated transmission services.

Providing the AER with flexibility to determine the extent (if any) of obligations and to exclude specific categories of negotiated services from the ring-fence is further consistent with the assessment criterion of principles of good regulatory practice, underlying this rule change project (see the discussion in Chapter 2).

<sup>73</sup> Clause 6A.21.2(a1) of the draft rule.

### 3.2.1 The AER may decide not to specify any ring-fencing obligations for negotiated transmission services

#### Box 2: Draft determination - No requirement for the AER to specify any obligations for the provision of negotiated transmission services

The draft rule would clarify that the AER, in relation to negotiated transmission services, may decide to:

- not specify any obligations,
- specify some or apply all obligations (that currently apply to prescribed transmission services) following a review of the Guidelines.

As a result, the AER the ring-fencing arrangements for negotiated transmission services compared to the arrangements for prescribed transmission services under the NER could differ.

The Commission expects that should the AER decide not to specify any ring-fencing obligations for the provision of negotiated transmission services, that it would provide reasons for doing so in its Explanatory Statement to the Guidelines.

The AER's rule change request outlines the types of obligations that the AER may decide to implement. These could include:<sup>74</sup>

- **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:
  - 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 the current Guidelines** to include prohibiting discrimination between an affiliate and competitor in connection with the provision of negotiated transmission services. The existing general non-discrimination obligations are targeted at preventing a TNSP from:
  - giving itself or its affiliate a financial benefit that is not available to its competitors
  - giving customers of its affiliate a financial or non-financial benefit that would not be available to them if they were customers of a competitor of the affiliate
  - using its position as a TNSP to advantage its affiliate in competing to provide contestable services.
- **Extending the definition of ring-fenced information under the current Guidelines 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 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

<sup>74</sup> AER, rule change request, p. 27-28. With the exception of additional reporting obligations, these measures are similar to those provided under the existing Guidelines.

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 relevant obligation under 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.

If the AER were to specify obligations for negotiated transmission services, we note that TNSPs would be able to seek a waiver from all or some of the obligations if they were able to demonstrate, to the AER's satisfaction, that they have rigorous processes in place to manage the risks of discrimination and/or that the costs of implementing the obligations would outweigh benefits to the market. For example, if the AER were to impose functional separation to address the risk of unintended disclosure of confidential information, TNSPs could demonstrate to the AER how the temporary quarantining of staff during the connections process adequately addresses this risk in their waiver application. We note that the waiver mechanism places the obligation on TNSPs to demonstrate how their processes support a clear and transparent connection process and address the potential for discrimination in the provision of contestable connection services.

### 3.2.2 The AER could exclude specific categories of negotiated transmission services from ring-fencing obligations

**Box 3: Draft Determination - The AER may exclude specific categories of negotiated transmission services from the ring-fencing obligations in the Guidelines**

The draft rule enables the AER to exclude some or all categories of negotiated transmission services from ring-fencing obligations in the Guidelines.

Our draft rule clarifies that the AER can decide to exclude specific categories of negotiated transmission services from ring-fencing obligations in the Guidelines. For example, the AER may impose obligations on TNSPs providing some specific categories of negotiated services, but exclude other specific categories where there are no identified issues.

Under the drafting proposed by the AER in its rule change request, the scope of the ring-fencing framework would be extended to include the provision of all negotiated transmission services. During the AER's consultation on this issue, stakeholders' concerns about the risks of discriminatory conduct were directed primarily towards the provision of contestable connection services, and not the other categories of negotiated transmission services.<sup>75</sup>

<sup>75</sup> The NER defines four categories of negotiated transmission services. See section XX.

The Commission notes that TNSPs could apply for a waiver from the AER to exempt them from the application of obligations under the Guidelines for specific categories of negotiated services. However, we understand that the process for applying for waivers is time-consuming and administratively burdensome. Providing the AER with the ability to carve out specific categories of negotiated services from the application of obligations from the outset would avoid the need for an additional waiver process.

As discussed in Section 2, in relation to our assessment criteria, providing the AER with clear flexibility helps ensure a smooth implementation of the rule by mitigating the risk of unintended consequences and the need for waiver processes.

