Transmission Ring-fencing Guideline

Response to AER Issues Paper

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Energy Networks Australia

Contents

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Key messages

- Transmission Network Service Providers (TNSPs) support the intent behind the ring-fencing arrangements. That is, to address the potential harms of (i) cross-subsidisation of unregulated activities and (ii) performing the TNSP's monopoly functions in a way that advantages the TNSP's activities in an unregulated market, such as by performing a monopoly function in a manner that discriminates against a competitor, or through misusing confidential information obtained from a competitor when performing a monopoly function.
- For transmission, the National Electricity Rules (NER, Rules) already contain substantial protections against these potential harms. This means the ring-fencing guideline for transmission has substantially less work to do than is the case for distribution.
- To deliver a fit-for-purpose transmission ring fencing framework that serves the interests of consumers the appropriate starting point for the AER's analysis is to consider the specific services offered by TNSPs, the nature of their customers, the potential for competition in the affected market(s) that exist, and the current regulatory framework in place for transmission. This contrasts with the AER's suggestion that it should start with the distribution ring-fencing arrangements and identify which parts of that framework could be adopted for transmission.
- There are material differences between transmission and distribution networks which need to be considered when setting the approach to transmission ring-fencing. These differences include:
  - More prescriptive existing Rules, including clear definition of the regulated transmission services (prescribed and negotiated), and a comprehensive framework for promoting competition – including ring-fencing measures – in relation to certain connection activities (discussed further below) together with broad information sharing requirements to support transparency
  - Transmission networks operate in a materially different market with a customer base involving around 300 customers across the NEM who are very large entities that are able to finance projects, such as wind-farms, in the order of $300-800 million and load customers that will typically be large industrial entities operating in a global market. This compares to around 10 million distribution connected customers that are primarily households and small businesses
  - Projects that tend to be large, lumpy, infrequent and bespoke to the particular circumstances of a project, and
  - Security and reliability issues on the transmission network can have wide-ranging implications for the wholesale market and customers given transmission is upstream in the supply chain, underlining the importance of a single point of accountability for transmission system outcomes.
- As noted above, a comprehensive framework already exists in the Rules to facilitate and protect contestability for contestable connection services, while also ensuring large and sophisticated customers can continue to benefit from the expertise and efficiency of the Primary TNSP. This framework addresses the potential harms that are the target of ring-fencing measures, and so obviates the need for further ring-fencing measures.

- A streamlined and efficient framework is required to permit battery and storage projects with market facing features in the efficient delivery of network services. It is important, however, that the process that the AER establishes for batteries and other network support technologies does not place the AER in the role of decision maker on the merits of the project, instead it must be limited to ensuring arm-length arrangements are in place. Therefore, the ENA recommends that a reporting and compliance framework be established to provide confidence that there is no cross-subsidy or discrimination regarding TNSP-owned storage facilities.
- The ring-fencing issues that may arise for future potential new contestable transmission services will be unique to each service. Therefore, before imposing ring-fencing arrangements it is necessary to first consider the individual characteristics of a service. Regulating 'just in case' increases substantially the likelihood of inefficient outcomes arising and is counter to the principles of good regulation.
- It is unlikely that the provision of other non-regulated electricity services provided by TNSPs would cause any material harms to competition and warrant additional ring-fencing provisions. These services arise infrequently and are sufficiently bespoke that functional separation may make providing these services unviable for TNSPs, which would be counter-productive for consumers.
- It is not appropriate to introduce additional regulation and rely on waivers in the event that the costs of ring-fencing arrangements are too high. Relying on waivers in this way is counter to the principle that the threshold for regulatory intervention is high given the costs it can impose. Imposing overly onerous regulation would serve only to embed inefficiencies in the market given businesses organise their operations based on the regulations that apply rather than the potential that a waiver could be provided.

Overview

Energy Networks Australia (ENA) is pleased to make this submission to the AER on behalf of its transmission members in response to the Issues Paper for the review of transmission ring-fencing arrangements.

ENA is the national industry body representing Australia's electricity transmission and distribution and gas distribution networks. Our members provide more than 16 million electricity and gas connections to almost every home and business across Australia. This submission is made on behalf of ENA's transmission members.

ENA supports the intent behind ring-fencing arrangements. That is, restricting cross-subsidy, discrimination, and the misuse of confidential information in order to prevent TNSPs using their position in a monopoly market to an advantage in related contestable markets.

For transmission, the Rules already contain substantial protections against these harms for the key services TNSPs provide. The implication of this is that for transmission the ring-fencing guideline has substantially less work to do than is the case for distribution, where there is much less prescription in the Rules, and where distribution operates in fundamentally different markets.

