

AER response to Australian Competition and Consumer Commission, in relation to electricity ring-fencing, pursuant to section 90(6)(d) of the *Competition and Consumer Act 2010*.

Electricity transmission in Victoria

1. What is the purpose of the National Electricity Rules (NER) and the Transmission Ring-Fencing Guidelines (TRFG) in relation to vertically integrated TNSPs and contestable businesses? Please outline the purposes for which these regulations were designed.

As noted in the AER's [Explanatory Statement](#) for ring-fencing in electricity transmission, the objective of the TRFG is to:

provide a regulatory framework that promotes competitive markets, generally by seeking to ensure a level playing field for providers in markets for contestable services while promoting the long-term interests of consumers.

The AER's Explanatory Statement notes two main types of potentially harmful conduct.

- Cross-subsidisation - where a Transmission Network Service Provider (TNSP) uses revenue from prescribed transmission services to subsidise its activities in contestable markets
- Discrimination in favour of itself or a related electricity service provider in relation to the provision of prescribed transmission services, or against a competitor to itself or a related provider when providing a prescribed transmission services.

Specifically, the TRFG implements the requirement of clause 6A.21.2 of the National Electricity Rules that a ring-fencing guideline is to provide for:

accounting and functional separation of the provision of prescribed transmission services by Transmission Network Service Providers from the provision of other services by Transmission Network Service Providers.

This compares to the objectives for the first transmission ring-fencing guideline made by the [ACCC in 2002](#) when the ACCC stated that the objective was to:

require a TNSP to establish arrangements to segregate (ie. ring-fence) its business of providing regulated transmission network services from other services. The aim is to separate as far as possible the monopoly powers of TNSPs from the contestable activities of generation and retail supply.

In 2023 the AER made significant changes to update the TFRG in light of the transformation underway in the Australian electricity market through the energy transition. These changes followed the first major AER review of the TFRG since 2002.

The AER's [2023 Explanatory Statement](#) for the revised TRFG noted that Australia's electricity market is undergoing a fundamental transformation. The AER noted that new markets are being developed and technology is being deployed in new ways that increase the potential scope of TNSP operations outside of traditional transmission network services.

New markets have been developed for services such as fast frequency response and system strength and they are being considered for other essential system services (such as inertia). These developments are opening new market opportunities, including for TNSPs. There is also increasing appetite to explore or promote contestability in areas that have traditionally been provided by monopoly TNSPs.

Amendments to the rules governing transmission connections arrangements have also expanded opportunities for third parties to provide elements of transmission connection services. Some jurisdictions have also adopted contestability in relation to the delivery and operation of major transmission projects within renewable energy zones.

TNSPs are also deploying assets such as batteries and synchronous condensers that can provide both contestable and network services. The opportunities for using such assets for multiple purposes are expanding, including through the new system security markets referred to above. While 'value stacking' these services may provide benefits to consumers, the opportunities for cross-subsidisation and discrimination are also increased where TNSPs own, operate and/or lease such assets.

Under the previous guideline, TNSPs were prohibited from operating in other parts of the electricity supply chain (generation and retail) except where revenue from those activities was no more than 5% of a TNSP's total annual revenue. Since 2002, the boundaries between these activities have blurred, and the scope of services that a TNSP can provide that do not clearly fall into generation, transmission, distribution or retail has expanded. With the expected increase in transmission investment through the energy transformation, the absolute value of the 5% revenue cap permitted under the previous guideline would have increased significantly, expanding TNSPs' opportunities to operate in other, generally prohibited, markets. Furthermore, deployment of technologies that can provide both transmission services and contestable services, such as grid-scale batteries, makes it harder to monitor and control the potential for cross-subsidisation.

To address these concerns, the AER removed the 5% revenue cap and strengthened TNSPs' legal separation obligations in the final guideline. The final guideline, as amended allows TNSPs to provide all transmission and distribution services but generally prohibits them providing other services without a waiver. In effect, this expands TNSPs' previous legal separation obligations to capture all non-transmission contestable electricity services and non-electricity services (with some exceptions), rather than just generation, distribution, and retail services.

The AER also noted in the TRFG explanatory statement that as contestable electricity markets have developed, the potential for TNSPs to favour themselves or an affiliate operating in those markets has also increased.

The AER noted that discrimination against competitors could potentially occur wherever a TNSP holds sensitive information obtained from providing regulated services or, in connection with the provision of regulated services, as the TNSP has the ability to discriminate in favour of itself or an affiliate.

