Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601
AERringfencing@aer.gov.au

23 January 2025

Dear Sir/Madam,

Proposed changes to the Distribution Ring Fencing Guideline

The Australian Energy Council ('AEC') welcomes the opportunity to make a submission on the Australian Energy Regulator's ('AER') consultation - *Proposed changes to the Distribution Ring Fencing Guideline.*

The AEC is the peak industry body for electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. AEC members generate and sell energy to over 10 million homes and businesses and are major investors in renewable energy generation. The AEC supports reaching net-zero by 2050 as well as a 55 percent emissions reduction target by 2035 and is committed to delivering the energy transition for the benefit of consumers.

Specific comment on the consultation questions.

1. Provide greater flexibility in determining the duration of ring-fencing waivers. The AER propose to modify clauses 5.3.4(b) and (c) and remove the current restriction on the maximum term for which ring-fencing waivers can be granted. The restriction currently limits waivers, other than for energy storage devices or stand-alone power systems (SAPS), to the current and upcoming regulatory control periods (i.e. 5 regulatory years, or a maximum of 5 years beyond the remaining duration of a DNSP's current regulatory control period).

The original reviews into removing restrictions on the maximum terms of waivers for both SAPS and then energy storage devices asked stakeholders to consider a range of issues associated with developing a fit for purpose regulatory regime that is consistent with the NEO (National Electricity Objective) and was in the long term interests of consumers. Fundamental to this question, and former reviews, is the type of model we should use to facilitate SAPS and distributed energy storage; should it be market led or regulated? In each of these earlier reviews the regulators decisions clearly put its faith in regulated investment. For all practical purposes these decisions allowed NPV calculations to stack up on immediate initiatives, as opposed to promoting the long term interests of consumers.

The Australian Energy Council's view remains that the long-term interests of consumers is best met through the development of competitive markets in services which are, or should be, contestable. In a market-led facilitation of SAPS and energy storage therefore, it is appropriate to restrict the ability for regulated network businesses to earn a regulated return on behind-the-meter and/or in-front-of-the-meter assets specifically associated with the provision these assets. This is because when networks supply and/or own these assets, competitive neutrality in the provision of these services to customers could be compromised.

Where the network owns these assets, they can in practice access the network support benefits far more easily than other participants in the market, allowing them to offer the customer services at a lower cost. Where in fact present, this seems like a positive at first glance. However, over time, this

allows the networks to dominate the market for either behind or before the meter services in their own service area, which would ultimately deny customers the dynamic benefits of effective competition. This is not least because the network will seek to retain as much of the value as possible, so any price differential will only be just enough to keep other competitors out. In our converse view the dynamic benefits of effective competition will over the medium term outweigh any short-term gains to customers from obtaining network provided SAPS or storage related services slightly more cheaply in the short term. Over time, the dynamic efficiency benefit would be expected to overtake the initial network provision benefit.

In addition, the direct investment by networks in energy storage and generation is a form of vertical integration. Vertical integration is generally more likely to result in the exercise of market power if at least one of the segments of the integrated entity is a monopoly. Networks in such circumstances are much more likely to have the incentives and ability to leverage the monopoly power they have in order to restrict competition in the other market. Rules to protect competition against this kind of vertical integration in transmission and generation already exist in the cross-ownership law. The Energy Council view is that this principle needs to be applied rigorously to network investments.

This is not arguing that networks should not have access to the benefits that SAPS or storage can offer. In fact, it is essential that they do so in order to achieve a lowest cost system for the benefit of customers. But they should be required to procure them from the competitive market, which may of course include a ring-fenced affiliate of the network.

So, for end-users to benefit from services that are capable of dynamic competitive offerings, it is essential that there is non-discriminatory access to these markets. This is where strong ring fencing is important because ring-fencing is an important safeguard to protect the emergence of a functioning competitive market. The current arrangements still allow network businesses to augment opportunities for growth in revenues, and substitutes to network services investments, but without the establishment costs of competitive market entry. Competitive businesses do not enjoy this comparative advantage, and the gap should not become greater by extension, and in class waivers a lack of oversight, of waiver time periods.

Protecting competition in developing markets

The restrictions currently limit waivers, other than for energy storage devices or stand-alone power systems (SAPS), to the current and upcoming regulatory control periods (i.e. 5 regulatory years, or a maximum of 5 years beyond the remaining duration of a DNSP's current regulatory control period). With the clear exclusions of SAPS and storage, and their obvious high capital costs, we wonder what other regulatory excursions are being contemplated here? The consultation notes that it expects advice from stakeholders on the following, and we provide responses herein:

(a) new services they expect to emerge as part of the energy transition where ringfencing may provide benefits or may result in appropriate barriers;

It is unrealistic to expect that ring fencing provides a barrier to the introduction of new services, excepting those with high capital costs that require long term investment certainty, already covered off by SAPS and storage carve outs. So, in this vacuum of identified services that are excluded by the current ring fencing regime, industry broadly assumes that this question is aligned with the Energy Networks Australia pitch to create a policy mandate for a DNSP-led rollout of kerbside public Electric Vehicle Charging Infrastructure (EVCI). This seeks to classify EV charging infrastructure as a 'distribution service' in the regulatory framework, claiming further that the distributors' existing poles and skilled workforce can be leveraged to provide community charging.