ENA has responded to the questions asked by the AER in the template provided. Therefore, this document is focused on a narrow set of issues that require additional elaboration. The specific areas of focus are as follows:

- Current context for transmission – which identifies the critical importance of ensuring TNSPs are able to invest efficiently given the current market circumstances.

- Transmission specific analytical framework – which considers the analytical framework adopted by the AER for deciding if changes should be made to the transmission ring-fencing guideline
- Current framework for contestable connections – which discusses the current arrangements to protect competitive outcomes for contestable connections and the harms that might arise through functional separation
- Large scale storage – which considers what arrangements are needed to ensure batteries and storage can deliver efficient outcomes for consumers
- Other contestable services – which discusses the treatment of other contestable services, but in particular any future contestable services, and
- Waivers – where we consider the appropriate role for waivers within the ring-fencing framework.

In addition, a detailed assessment of transmission services, with a particular focus on connections, is included in Appendix A.

Current context for transmission

The electricity market is currently undergoing a substantial transformation towards a low carbon future. This transformation will inevitably require substantial transmission investment to facilitate new renewable energy generators connecting to the NEM and to ensure efficient inter-regional transmission flows. More than ever, it is essential for the expansion of the transmission network and new connections to be coordinated with new generation investment to minimise the total system cost, especially given the role transmission has in facilitating efficient wholesale market outcomes.

Onerous, or ill-conceived, transmission ring-fencing measures have the potential to frustrate the efficient delivery of electricity investment and raise the cost of transition. The scale of the investment task required means that the costs imposed onto customers and the broader Australian economy will be more material than ever before. Therefore, the AER needs to ensure that the regulatory arrangements enable TNSPs to access to all the available tools to deliver efficient investment and to be able to respond flexibly to changes in the demands for transmission investment.

A transmission specific analytical framework is required

At a broad level, the current arrangements in the Rules, combined with the existing transmission ring-fencing guideline, are working well in all jurisdictions.[1] Therefore, the AER needs to provide evidence that change is required and demonstrate a reasonable likelihood that any changes will promote the long-term interests of consumers. This suggests a proportionate approach is needed. We accept that new developments since the existing Guideline was drafted implies that some refinement is required – the

[1] This includes Victoria where the regime differs from other jurisdictions, not least as contestable services are a fundamental characteristic of the framework that has been in place for several years.

treatment of batteries and related technologies being the principal example – and we provide our thoughts on the appropriate ring-fencing measures for this activity below.

To ensure that any changes made to the transmission ring-fencing guideline provide a fit-for-purpose framework that delivers benefits to consumers, the AER's analysis must commence from the appropriate starting point. This means determining the specific requirements for transmission ring-fencing arrangements by having regard to the specific services offered, the nature of the customers, the potential competitive market that exists, and the current regulatory framework in place. An alternative approach where the starting point is the distribution ring-fencing arrangements and identifying what parts of that framework could be adopted for transmission would not be consistent with the National Electricity Objective (NEO) in seeking first to protect the interests of consumers.

Starting from the specifics of transmission will ensure that additional regulation is only applied where it can be demonstrated that the benefits of that regulation will exceed the cost. This is what is required to demonstrate that the change will promote the National Electricity Objective (NEO). It also reflects that regulatory intervention should never occur 'just in case' there are benefits in the future. This is because regulation can impose substantial costs, some of these obvious, such as administrative costs, while others are less obvious.

It is the less obvious costs that can be more substantial and so have the biggest impact on consumers through the efficient delivery of services. In the case of ring-fencing, consumers may be adversely impacted through increased barriers to the efficient delivery of services, or a weakening of the depth of competition for certain services where it is no longer feasible for TNSPs to offer those services. To ensure consumers can continue to receive the services they need and are increasingly demanding as we transition to a new energy future, a high threshold needs to be met before additional regulation is imposed. This means that in addition to taking account of the cost of the potential harms that ring-fencing is seeking to protect against, the AER needs to take into account the costs that any new regulation may impose.

Once the AER has identified what role the ring-fencing guideline has for transmission given existing protections and the nature of the specific services offered, it is then appropriate to consider if it is possible to implement solutions in a way that is consistent with distribution. ENA is open to aligning the drafting of the transmission guideline with that of the distribution guideline where obligations are similar. However, this should only be done where it is clear that the solution would better promote the NEO.