To address concerns that TNSPs are able to favour themselves or their affiliates participating in other contestable electricity markets, the AER strengthened the previous guideline's functional separation obligations. The final guideline:

- introduces the concept of a 'related electricity service provider,' which includes not only a TNSP's affiliates but parts of a TNSP that provide contestable (i.e., nonregulated) transmission services;

- clarifies and strengthens obligations around information access and disclosure, including the establishment of an information sharing protocol; and
- requires TNSPs to establish, maintain and keep an information register about information that has been shared.

We have also added a new obligation on TNSPs to require any agreements with third party service providers who provide services to the TNSP to contain provisions mirroring the guideline's non-discrimination and information access and disclosure provisions.

This approach recognises that third parties who assist with a TNSP's provision of prescribed transmission services can also engage in discriminatory behaviour.

We have not added new obligations in relation to staff and office separation or restrictions on cross-branding and promotions. We do not have sufficient evidence at this time that the benefits of these functional separation obligations would outweigh the costs. This is due to the relatively small size of TNSPs and the nature of their customers, which are typically large, sophisticated corporate entities. However, we have retained the previous guideline's provisions requiring the marketing staff of TNSPs and affiliates to be separate.

2. Please explain how the TRFG seeks to ensure ring-fencing between contestable and non-contestable businesses.

The Transmission Ring-fencing Guideline seeks to prevent TNSPs from using their position as monopoly providers of prescribed transmission services to distort outcomes in contestable markets. The harms which the Guidelines seek to prevent are cross-subsidisation and discrimination.

The Guideline seeks to prevent these harms from occurring by requiring a TNSP to separate the provision of prescribed transmission services from contestable services that may be provided either by the TNSP, its affiliates, or third parties.

Clause 3 of the Guideline requires TNSPs to legally separate from affiliated entities that provide services other than transmission services, and to establish and maintain separate accounts from an entity providing other services.

Clause 4 of the Guideline places controls on the disclosure and sharing of 'ring-fenced information' with affiliated entities. Controls are also placed on the sharing of marketing staff between TNSPs and affiliated entities. This clause does not however provide for the separation of other operational staff, or offices. In this regard the Transmission Ring-fencing Guideline is less onerous than the like Guideline applicable to Distribution Networks.

It is important to note however that not all monopoly functions of TNSPs sit within the ring-fencing arrangements, as negotiated transmission services do not fall within the current scope of the AER's Guideline.

This was highlighted during the AER's substantive review of the transmission ring-fencing arrangements in 2022-23. A significant number of stakeholders raised concerns about the ability of TNSPs to discriminate against competitors in providing contestable connection services (which are non-regulated transmission services) due to their monopoly role in providing the non-contestable elements of a connection (which are provided as negotiated transmission services). The proposed rule change would give the AER additional regulatory tools to manage these potential harms.

3. Please explain how the NER and TRFG (including the requirements in the non-discrimination obligation) would operate to prevent AusNet from discriminating against Origin’s generator rivals (by delaying or prioritising generator connections).

A TNSP is required by NER clause 6A.21.1 to comply with the TRFG.

Section 4 of the TRFG requires a TNSP to not discriminate between any of its related entities (described as a *related electricity service provider*) and any competitor or potential competitor to that related entity. This obligation includes:

- Treating a related entity as if it were not a related entity of the TNSP
- Dealing with a related entity on substantially the same terms and conditions as it deals with a related entity, when there are like circumstances
- Providing substantially the same quality, reliability and timeliness of service to a related entity and a competitor or potential competitor, when there are like circumstances.

A breach of the TRFG is a tier 1 civil penalty under the *National Electricity (South Australia) Regulations*. Maximum penalties are \$10 million, or up to three times the benefit reasonably attributable to the breach, or 10% of annual turnover.

The TRFG provides further restrictions on potential discrimination by placing restrictions on TNSPs in sharing information with a related electricity service provider (discussed below).

Starting in calendar year 2024, a TNSP will be required to report any breaches of the TRFG within 15 business days and will be required to submit to the AER an annual report, along with an independent audit report, of its compliance with the TRFG, including the non-discrimination obligations.

4. Are there forms of conduct that a transmission network operator could undertake to favour a co-owned generator or retailer that would be difficult to detect or difficult to take enforcement action against using existing regulations?

A [2006 ACCC/AER submission](#) to the Energy Reform Implementation Group (ERIG), established by Australian energy Ministers noted that at times there may be the potential for *subtle forms of discrimination that a vertically integrated firm might choose to engage in such as sharing confidential information with its affiliate*

One area where these challenges may arise is in relation to connections. In this context, there is a risk of discrimination in relation to the connection of new generation or battery assets to the transmission network, where a TNSP may seek to favour a related affiliate in negotiating a connection or in the delivery of competitive connection services. This is discussed in more detail below in response to Question 7.

