



HOUSTONKEMP
Economists

Powercor's transmission licence application

Review of a report by Baringa for AusNet Transmission

July 2024

Report author



Contact Us

Sydney

Level 40
161 Castlereagh Street
Sydney NSW 2000

Phone: +61 2 8880 4800



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Executive summary

Powercor has applied to the Essential Services Commission (ESC) for an electricity transmission licence covering its distribution network area in western Victoria. This would have the practical effect of placing Powercor in a similar competitive position to AusNet for contestable transmission services, which also effectively has a geographic-based transmission licence for the entirety of Victoria, and a distribution licence for part of Victoria. Baringa Partners, in a report commissioned by AusNet Transmission, has raised several concerns about the unintended consequences that granting this licence might have.

The concerns raised by Baringa can be grouped into five areas. These relate to the impact that the granting of an geographic-based transmission licence to Powercor, as a distribution network service provider has on:

- competition for transmission services;
- transparency and awareness about contestability for transmission services with customers;
- allocation of costs between distribution and transmission customers;
- the mechanism for resolving technical or operational needs at shared sites; and
- alignment with the current and future regime for transmission service provision in Victoria.

Relevantly, Baringa acknowledges that they are supportive of more competition in the transmission framework, and that there are no material concerns with a distribution network service provider or its affiliates, being granted a transmission licence “in the context of an actual or contemplated augmentation to the declared shared network (DSN) in Victoria”.¹

It follows that much of Baringa’s concerns arises only in the specific circumstance whereby Powercor competes to provide connection transmission services to large loads, such as data centres or renewable generators.²

HoustonKemp Economists has been engaged by Powercor to undertake a careful review of the concerns identified by Baringa. Our approach has involved setting out the basis (if any) for the concerns identified, and evaluating those concerns as to whether they are matters that the ESC should take into consideration when evaluating Powercor’s electricity transmission licence application.

In short, we find that the concerns raised by Baringa are not valid and so should not be taken into consideration by the ESC in its evaluation of Powercor’s licence application. Our reasons in relation to each area of concern are summarised below.

Concerns about the impact on competition for transmission services

Baringa argues that granting Powercor a transmission licence could reduce competition by facilitating the bundling of non-contestable distribution and contestable transmission services and by giving Powercor other unfair advantages. However, in our opinion:

- the existing regulatory framework, including Powercor's proposed tender policy, already prevents anti-competitive bundling of services;
- information asymmetries and leveraging of distribution assets are legitimate competitive advantages that can drive efficiency and innovation, and so should not be considered as unfair practices;

¹ Baringa, *Powercor's transmission licence application*, June 2024, p. 4.

² *Ibid*, p. 26.

- current ring-fencing guidelines enforced by the AER already aim to prevent cross-subsidisation and discrimination; and
- importantly, a transmission licence does not give Powercor any new ability to compete for contestable projects that it does not already have and so any entity can bid for contestable transmission projects without holding a licence.

In short, we do not believe that the granting of an geographic-based transmission licence to Powercor raises concerns for transmission competition. Indeed, we believe that it enhances competition by reducing barriers to participating in competitive transmission processes, enabling Powercor to effectively bid for contestable transmission projects – an outcome that serves the long-term interests of consumers.

Concerns about transparency of contestability

Baringa argues that the granting of a transmission licence raises the potential for reduced transparency of transmission contestability. In our opinion, Baringa's concerns about customer awareness of contestable services in the context of assessing a transmission licence application are misplaced because:

- these issues exist regardless of whether Powercor holds a transmission licence;
- customers engaging in large transmission projects are sophisticated commercial entities capable of undertaking appropriate due diligence and so do not need protection through the licensing framework;
- Powercor's tender policy adequately addresses transparency by committing Powercor to tendering for contestable transmission services; and
- any residual concerns about transparency of contestability are best addressed through general regulatory mechanisms, not licensing.

In addition, we do not believe that the role of the ESC licensing framework is to facilitate asset specific market engagement and regulatory oversight for specific projects. Rather the licensing framework addresses matters of technical and financial capacity to provide transmission services. There are other aspects of the transmission planning and regulatory framework that are more appropriate to addressing awareness of contestability.

Concerns about inappropriate cost allocation

While proper cost allocation between distribution and transmission services is important, granting a transmission licence to Powercor does not change existing regulatory safeguards. This includes requirements to submit to the Australian Energy Regulator (AER) a cost allocation method for approval, consistent with the cost allocation principles set out in the rules, and the AER's cost allocation guideline. In addition, each business is required to submit independently audited accounts to the AER annually. We believe that these safeguards within the regulatory framework are sufficient to address the cost allocation concerns raised by Baringa.