Transmission networks have materially different characteristics to distribution networks

There are fundamental differences between the nature, operating environment and regulatory environment of transmission and distribution activities that mean that the distribution framework is not the logical starting point for any analysis. The characteristics of transmission networks that the AER needs to account for when considering its approach to ring-fencing in relation to transmission include:

- Customers that directly interact with, and connect to, transmission networks are materially different to those that connect to distribution networks. Distribution networks connect to around 10 million consumers while transmission networks have only around 300 directly connected customers across the NEM. Customers connected to the transmission network are very large players with a high degree of commercial sophistication and are typically very well resourced. For instance, a renewable

connection typically requires access to finance in the order of $300-$800 million, while a battery connection will be in the order of tens of millions of dollars and potentially beyond $100 million. Load connections will typically be for large industrial entities that operate on a global scale. The implication of this customer base, which is starkly different to the households and small businesses connected to distribution networks, are that:[2]

- They are better informed and resourced and able to test the reasonableness of offers, including through tenders or expert external advisors, and the detailed technical, legal, and other material that is provided by TNSPs on their websites or upon request, and so hold countervailing power
- Branding would not be a factor that would affect competition as customers have the sophistication to 'see through' brands
- Customers are likely to ensure all potential providers of a contestable service are well informed in advance of works being needed such that it is unlikely that the Primary TNSP would obtain any competitive advantage through the potential receipt of early notice of a possible new contestable connection project,[3] and
- Competition law provisions are at the forefront given customers and third party providers are well versed in these requirements, such that these legal requirements are 'front of mind' in the way TNSPs operate.

» An existing regulatory framework that has significantly more prescription in the Rules than is the case for distribution. Unlike for distribution, for transmission the Rules prescribe that TNSPs can provide prescribed transmission services, negotiated transmission services, and non-regulated transmission services with significant prescription provided on what services are regulated in what way. Indeed, the Rules prescribe what are prescribed transmission services whereas in distribution the core services are decided by the AER at the time of a determination through the Framework and Approach process. The Rules approach to the definition of services is reflected in the model that has been adopted for reform of transmission connections where the Rules clearly prescribe the framework, including for non-regulated connection services. This approach reflects that for transmission, unlike for distribution, there is little variance between service providers as to the services that are offered. Further, in transmission service outcomes can have wide-ranging market impacts that make certainty through a Rules framework more important. That is, transmission outcomes have a greater influence on wholesale market outcomes, and service performance outcomes for TNSPs can have material impacts on supply for the broader customer base.

» Transmission projects tend to be large, lumpy, infrequent, and bespoke to the particular circumstances of the project. Typically, they also have large lead times. Importantly, the competition is for the timely provision of a large asset, rather than for the ongoing provision of a service, and so the window where competition is possible is narrow. Conversely, distribution services are more

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2 Energy Networks Australia notes that even if smaller operators are connecting to the transmission network than may have been the case in the past, these operators will still be significantly larger and more sophisticated than distribution connected customers.

3 Noting that, for Victoria, it is AEMO that determines if the contestability threshold is likely to be met or not for network connections.

programmatic in nature, and may involve the ongoing provision of a service and so ongoing potential for competition.

» Services outside of prescribed transmission services are mostly still core network services. Consequently, the fact that such services are regulated differently is in large part due to customers being large and sophisticated and the services being bespoke and lumpy.

An effective framework has already been established to protect against harms for contestable connection services

Contestable network connections are the primary non-regulated service that is provided by TNSPs.[4] As such, the approach to ring-fencing for this service is of material importance given it can have significant impacts on TNSPs, transmission connected customers, and the market more broadly. ENA is concerned that the current proposals by the AER, particularly with respect to functional separation, would not promote the NEO and so would lead to worse outcomes for consumers.

The Australian Energy Market Commission (AEMC) carefully designed a framework for contestable transmission connections to protect against the key potential harms ring-fencing is designed to address, namely: cross-subsidisation and performing the TNSP's monopoly functions in a way that advantages the TNSP's activities in an unregulated market (such as discrimination or the misuse of confidential information), while also enabling the efficiency benefits and expertise of TNSPs to be harnessed for the benefit of consumers. The key feature that achieves this outcome is the inclusion of protections for competition in the Rules that do not require TNSPs to functionally separate the provision of prescribed transmission services from non-regulated contestable connection services.[5] It is notable that the AEMC affirmed this framework when updating the framework to accommodate Designated Network Assets (DNAs).

The intention that TNSPs be able to provide both non-regulated services and regulated services is evident in certain design features of the Rules. For instance, the Rules clearly state that the Primary TNSP can provide contestable connection services as non-regulated services, while they are also required to provide certain services as a monopoly service (negotiated transmission services) when below a threshold value. Further, a clause such as clause 5.3.8(a1), which is focused on the protection of confidential information, would have no purpose if there was functional separation of contestable connection services.[6]

TNSPs must maintain connection related resources within their regulated business to comply with Rules obligations (e.g., delivery of connection projects below the $10 million contestability threshold). Currently

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[4] Noting that in Victoria AEMO is the Declared Transmission System Operator and is responsible for the planning of the transmission network, connections and acquiring augmentation services through a contestable process. As such, the discussion in this section is focused mostly on the arrangements that exist outside of Victoria.