As noted by AER in a [request for a change to the National Electricity Rules](#) (NER) submitted on 18 July 2023 to the Australian Energy Market Commission (AEMC), many of the discriminatory behaviours may be difficult to detect owing to the need for connecting parties to maintain commercial relationships with the relevant TNSP. In a submission to the AER for the development of the rule change request, one integrated generator-retailer stated that “it will often not be in the interest of a connecting party to challenge perceived discriminatory behaviour”. This is discussed further below in the response to question regarding dispute resolution arrangements for generator connections.

The potential harms from discrimination may also extend to the operation of the transmission network. There is a potential for a detriment to competition if competitor generators hold a perception that a TNSP in some circumstances may use its functions of operating the network to discriminate in favour of generator owned or operated by an affiliated entity. We note that such conduct may be difficult to detect in practice and the risk of it occurring may impact on investment decisions by potential competing generators.

The AER notes that there is a Service Target Performance Incentive Scheme (STPIS) for transmission which may help to mitigate the risk of discrimination occurring through the operation of the transmission network.

This scheme provides incentives for TNSPs to improve or maintain a high level of transmission network services for the benefit of participants in the National Electricity Market (NEM) and end users of electricity. The scheme has three components: a service component which acts as a key indicator of network reliability; a market impact component to encourage TNSPs to minimise the impact of outages on the dispatch of generation; and a network capability component that encourages TNSPs to undertake priority projects of benefit to customers that they would not otherwise undertake.

We note that, by providing a direct financial incentive for TNSPs, this scheme may operate to mitigate incentives on TNSPs to engage in harmful discriminatory conduct. However, the STPIS has been established primarily to drive efficient operation of the transmission network, rather than to address behaviour that damages competition. Further, the value of the incentives from STPIS in some cases may be insufficient to either deter the harmful conduct or to reassure potential investors in new, competing generation.

5. Does the prohibition on information sharing in the regulations apply to information acquired through network planning (as distinct from information acquired from / related to customers)?

The TRFG requires a TNSP to not disclose *ringfenced information* other than in specific circumstances. Ringfenced information is defined by the TRFG as:

- *Information about electricity networks, electricity customers or electricity services where that information is acquired or generated by a TNSP in connection with its provision of prescribed transmission services*
- *which is not publicly available*
- *and is not aggregated information that does not relate to an identifiable customer or class of customers.*

The restrictions on sharing information cover both information acquired through network planning activities (part of a TNSP's function in providing prescribed transmission services) and information concerning individual customers.

The TRFG also describes circumstances where such information may be shared. These include, for example, where disclosure is required by any law or where a relevant customer has given explicit informed consent to that sharing.

In addition, the TRFG contains obligation on TNSP related to the sharing of staff which may have the effect of limiting opportunities where ringfenced information can be shared that may give a competitive advantage.

6. Does the dispute resolution regime provided for in the regulations act as an effective forum for resolving the concerns of parties seeking to access the transmission network?

The risks of harm to connection applicants are somewhat mitigated under chapter 5 of the NER which requires commercial arbitrations entered into under Rule 5.5 to be resolved within 30 days.

However, as set out in the AER's Rule Change Request, timing is critical, as delays can cause significant additional costs and ultimately foregone income until the connection can be completed. Delays may also impact timing commitments for financing arrangements which can jeopardise the connection project. Accordingly, in circumstances where the dispute resolution regime is enlivened, it is possible that some harms are unavoidable. Whether due to the real or perceived abilities of TNSPs to delay connections to the shared network, connecting parties may ultimately prefer to deal with the incumbent TNSP and its affiliate for transmission connections.

As is the case in relation to the connection framework, connecting parties may not feel comfortable to pursue remedies because of the need to maintain a commercial relationship with a TNSP. The AER experienced relatively low levels of engagement from generators considering the number of parties contacted for comment during its rule change request consultation. This reluctance to comment may be on account of the above need to maintain commercial relationships with the incumbent TNSP.

7. The Applicants submit that AusNet has no ability to refuse or delay non-Origin generators from connecting to the AusNet transmission network, and no ability to plan or augment the transmission network in a way that would foreclose non-Origin generators, due to AEMO's role in these processes.

Is this consistent with the AER's understanding of the impact of AEMO's role in these processes? In particular, to what extent does the way in which the connection process is regulated under the rules reduce the scope for AusNet to covertly delay and/or prioritise generator connections?

In principle, monopoly transmission network services that are provided on an exclusive basis by a single entity, should be covered by the ring-fencing framework, where there is a risk of cross-subsidisation or discriminatory behaviour. However, in a May 2023 [consultation paper](#) on *Options to address gaps in transmission ringfencing framework*, AER pointed out that clause 6A.21.2(a) of the NER prevents the AER from requiring accounting or functional separation of negotiated transmission services from non-contestable transmission services. The effect is that the TRFG cannot require separation of the non-contestable components of a transmission connection from the contestable components of transmission connections provided by a TNSP. This is despite the fact that the non-contestable components of a transmission connection are provided on an exclusive basis by the incumbent TNSP in accordance with Chapter 5 of the NER.