Level 13, 575 Bourke Street
Melbourne 3000
GPO Box 1823 Melbourne Victoria 3001

P +61 3 9205 3100
E info@energycouncil.com.au
W energycouncil.com.au

ABN 926 084 953 07

The ENA claims that DNSPs can deliver kerbside charging infrastructure at:

- lower cost,
- faster, and
- and with more competition and less disruption than other operators,

thus leading to an improved customer and community experience.

There are two fundamental problems with enabling this approach, either via extending the waiver timeline to accommodate the asset life under ring fencing arrangements, or through actually classifying a competitive market as a distribution service. This is because:

I. There is no veracity to any of the claims about the speed and effect of DNSP kerbside charging (but they could be tested in a sandboxing arrangement first) and
II. Classifying a competitive product as a distribution service is not consistent with good regulatory practice.

Beyond EVCI, it is at this time difficult to imagine other long life capital intensive regulatory excursions that would require an extended or open-ended time limit. The whole practice of the ring fencing waiver has the premise that the waiver is provided *for a purpose* and *for a period*, and there is a compelling logic to that, because an open ended or extended waiver period is the same in practical effect as a change in law, and waivers should not, and for market confidence cannot become a substitute for that. The review period in waivers remains essential for corrective changes.

(b) the costs of ring-fencing those services and whether such costs potentially will be outweighed by benefits to consumers.

Ring fencing is essential to ensure that all relevant competitive service providers can compete for the provision of contestable services on the same terms, and that the competitive process will ensure the discovery of the best price. Success will reveal itself through healthy competition between all service providers, leading to innovation and greater efficiency. It is a false narrative to presuppose that the costs of ring-fencing those services and whether such costs potentially will be outweighed by benefits to consumers without having first revealed the competitive price.

Of course, the failure of ring fencing will reveal itself through lacklustre competition, the absence of depth in the market for contestable services or non-network alternatives and a consolidation of the uneasily close commercial relationships between regulated network providers and their ring-fenced affiliates. It is this failure that also results in long-term consumer costs that are above what they could have been, and efficiency lower than it could have been. These latter two outcomes are contrary to the National Objectives.

We also observe again that nothing in any Ring-Fencing Guideline prevents the DNSP owners investing separately in legally separated businesses in the provision of competitive services, as opposed to their seeking economies of scope for their regulated businesses, that is inconsistent with ring fencing and national objectives. A principles based assessment is required by the AER in this regard at this time.

(c) the extent to which the current ring-fencing framework can either support the competitive provision or hinder the delivery of these services to consumers.

The current ring fencing framework has been steadily eroded in its support of the competitive provision of assets and services, and it is counter intuitive to suggest that weakening it further will result in greater support for competitive outcomes.

Level 13, 575 Bourke Street
Melbourne 3000
GPO Box 1823 Melbourne Victoria 3001

P +61 3 9205 3100
E info@energycouncil.com.au
W energycouncil.com.au

ABN 926 084 953 07

Encouraging private capital to continue to invest rationally means that the regulatory framework must support investor confidence in investing in long lived assets. The AER should therefore apply a high threshold to relaxation within its waiver framework to protect and encourage competition in the developing competitive energy markets. Beyond the benefit of convenience to the AER, and the obvious benefit of relaxed regulatory oversight and economies of scope to distribution networks, it is not apparent that there is any benefit to consumers or emergent markets. There is no substantiable need for any further changes to the current restriction on the maximum term for which ring-fencing waivers can be granted.

In closing, the current Guideline provides for a case-by-case assessment of any Distribution Network Service Providers (DNSP) proposal. It is incumbent on the AER to administer the Guideline in a manner that provides confidence in an enduring and stable framework.

2. Standardise the way in which DNSPs submit annual compliance reports. Specifically, we propose to add a requirement that DNSPs' annual compliance reports for ring-fencing must include a letter signed by the highest-ranking officer of that DNSP.

We do not have any specific comment on this proposal, other than to note that an internal consistency in relation to both the likelihood and consequences of a ring-fencing breach, as and when compared to other AER reporting requirements, is required.

Any questions regarding this submission should be directed to the undersigned at david.markham@energycouncil.com.au

Yours sincerely,

David Markham
Manager DER and Networks Policy
Australian Energy Council