[5] The details of these protections are contained in Appendix A.

[6] This is because the primary purpose of functional separation would be to protect information held by the Primary TNSP being used to aid the contestable provision of connection services.

these resources will also be used when providing non-regulated services with appropriate measures in place to ensure compliance with obligations to protect confidential information. The need to retain a team to provide monopoly connection services means some TNSPs may find it difficult to justify a duplicate team and stand-alone business to tender for contestable connections. This could have the perverse effect of seeing TNSPs withdraw from the market for contestable connections and so reduce the depth of competition in the market. It would also remove an experienced and efficient provider for customers to choose. It is hard to see how this could be an outcome that would promote the long-term interests of consumers and would also be inconsistent with the intent of the AEMC regime.

The points raised above have previously been accepted by the AER in its initial Discussion Paper for the review of the transmission ring-fencing guideline. Given the AEMC found that the framework promoted the NEO, and the AER has previously affirmed that an effective regime exists, ENA considers that legal and functional separation is not required for connections and the AER needs to provide compelling evidence to justify rejecting the AEMC's framework and to fundamentally shift from its previous views. Specifically on this matter the AER's previous statement was as follows:[7]

> *We consider that, in respect of connection services, these risks of discrimination are largely addressed by the TCAPA Rule Change. TCAPA put measures in place that reduce the opportunity for a TNSP to favour itself when competing to provide contestable connections for generators or load. The TCAPA rule change clarified that non-regulated transmission services comprise specific components of IUSA and dedicated connection assets and can be provided by the TNSP or any other service provider. This in turn places competitive pressure on TNSPs to improve their service offerings. TCAPA also sets out the information that a TNSP must place on its website and provide to connection applicants on request, to ensure sufficient transparency of information and support competitive provisions of IUSA assets. This is similar in some respects to requirements under the ring-fencing guidelines to ensure that the NSP or an affiliate of the NSP does not gain a discriminatory advantage due to privileged access to commercially sensitive information about the network. Moreover, we consider it reasonable to expect that parties connecting to the transmission network tend to be generally well-resourced, with access to specialist technical and legal advice and some negotiating power against the TNSP. We consider the TCAPA framework significantly reduces the scope for a TNSP to discriminate in favour of itself. Moreover, we understand that in some smaller markets where there are relatively few or infrequent connections to the transmission network (e.g. Tasmania), the TNSP remains an important provider of unregulated connection services.*

Lastly, the AER needs to keep front of mind that, aside from the concern about cross-subsidisation,[8] the purpose of ring-fencing measures is to address the potential for a TNSP to perform its monopoly function in a way that depresses competition in a related market in contravention of the Rules – this behaviour is often referred to as a firm leveraging its monopoly power. This capacity for a TNSP to depress competition in connections stems from the fact that, when undertaking its monopoly function, the TNSP may have an approval role and/or gain commercially sensitive information (for example, both of these

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[7] AER, 'Electricity Transmission Ring-fencing—a review of current arrangements, Discussion Paper', November 2019, pp.29-30.

[8] How costs are allocated between services becomes an issue whenever a regulated business provides other services, irrespective of whether there is the capacity to depress competition in that other market. However, the existing measures address this concern.

things arise in relation to the design of an IUSA or DNA[9]). However, it necessarily follows that there can only be concerns that may justify ring-fencing measures in relation to a TNSP's activities in relation to transmission connections to its own transmission network. To the extent that a TNSP attempts to compete for other works – for example, in relation to distribution connections – there is no justification whatsoever for ring-fencing, and indeed imposing such measures would only depress competition in that other market to the detriment of consumers.

A streamlined and efficient process is required to assess battery and storage projects with competitive market facing features

ENA supports the AER's proposal that the ring-fencing arrangements not limit TNSP's approach to delivering the services they are required to provide under the Rules. This is achieved by focusing on the services as already defined in the Rules, such as prescribed transmission services, and not focusing on the specific technologies or activities used to deliver those services. This approach means that TNSPs can identify and implement the most efficient solution to meet a network need, even if the technology used to address that need is not a traditional network asset. As such, the long-term interests of consumers are promoted through TNSPs continuing to be able to consider the full suite of build or buy solutions for meeting a network need.

However, for those technologies that have the potential to provide contestable energy market services, potential ring-fencing issues may arise. Whilst an option would be for TNSP-owned batteries that are installed for network services to not be used for other markets, this may be materially detrimental to consumers, particularly in instances where the harnessing of multiple benefit streams is needed to make a storage project commercially viable for network support purposes.