### 3.3 The AER would be required to update the Guidelines within twelve months of the rule commencement date

**Box 4: Draft Determination - The AER must update the Guidelines within twelve months of the rule commencement date**

The draft rule would require the AER to review and update the Guidelines within twelve months of the rule commencement date, in accordance with the transmission consultation procedures.

Our draft determination is to require the AER to update the Guidelines within twelve months from the rule commencement date (which would be two weeks after the final rule publication date).<sup>76</sup> The AER would be required to do so in accordance with the transmission consultation procedures.<sup>77</sup>

This means that the AER must publish its updated Guidelines, which would need to include references to negotiated transmission services, before 30 May 2025. The AER would specify a subsequent transitional period in its updated Guidelines for TNSPs to implement any new obligations to ring-fence negotiated from non-regulated transmission services.

The implementation time frame under the draft rule is a change from the AER's proposal, which specified eighteen months for the AER to amend its Guidelines. The Commission's decision on the implementation time frame was guided by the urgency of the issue in the context of a substantial increase in demand for new transmission connections from renewable energy and storage developments to facilitate the energy transition. That being said, we acknowledge resourcing constraints given the significant work being undertaken across the industry over the next twelve months with the AER conducting several guideline updates.

<sup>76</sup> Clause 11.[1].2 of the draft rule.

<sup>77</sup> The procedures for consultation with registered participants or other persons as set out in Rule 6A.20 of the NER.

## A Rule making process

A fast track rule change request includes the following stages:

- a proponent submits a rule change request
- the Commission initiates the rule change process by publishing a notice which communicates the Commission's decision to fast track the rule change
- the Commission publishes a draft determination and draft rule (if relevant)
  - stakeholders lodge submissions on the draft determination and engage through other channels to make their views known to the AEMC project team
- the Commission publishes a final determination and final rule (if relevant).

You can find more information on the rule change process on our website.<sup>78</sup>

### A.1 The process to date

On 18 January 2024, the Commission published a notice advising of its intention to initiate the rule making process in respect of the rule change request.<sup>79</sup> The Commission decided to fast track this rule change request. This is because it concluded that the consultation carried out by the AER was adequate having regard to the nature and content of the request.<sup>80</sup>

Accordingly, the Commission did not publish a consultation paper upon initiation of the rule change process and there has been no formal consultation carried out by the AEMC in this rule change process to date.

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78 See our website for more information on the rule change process: <https://www.aemc.gov.au/our-work/changing-energy-rules>.

79 This notice was published under section 95 of the NEL.

80 The decision to fast track the rule change request was made under section 96A(1)(a) of the NEL.



## B Regulatory impact analysis

The Commission has undertaken regulatory impact analysis to make its draft determination.

### B.1 Our regulatory impact analysis methodology

#### **We have considered a range of policy options**

The Commission compared a range of viable policy options that are within our statutory powers. The Commission analysed these options: the rule proposed in the rule change request; a business-as-usual scenario where we do not make a rule; and a more preferable rule featuring more explicit flexibility on the AER to impose obligations on TNSPs. These options are described in section 3.1.

#### **We have identified who would be affected and assessed the potential benefits and costs of each policy option**

The Commission's regulatory impact analysis for this rule change used qualitative methodologies. It involved identifying the stakeholders impacted and assessing the potential benefits and costs of policy options. The depth of analysis was commensurate with the potential impacts. The Commission focused on the types of impacts within the scope of the NEO.

Table B.1 summarises the regulatory impact analysis the Commission undertook for this rule change.

Based on this regulatory impact analysis, the Commission qualitatively evaluated the potential costs and benefits of policy options against the assessment criteria discussed in section 2.3. Based on this qualitative assessment, the Commission considers that our draft rule would deliver benefits for consumers by supporting effective competition in the market for contestable connection services. Effective competition will ultimately reduce the system costs of the energy transition, with lower costs passed onto consumers.