Relevantly, the granting of a transmission licence to Powercor does not alter these fundamental regulatory requirements. Through the regulatory pricing process, Powercor would need to satisfy the AER that its distribution costs are efficient for the provision of distribution services only.

Further, the early upgrade of a distribution connection to a transmission connection reflects uncertainty with connection arrangements and pricing in general. Whether exit fees are required, should be considered as part of a wider debate about connection charging policies.

Concern about the loss of a mechanism for resolving technical or operational needs at shared sites

Baringa argues that a geographic-based transmission licence could create difficulties in resolving technical and operational needs at shared sites, such as switchyards, which results from the application of

contestability for transmission services. Baringa argues that the current process of asset-specific licensing creates a mechanism for these problems to be resolved.

To the extent that these problems arise and are material, then we do not believe that the transmission licensing process provides the best mechanism for their resolution. Specifically, we believe that these matters can be best managed through industry practice within the existing regulatory framework. Regulatory intervention should only be considered if there are particular concerns that cannot be resolved through the direct interactions of the entities involved.

Alignment with current and future regulatory frameworks for transmission planning and contestability

Baringa raises concerns that the granting of a geographic-based transmission licence to Powercor could create inconsistencies and confusion in relation to the current national regime for transmission services in Victoria. Further, they raise questions as to its consistency with the upcoming Victorian Transmission Investment Framework.

We disagree with Baringa's concerns. This reflects our opinion that the transmission licensing framework is separate from the planning and contestability frameworks, and serves a different purpose. Specifically, the licensing framework ensures that the ESC can exercise regulatory oversight of transmission service providers, ensuring that transmission operators meet specific technical, financial, and operational standards. There are other elements of the regulatory framework designed to address contestability and transmission planning arrangements.

In our opinion, the licensing framework should be distinct from those regulatory frameworks. Further, we do not believe that the granting of a geographic-based transmission licence to Powercor raises concerns that warrant changes to the contestability or planning frameworks currently in place for transmission network service providers in Victoria.

There is no need for additional licence conditions to address the concerns raised by Baringa

Baringa outlines various transmission licence conditions that it suggests are needed to address the concerns that it has raised. Given that we do not agree with the concerns of Baringa, we do not believe that there is a need for additional licence conditions to be placed on Powercor's transmission licence by the ESC.

Relevantly, if there are any future concerns about transmission contestability, cost allocation or ring-fencing of activities, then these can be considered as part of the ordinary course of developing the regulatory framework applying to transmission network service providers in Victoria. In our opinion, using licence conditions to address these matters is not consistent with the design of the overall regulatory framework.

In summary, Baringa's concerns about granting Powercor a geographic transmission licence are not valid. Existing regulatory frameworks adequately address issues of competition, transparency, and cost allocation. The granting of a transmission licence to Powercor would not create inconsistencies with current or future regulatory arrangements, nor would it impede proper oversight of transmission projects. While continual refinement of the regulatory framework is valuable, these considerations should not prevent the ESC from granting a transmission licence to Powercor.

1. Introduction

On 30 April 2024, Powercor Australia Limited (Powercor) submitted an application to the Essential Services Commission (ESC) for an electricity transmission licence in Victoria. The proposed licence would cover Powercor's existing distribution network area, which primarily encompasses the western half of Victoria.

In response, AusNet Transmission (AusNet) engaged Baringa Partners (Baringa) "to identify matters which warrant further consideration by the ESC in the assessment of the electricity transmission licence application by Powercor."³ Baringa's report outlines:

- current arrangements for the provision of transmission and distribution network services in Victoria;
- the motivations underlying Powercor's application;
- potential implications should Powercor's transmission licence be granted;
- responses to the ESC's consultation questions; and
- recommended licence conditions, should the ESC decide to grant the licence.

Within this context, HoustonKemp has been asked by Powercor to provide an independent review of the concerns raised by Baringa.

Our approach has involved a comprehensive analysis of the Baringa report, coupled with an in-depth examination of the regulatory framework governing transmission licensing and the associated competitive concerns. By integrating these key elements, we have critically assessed Baringa's claims within the broader context of the energy market and regulatory landscape, ultimately forming our own opinion on the merits of their position.

The remainder of this report is structured as follows:

- in section 2, we briefly explain the role of licensing in the transmission economic framework, which is relevant to a consideration of the matters raised by Baringa;
- in section 3, we consider whether the granting of a transmission licence to Powercor raises concerns that the ESC should consider, by summarising and assessing the principal concerns and arguments made by Baringa in relation to Powercor's transmission licence application; and
- in section 4, we consider whether there is a need for licence conditions to address any of the matters raised by Baringa.