As identified in our submission to the previous Discussion Paper, transmission businesses have developed successful models under the current framework to address competition concerns associated with market facing technologies used to provide network services. To that end, ENA supports a framework that would permit these models to be deployed into the future in an efficient and streamlined way. ENA recommends that the framework identify the arrangements required for TNSPs to demonstrate that there are no ring-fencing related concerns and for TNSPs report against this framework. For example, requirements could be included in the RIT-T for TNSPs to comply with, and report on, certain actions that that have been taken to prevent cross-subsidy. This approach provides transparency, ensures ring-fencing related concerns are addressed, while also taking into account that the commercial arrangements for storage projects connected to the transmission network can be long and complex and so frequently change until finalised. Providing certainty about the arrangements upfront, and requiring reporting against these, means that investors will have confidence to proceed with a project even where commercial arrangements are yet to be finalised.

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[9] Note that the Rules contain a range of measures to address this potential for anti-competitive leveraging (these are set out in the Attachment).

It is also important that the process that the AER establishes for batteries and other network support technologies does not place the AER in the role of decision maker on the merits of the project, which would be a risk with a waiver model. There is already a robust framework of incentives and administrative tools, such as the RIT-T and annual planning processes, that are aimed towards ensuring efficient investment proceeds. As such, having the AER separately assess the merits of a project would be counter to the fundamental design of the regulatory regime where businesses are responsible for their own investment decisions. Instead, the framework must be focused only on ensuring that arrangements are in place that put TNSPs at arms-length from market-facing services and the associated market outcomes.

Future services are best considered on a case by case basis

The AER's Issues Paper refers in several places to potential new services that may emerge in the future and the need to include arrangements that ensure that the competition for these services is protected. ENA considers it is inappropriate to regulate services that do not even exist yet as this would stifle market development and harm the long-term interests of consumers.

The potential ring-fencing issues that arise for transmission services are likely to be unique to each service. This is evident by the substantially different ring-fencing issues that arise between the use of batteries to provide both network support and contestable services, and the issues that arise with contestable connections. Therefore, before imposing ring-fencing arrangements it is necessary to first consider the individual characteristics of the service in question.

Further, for transmission, changes to the scope for contestability are likely to occur through the Rules. Therefore, it is reasonable to expect that appropriate consideration will be given to what rules are needed to further protect competitive markets. Any ring-fencing requirements should only be made once the AER is able to consider the protections in the Rules that are already available, the materiality of the harm (if there is one), and whether any additional protections are required.

It not clear, however, how imposing 'just in case' regulation promotes the interests of customers and the NEO. Indeed, imposing regulation before a case has been demonstrated for that regulation creates a considerable risk that consumers will be adversely impacted through less efficient provision of those services. This could be because efficient market solutions are prevented by the regulation, or the regulation adds, unnecessarily, to the cost of providing the service. At a time when new transmission investment is required and where there are genuine concerns with energy affordability, we find the AER's approach concerning.

No additional ring-fencing is required for other transmission non-regulated services

In terms of other transmission, or transmission related, non-regulated services that TNSPs currently provide (such as consulting services, testing services or microgrids), it is difficult to foresee material harms from sharing resources in relation to these services. These services arise infrequently, tend to be closely related to the core network services function, and are provided for large and sophisticated

customers. These factors mean that incumbent TNSPs tend to be an important supplier of services to customers in the market, although the value of the services is comparatively low.

Again, the nature of the other non-regulated services offered by TNSPs was something that was previously well understood by the AER in its Discussion Paper where it stated the following:[10]

> *However, we understand that aside from connection services, other types of non-regulated transmission services occur relatively rarely in the NEM. Some of these other (non-connection related) non-regulated transmission services appear to require involvement of the TNSP and have limited scope for competition. Some also appear to have similar features to connections that that they involve large, well resourced customers with bargaining power against the incumbent TNSP.*

The existing cost allocation processes the TNSPs undertake are well established and sufficient to address concerns about cross-subsidisation between these activities. Additional ring-fencing would be particularly onerous relative to the value of the services such that it may become uneconomic for some TNSPs to provide the services. The removal of TNSP-provision of such services may, therefore, delay projects or increase the costs at which they can be delivered (by other parties) – outcomes that will be detrimental to customers.

Reliance on waivers increases the cost of regulation

In many instances the AER has indicated that a waiver could be adopted in those circumstances where the ring-fencing arrangements imposed are overly onerous or are clearly not appropriate. ENA considers that this approach substantially increases the risks that the ring-fencing arrangements impose significant costs, increase investment risk for networks, and so do not promote the long-term interests of consumers.