The AER's consultation paper noted that the TRFG at present is not able to address potential harmful conduct such as a TNSP using the connection process to discriminate in favour of itself or an affiliate in relation to customers seeking contestable connections.

On 18 July 2023, AER submitted a [rule change request](#) to the AEMC seeking to have the NER include negotiated transmission services within the scope of the TRFG. If approved, this change would provide the AER with additional regulatory tools to manage the potential harms associated with possible discriminatory behaviour and would provide greater transparency for connection applicants and third-party service

providers. In raising this rule change the AER has noted that the market for contestable transmission connections is still nascent and should be supported where possible. If TNSPs are acting in a manner which undermines customers procuring third party providers to deliver contestable works, this would negatively impact the cost of connections, increasing the cost of, and potentially delaying, the energy transition.

In particular, in Victoria, responsibility for transmission planning is divided between AEMO and AusNet (with the specific responsibilities outlined in chapters 5 and 8 of the NER). AEMO's role limits AusNet's ability to discriminate between generators to the extent that AEMO is responsible for making decisions about network planning and augmentation. However, AEMO's role does not prevent AusNet creating delays in connection or discriminating in favour of affiliates in relation to connections, or in operating the network to favour its affiliates. As we have noted elsewhere in this response, the AER has raised a rule change proposal to address gaps in the existing ring-fencing network governing negotiated services to help address the potential for discrimination in relation to connections.

We note that the Victorian Government is currently developing a new *Victorian Transmission Investment Framework*. It is not possible to provide comment on how that new framework will address the potential for discrimination given that draft legislation is not expected to be made public until early 2024.

8. To what extent are the dispute resolution mechanisms in the NER capable of being applied to discriminatory behaviour by AusNet towards Origin's generator rivals?

The dispute resolution mechanisms under Rule 5.5 are available to connecting parties provided the disputes relate to the price or other terms and conditions of prescribed or negotiated transmission services. However, we note that connecting parties may be reluctant to participate in this regime on account of the monopoly power of TNSPs and the need to maintain a commercial relationship.

Electricity distribution in Victoria

9. Please explain how the regulations would operate to prevent AusNet from discriminating against 'embedded' generators in connection to the distribution network.

Embedded generation refers to a range of technology of varying scale and with different owner interests. It is helpful to distinguish between embedded generation that is owned by a small customer (eg. household solar panels) and larger-scale embedded generation such as a grid-scale battery or a larger co-generation plant.

The AER's Distribution Ring-fencing Guideline imposes obligations on a DNSP when the embedded generation which is connected, or seeking to connect, to the network is owned or controlled by an affiliated entity.

Each DNSP is required to self-report any breaches of the Guideline within 15 business days. In addition, compliance by DNSPs is monitored through a requirement for each business to submit an annual report of compliance along with an independent audit report provided by each DNSP. Additionally, monitoring can rely on complaints or reports of behaviour submitted by other parties.

10. Please explain how the regulations seek to prevent distribution network owners from favouring a co-owned retailer.

The Distribution Ring-fencing Guideline (DRFG) contains a general obligation not to discriminate at clause 4.1. This requires a DNSP to treat a related entity as if they were not a related entity; deal with them on substantially the same terms and conditions as a competitor; provide substantially the same quality, reliability and timeliness of service; and not disclose information obtained through dealings with a competitor. As is the case for the TRFG, breaches of the DRFG attract Tier 1 civil penalties.

While the Distribution Ring-fencing Guideline (DRFG) does not contain specific reference to retailers, a retailer provides 'other electricity services' and accordingly qualifies as a *related electricity service provider*.

11. Are there forms of conduct that a distribution network operator could undertake to favour a co-owned generator or retailers that would be difficult to detect or difficult to take enforcement action against using existing regulations?

AER's Distribution Ring-fencing Guideline has comparable objectives to the TRFG in promoting the development of competitive markets by seeking to provide a level playing field between DNSPs and third-party providers in new and existing markets for contestable services.

The Distribution Guideline does this by imposing obligations on DNSPs targeted at, among other things, preventing discrimination involving related electricity service providers and cross-subsidisation.

Monitoring of compliance by DNSPs relies on a process of self-reporting of breaches of obligations and annual reports of compliance. These annual reports are required to be submitted to the AER along with independent audits for each DNSP. Additionally, monitoring can rely on complaints or reports of behaviour submitted by other parties.