³ Baringa, *Powercor's transmission licence application*, June 2024, p 7.

2. The role of licensing in the economic framework

In this section, we briefly describe the role of transmission licensing in the broader economic and regulatory framework for electricity networks in Victoria.

2.1 Overview of electricity transmission regulation in Victoria

Victoria employs a unique model for electricity transmission planning and ownership that differs from other National Electricity Market (NEM) jurisdictions. Unlike most other jurisdictions⁴ where a single transmission network service provider (TNSP) is responsible for planning, owning, and operating the transmission network, Victoria has separated these functions. The Australian Energy Market Operator (AEMO) currently holds the role of transmission network planner, while ownership and operation of transmission assets is spread across multiple declared transmission system operators (DTSOs).

This arrangement stems from Victoria's electricity industry reforms in the 1990s and is underpinned by state-specific legislation, particularly the *National Electricity (Victoria) Act 2005*. Under this framework, AEMO is responsible for planning and procuring augmentations to the declared shared network, either through directing non-contestable works to incumbent DTSOs or conducting competitive tenders for contestable augmentations.

The primary DTSO in Victoria is AusNet Services, which owns and operates most of Victoria's transmission assets, but other entities also own and operate specific transmission assets, particularly those connecting renewable energy projects. The Essential Services Commission (ESC) plays an important role in the regulatory system by issuing and overseeing transmission licences, while VicGrid, a recently established body, is set to take over transmission planning responsibilities from AEMO in the near future.

2.2 Purpose and function of transmission licences

The primary purpose of transmission licences in Victoria is to provide a formal authorisation for entities to engage in electricity transmission activities within the state. This licensing regime enables the ESC to exercise regulatory oversight, ensuring that transmission operators meet specific technical, financial, and operational standards. A transmission licence grants its holder the legal right to transmit electricity via specified transmission system assets or, in some cases, within a defined geographic area.

The nature and scope of transmission licences can vary significantly. Traditionally, the ESC has issued asset-specific licences, which permit the licensee to transmit electricity using particular, identified transmission assets. That said, for AusNet Transmission, its licence applies more broadly to the transmission system in Victoria, rather than specific identified assets. It follows that this has led to a need for newer declared transmission system operators (DTSOs) to seek a new licence every time they construct a new specific transmission project, say to connect a renewable generator. This requirement does not apply to AusNet Transmission, which can use its existing licence without the need to seek a new licence.

It follows that Powercor's recent application for a geographic-based licence represents a potential shift in approach for new DTSOs, but reflects the position that AusNet Transmission is in when competing for contestable transmission projects. A geographic-based licence, if granted, would allow the holder to transmit

⁴ EnergyCo in New South Wales has responsibility for planning transmission network investments to support renewable energy zones. The NSW framework has introduced the concept of alternative transmission operators for REZ, separate to Transgrid – the jurisdictional transmission planner.

electricity within a specified region, potentially offering greater flexibility in terms of future asset development and service provision.

Importantly, while transmission licences have historically been asset-specific, there is no requirement for this to be the case. It follows, that it is open to the ESC to grant an area-specific licence under the current framework.

2.3 Relationship to contestability framework

The transmission licensing regime in Victoria is closely intertwined with the contestability framework established by the National Electricity Law (NEL) and National Electricity Rules (NER). While licensing determines who is authorised to provide transmission services, the contestability provisions dictate which services can be competitively tendered. Importantly, holding a transmission licence does not automatically grant the right to construct or operate specific assets. Rather, it facilitates and streamlines the holder's participation in competitive processes for contestable transmission services, by removing the need to apply for and receive a licence if successful.

For contestable augmentations to the declared shared network, AEMO conducts competitive tenders to determine who will construct and operate the new assets. Any entity wishing to participate in these tenders must either hold a transmission licence or be willing to obtain one if successful. This requirement ensures that only technically and financially capable entities can compete for and ultimately provide these critical infrastructure services. The interaction between licensing and contestability therefore plays a crucial role in shaping the competitive landscape of Victoria's transmission sector.

Finally, the granting of a geographic licence does not alter the opportunities for projects to be contestable, nor does it create special rights to the holder to non-contestable transmission projects. The current arrangements for non-contestable augmentations needing to be constructed by the incumbent DTSO remain the same irrespective of the granting of a geographic-based transmission licence to Powercor.

2.4 Economic rationale for licensing

The primary economic rationale for transmission licensing is to ensure that entities operating critical electricity infrastructure possess the necessary technical, financial, and operational capabilities. By setting minimum standards for licensees, the regime helps safeguard the reliability, safety, and efficiency of the transmission network as a whole. This is particularly important given the natural monopoly characteristics of transmission infrastructure and its crucial role in the broader electricity supply chain.