As indicated above, it is generally accepted that the threshold for regulatory intervention should be high given the costs that it can impose on TNSPs and therefore consumers. The AER's proposal appears to take the opposite approach. That is, regulation is imposed in case it provides a benefit, but with exemptions provided through a waiver where it becomes obvious that the regulation is distorting efficient outcomes. However, this approach ignores that entities will organise their businesses based on an expectation that the regulations will apply. As such, administrative costs, and other less visible costs caused through distortions to behaviour, will be embedded in the market even before a waiver can be provided. ENA recommends that the AER should only impose additional ring-fencing obligations where there is a demonstrated clear benefit from those obligations relative to their associated risks / costs on networks and consumers.

ENA notes that the AER's proposed reliance on waivers, with the exception of batteries, appears to be materially different to how they are used in distribution. Aside from batteries, in distribution waivers appear to have only been used by the AER to provide distributors with additional time to comply with

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[10] AER, 'Electricity Transmission Ring-fencing—a review of current arrangements, Discussion Paper', November 2019, p.30.

arrangements, rather than to change the obligation itself. Therefore, it is not clear that they should be differently applied in transmission.

It is also not appropriate for the AER to use a waiver process merely as a means of gathering information about how TNSPs are operating. The AER already has extensive information gathering powers that can be relied upon for this purpose without the need for additional regulatory intervention. Further, TNSPs are always open to dialogue with the AER to address any questions that staff may have on a more informal basis.

To the extent that the AER chooses to rely on waivers, it should make clear under what circumstances it intends to provide a waiver for each issue it has identified that a waiver may be feasible. It should also set out clear procedures it will follow for assessing and approving waivers to ensure that the process is as efficient as possible.

Appendix A: Detailed assessment of transmission services

The purpose of this appendix is to provide a more comprehensive review of the need for additional ring-fencing measures for those services that TNSPs current provide. The intention is to identify what potential ring-fencing related harms might exist for each service and the extent that the regulatory framework addresses those harms. The focus here is on transmission connections, given these are the primary contestable service provided by TNSPs. However, other contestable services provided by TNSPs are also addressed below. Further, the material in this appendix relates mostly to the arrangements in jurisdictions outside of Victoria noting AEMO has a unique role in that jurisdiction.

Contestable connection services

Description of the service

The connections framework established in the Rules is based around connection assets and the services associated with those assets. For each asset, and associated service, a form of regulation is determined. In the Rules this is referred to as the service classification.

The most material change in the framework made by the AEMC from what existed previously was to create IUSAs and permit them to be provided on a contestable basis. However, IUSAs are provided on a contestable basis only in limited circumstances. Specifically, where the capital cost of all components that make up an IUSA is reasonably expected by the Primary TNSP to be at or below $10 million, the detailed design, construction and ownership of the IUSA is a monopoly service for the TNSP.[11] Therefore, the Primary TNSP is obliged to provide IUSAs in some circumstances, and is permitted, but not obliged to, provide IUSAs when above the threshold.[12] Further, TNSPs retain obligations with respect to the control, operation and maintenance of IUSAs (and DNAs) that are designed, constructed and owned by a 3rd party.

The Rules state that the Primary TNSP has non-contestable obligations with respect to the following assets and services associated with transmission connections:

- The primary transmission network (i.e. cut in works)
- Detailed design, construction and ownership of Identified User Shared Assets (IUSA) valued at $10 million or less together with certain IUSA SCADA, communications and protection assets
- Functional specification for contestable IUSAs and DNAs
- Control, operation and maintenance of of 3rd party provided IUSA, and
- Control, operation and maintenance of 3rd party owned DNA

The Rules indicate that the following assets can be designed, constructed and owned on a contestable basis:

- IUSA
- DNA, and

11 Clause 5.2A.4(b) of the NER.

12 Clause 5.2A.4(a) of the NER.

» DCA.

Potential competitive concerns and mitigants

ENA has identified three potential competitive concerns that might arise with respect to the contestable provision of connection services. This section sets outlines for each potential harm:

» what the harm is and its expected materiality, and

» what mitigants exist to address or limit the potential harm.

The intention is to identify whether the existing arrangements are effective in mitigating the perceived harm.

Harm 1: Cost shifting to the regulated business

- A possible harm when a TNSP provides both regulated and contestable services is that the TNSP recovers some of the costs that should be allocated to contestable customers from regulated customers. The purpose of behaving in this way would be to achieve a competitive advantage in the offers it is able to make to connecting parties (through a subsidy from regulated customers). ENA considers that this is a sufficiently material potential harm that it is necessary for the market to have confidence that it is addressed.