**Table B.1: Regulatory impact analysis methodology**

Assessment criteria	Primary costs Low, medium or high –	Primary benefits Low, medium or high –	Stakeholders affected	Methodology QT = quantitative, QL = qualitative
Principles of market efficiency	Potential increase in costs to connecting parties if TNSP withdraws from contestable market	Improved competition and reduction in costs for parties connecting to the grid	<ul style="list-style-type: none"> <li>• TNSP</li> <li>• Competitive connection service providers</li> <li>• Connecting parties</li> <li>• AER</li> </ul>	QL: stakeholder feedback to assess the benefits and costs to TNSPs and connecting parties
Implementation considerations	May increase cost of compliance for TNSPs and monitoring costs for the AER	Nil	<ul style="list-style-type: none"> <li>• TNSP</li> <li>• AER</li> </ul>	QL: stakeholder feedback to assess the benefits and costs to TNSPs and connecting parties
Principles of good regulatory practice	Nil	Creates flexibility and increases consistency	<ul style="list-style-type: none"> <li>• TNSP</li> <li>• AER</li> </ul>	QL: stakeholder feedback to assess the benefits and costs to TNSPs and connecting parties

## C Legal requirements to make a rule

This appendix sets out the relevant legal requirements under the NEL for the Commission to make a draft rule determination.

### C.1 Draft rule determination and draft rule

In accordance with section 99 of the NEL, the Commission has made this draft rule determination for a more preferable draft rule in relation to the rule proposed by the AER.

The Commission's reasons for making this draft rule determination are set out in chapter 2.

A copy of the more preferable draft rule is attached to and published with this draft determination. Its key features are described in chapter 3.

### C.2 Power to make the rule

The Commission is satisfied that the more preferable draft rule falls within the subject matter about which the Commission may make rules.

The more preferable draft rule falls within section 34 of the NEL as it relates to:

- regulating the activities of persons involved in the operation of the national electricity system (NEL s34(1)(a)(iii))
- conferring a function on the AER to make, prepare, develop or issue guidelines in accordance with the Rules, including guidelines (NEL s34(3)(e))
- conferring a power of direction on the AER to require a person on whom an obligation is imposed under the Rules (including a Registered participant) to comply with a guideline (NEL s34(3)(h)).

### C.3 Commission's considerations

In assessing the rule change request the Commission considered:

- its powers under the NEL to make the draft rule
- the rule change request
- the Commission's analysis as to the ways in which the draft rule will or is likely to contribute to the achievement of the NEO.

There is no relevant Ministerial Council on Energy (MCE) statement of policy principles for this rule change request.<sup>81</sup>

### C.4 Civil penalty provisions and conduct provisions

The Commission cannot create new civil penalty provisions or conduct provisions. However, it may recommend to the Energy Ministers' Meeting that new or existing provisions of the NEL be classified as civil penalty provisions or conduct provisions.

The draft rule does not amend any clauses that are currently classified as civil penalty provisions or conduct provisions under the National Electricity (South Australia) Regulations.

<sup>81</sup> Under s. 33 of the NEL the AEMC must have regard to any relevant MCE statement of policy principles in making a rule. The MCE is referenced in the AEMC's governing legislation and is a legally enduring body comprising the Federal, State and Territory Ministers responsible for energy. On 1 July 2011, the MCE was amalgamated with the Ministerial Council on Mineral and Petroleum Resources. In December 2013, it became known as the Council of Australian Government (COAG) Energy Council. In May 2020, the Energy National Cabinet Reform Committee and the Energy Ministers' Meeting were established to replace the former COAG Energy Council.

The Commission does not propose to recommend to the Energy Ministers' Meeting that any of the proposed amendments made by the draft rule be classified as civil penalty provisions or conduct provisions.

## Abbreviations and defined terms

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
CCA	Competition and Consumer Act 2010
CRI	Connections reform initiative
Commission	See AEMC
DCA	Dedicated connection asset
DNA	Dedicated network asset
DNSP	Distribution network service provider
ISP	Integrated system plan
IUSA	Identified user shared asset
NEL	National Electricity Law
NEO	National Electricity Objective
NER	National Electricity Rules
NERL	National Energy Retail Law
NERO	National Energy Retail Objective
NERR	National Energy Retail Rules
NGL	National Gas Law
NGO	National Gas Objective
NGR	National Gas Rules
NT Act	<i>National Electricity (Northern Territory) (National Uniform Legislation) Act 2015</i>
Proponent	The individual / organisation who submitted the rule change request to the Commission
REZ	Renewable energy zone
TCAPA	Transmission connections and planning arrangements
TNSP	Transmission network service provider