Mitigants

The following mitigants to cost shifting exist within the existing framework:

» Established Rules obligations for cost allocation in Part G of chapter 6A. These require adherence to cost allocation principles, AER guidelines to give effect to those principles (including specification of the detailed information to be included in a TNSP's Cost Allocation Methodology), and a requirement for the AER to approve, or amend where it refuses to approve, the TNSP's Cost Allocation Methodology.

» Requirements for TNSPs to comply with regulatory accounting requirements that are given effect through the AER's powers to gather information under Division 4 of the National Electricity Law. This power ensures that the AER has access to whatever information it feels it needs in order to regulate TNSPs.

» Transmission services are clearly defined in the Rules thus limiting potential for misallocation.

ENA considers that these arrangements to limit cost shifting are robust and is not aware of any concerns that have been raised in their ability to ensure the proper allocation of costs. It is relevant to note that if the AER had such concerns, it could address these through its powers with respect to approving cost allocation methods and also information gathering.

Harm 2: Use of confidential information obtained for regulated services for bids on contestable services

The potential harm in this case is that a TNSP obtains certain confidential information that gives it an advantage when making a contestable offer. For instance, a TNSP might obtain information about a competitor's project (such as an innovative detailed design option) and use this information to improve its own contestable offer. Using this information in this way would potentially provide TNSPs with a

material benefit. Conversely, there may be information about the network more generally that the TNSP holds that enables it to make superior offers for contestable services.

Mitigants

Information provided to the Primary TNSP that may provide it with an advantage when tendering for, or negotiating, contestable services is protected under clause 5.3.8(a1). This requires that the Primary TNSP not use information provided to it in relation to its provision of non-contestable services for the purposes of tendering for or negotiating contestable services. TNSPs have implemented robust arrangements to ensure that this information is protected, while also avoiding the need for permanent functional separation. ENA considers this is a robust provision in the Rules that specifically protects the harm identified here. Given this, it is not clear how additional arrangements would provide any additional benefit, noting a requirement for functional separation (which would be aimed at the same objective of clause 5.3.8(a1)) would potentially make contestable provision of connection services unviable for some TNSPs and so reduce the depth of competition in the market and also deny the market the benefits of TNPS's efficiencies of scale and scope.

On a practical level, it is also noted that at no point does the TNSP have access to commercial or pricing information from competing contestable bids. Further, all technical and design information from contestable bids is only seen by the TNSP at the connection application stage after the competitive process has concluded.

In terms of other information that the TNSP already holds through its role as the Primary TNSP for a region, the Rules introduced with the DCA framework include extensive information provision requirements. This means that important information is either published or must be provided upon request. Therefore, ENA believes there is no reason to think that a TNSP would have a substantial information advantage over other potential providers. In that context, it is also important to note that potential connecting parties are likely to provide whatever information they give to the Primary TNSP to any other parties they are considering for contestable provision of connection services. That is, there is no reason for a connecting party to provide information to the Primary TNSP but withhold this information to other potential tendering parties. Indeed, it is in the interests of the connecting party to provide all prospective parties the same information at the same or similar time.

Under the Rules, TNSPs are required to provide the following information that is relevant to connections on their website:[13]

- Legal information relating to:
  - Standard connection agreements
  - Standard network operating agreements
  - Standard interface works construction agreements
  - Standard relocation deeds
  - Environmental approvals (generic)
  - Development approvals (generic)

[13] Schedule 5.10 of the NER.

- Technical specifications for:
  - Design standards
  - Generic interface works
  - Generic substation layouts
  - Typical overhead line structures
  - Typical underground cable arrangements
  - Typical primary plant
  - Typical secondary systems
- Typical operating and maintenance scheduling
- Timescales for commissioning (generic), and
- Amount and terms and conditions of the connection application charge.

Under the Rules, TNSPs are required to provide the following information that is relevant to connections upon direct request:[14]

- Detailed technical requirements for a particular connection
- Timescales for:
  - Easement acquisition (site specific)
  - Commissioning (site specific)
- Legal information related to:
  - Environmental approvals (site specific)
  - Development approvals (site specific), and
- Financial information related to the relocation of existing assets

In addition, the functional specification that is produced for a contestable connection includes detailed technical information and requirements for a particular connection that ensures that there is a level playing field.[15]

It is not obvious that there are any material gaps in the information framework for connections such that TNSPs have any advantage that warrants the permanent functional separation of staff, offices and resources. It appears to be robust and comprehensive. Further, there is no evidence that market participants have concerns in this area. To the extent there are information gaps these should be addressed through the Rules framework to ensure the obligations remain together and duplication is avoided.

14 Schedule 5.10 of the NER.

15 Clause 5.3.3(9) of the NER.

Harm 3: Discrimination in relation to the Functional Specification and / or O&M costs

The Primary TNSP is required to specify the Functional Specification for a connection[16] and also identify the operating and maintenance costs that are reasonably expected to apply for that connection.[17] It is possible that the Primary TNSP proposes a Functional Specification and Operating and Maintenance costs that are in excess of what is actually required for a third party IUSA or DNA. The objective for doing this would be so that the obligations and costs imposed on third parties are made materially higher than necessary.

Mitigants

In terms of the Functional Specification, the key mitigants that protect against such behaviour are that:

- There is recourse to an assessment by an Independent Engineer where there are concerns that the technical requirements are unreasonable,[18] and
- The detailed design of an IUSA or DNA, which would be the case also for the detailed design of the Primary TNSP, must be consistent with the Functional Specification provided in the connection enquiry response. This means that all providers are on a level playing field and it is not possible for the TNSP to offer a detailed design that is below the functional specification [19]

In addition, it is relevant to note that precedent in terms of actual designs and previous Functional Specifications would guide stakeholders views as to whether the proposed Functional Specification was appropriate.

With respect to cost elements associated with connections, there are extensive provisions in the Rules to ensure that these are reasonable. In addition to requirements to negotiate in good faith and offer fair and reasonable terms, the following specific provisions apply:

- Negotiating principles in the Rules that apply to prescribed transmission services, negotiated transmission services and DNA services[20]
- For connection applicants, specific additional negotiating principles, including that on request at TNSP had to demonstrate that the charges for providing a negotiated transmission services reflect the costs incurred[21]
- A requirement for the network operating agreement to be negotiated in accordance with negotiating principles in the Rules[22]
- Commercial arbitration of disputes having regard to negotiating principles and other determinations by the AER (e.g. the pricing methodology)[23]

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16 Clause 5.3.3(9) of the NER.

17 Clause 5.3.3(10) of the NER.

18 Clause 5.4 of the NER.

19 Clause 5.3.4(b1)(i) of the NER.

20 Schedule 5.11 and Schedule 5.12 of the NER.

21 Clause 5.2A.6 of the NER.

22 Schedule 5.12 of the NER.

23 Clause 5.5.5 of the NER.

- Requirement that the indicative costing for operating and maintenance must be based on the Functional Specification[24]
- If any item in the statement of costs associated with the offer to connect differs substantially from the estimate provided by the TNSP the TNSP is required to explain the differences.[25]

It should be noted that the Rule change which introduced the DNA concept also required that DNA are designed, constructed and operated to system standards.

ENA considers that these rules are comprehensive and go beyond what might ordinarily be expected from a ring-fencing guideline. As such, it is not clear that any additional arrangements can be expected to promote the NEO.

Other contestable services

In terms of the other contestable services that TNSPs provide, ENA provided material related to the potential harms and associated mitigants in our submission to the first Discussion Paper. That material is repeated here for convenience. The key points are that:

- Contestable services offered by TNSPs arise infrequently, are bespoke, tend to be closely related to core network services in function, and are provided for large and sophisticated customers
- The overall value of the services relative to other things TNSPs do undertake is low, although the availability of the service can be high for customers given limited providers.
- Additional ring-fencing provisions in addition to current arrangements would be particularly onerous relative to the value of the service, such that continued provision of the service may become uneconomic for some TNSPs. This would reduce the overall number of supply options available for customers.

In short, the potential for harms to arise in the provision of these services is minimal and existing protections in the transmission framework are adequate to mitigate such risks, as outlined in Table 1.

[24] Clause 5.3.3(b)(10) of the NER.

[25] Clause 5.3.6(b2)(2) of the NER.

Table 1: Mitigants against competitive harms for other contestable electricity services

Service	Potential Harm	Mitigant
Consulting services » Advice on network information that can facilitate connection applications » Infrequent and low value services » Adjacent to other prescribed network services but provided on an 'at request' basis » Not a service for the supply of electricity	» Access to information before the 'market' » Access to confidential information » Cross-subsidy from regulated services	» Confidentiality provisions in existing framework » Non-confidential information already published or available to any party upon request » Current robust cost allocation framework in the Rules » Competition law
Micro-grid » A 'behind the meter' service where supply is offered independent of the main grid » Potential to remain connected to broader grid and sell generation to the wholesale market	» Access to information before the 'market' to assist in optimising the investment in the microgrid » Real-time information on network congestion	» Real-time information is already public or available from AEMO » Confidentiality provisions in existing framework » Non-confidential information already published or available to any party upon request
Testing services » Technical advice and support (eg insulation testing) » Condition monitoring » Not a service for the supply of electricity	» Cross-subsidy of competitive activities through regulated services	» Current robust cost allocation framework in the Rules