Licensing also serves to facilitate new entry and competition where appropriate. By providing a clear pathway for new entities to enter the market and compete for contestable services, the licensing regime can promote innovation, efficiency, and cost-effectiveness in transmission service provision. Additionally, licensing provides a mechanism for ongoing regulatory oversight of transmission entities, allowing the ESC to monitor compliance with licence conditions and other regulatory obligations, thereby protecting the long-term interests of consumers.

2.5 Interaction with other regulatory mechanisms

Transmission licensing in Victoria operates alongside several other regulatory mechanisms that collectively govern the electricity transmission sector. One key interaction is with the revenue regulation framework administered by the Australian Energy Regulator (AER). While licensing determines who can provide transmission services, the AER's revenue determinations set the maximum allowed revenue for regulated transmission services, influencing the financial returns available to licensees.

Licensing also interacts with performance standards and compliance monitoring regimes. Licence conditions often incorporate or reference technical and operational standards that licensees must meet, complementing other regulatory instruments such as the National Electricity Rules. Further, the licensing regime intersects

with ringfencing requirements, which aim to prevent anti-competitive behaviour by vertically integrated network businesses. These ringfencing obligations, ensure appropriate separation between regulated monopoly services and contestable activities.

2.6 Current licensing approach in Victoria and the role of the ESC

The current approach to transmission licensing in Victoria has predominantly focused on issuing asset-specific licences. Under this model, the ESC grants licences that authorise the holder to transmit electricity using specific, identified transmission assets. This approach has been applied to DTSOs like AusNet Services, as well as to new entrants constructing particular transmission projects, such as those connecting renewable energy generators to the grid.

That said, AusNet Transmission's licence applies to its 'electricity transmission system', which is a broad definition of specific assets.⁵ This broad definition has the practical effect of allowing AusNet to compete for contestable transmission services without needing to seek a new asset-specific licence.

For new transmission projects, the licensing process typically follows a competitive tender or negotiation process for the project. Once an entity is selected to construct and operate a new transmission asset, they apply for a licence specific to that asset. This approach ensures that licensing aligns closely with the actual development and operation of transmission infrastructure, providing clarity on the scope of each operator's responsibilities and facilitating targeted regulatory oversight.

The ESC has an important role in assessing transmission licence applications in Victoria. In this capacity, the ESC must balance multiple statutory objectives, including promoting the long-term interests of Victorian consumers, facilitating efficiency in the industry, and promoting competition where feasible. The ESC's licence application assessment criteria include the applicant's technical and financial capacity, as well as their ability to comply with relevant regulatory obligations.

⁵ Essential Services Commission, *Electricity Transmission Licence – AusNet Transmission Group Pty Ltd*, As varied on 20 March 2019, clause 2.

3. Does the granting of a transmission licence to Powercor raise concerns that the ESC should consider in its assessment?

In this section, we analyse the key concerns raised by Baringa regarding Powercor's transmission licence application. We start by summarising the key concerns, and then consider each of the five areas of concern identified in greater detail.

3.1 Summary of the concerns raised by Baringa

The Baringa report assesses Powercor's application for a geographic-based transmission licence in Victoria, highlighting several potential risks and unintended consequences. Baringa acknowledges that the concerns stem principally from Powercor applying for a geographic-based transmission licence covering its distribution network area in Western Victoria. While Baringa acknowledges that there is no restriction on the ESC granting a geographic-based transmission licence, it notes that historically transmission licences have been granted with reference to specific transmission assets.

In summary, the key concerns raised by Baringa include that the granting of a geographic-based transmission licence to an existing distribution network service operator:

1. affects competition for transmission services by:
 - a. reducing transparency between non-contestable distribution services and contestable transmission services, by allowing Powercor to bundle these services; and
 - b. giving Powercor an unfair advantage in competing for transmission projects due to information asymmetries and ability to leverage its distribution assets;
2. raises concerns about transparency and awareness about contestability for transmission services with customers through;
 - a. customers that might be unfamiliar with the electricity regulatory system being unaware when engaging with Powercor that some transmission network services are contestable; and
 - b. its belief that the process of the ESC assessing an asset specific licence provides oversight of the activity of the business engaged in transmission services, and also facilitates customer engagement;
3. inappropriate allocation of costs between distribution and transmission customers, especially as connection services for some customers and assets change over time;
4. results in the loss of a mechanism for resolving technical or operational needs at shared sites like switchyards; and
5. is inconsistent with the current and future framework for transmission service provision in Victoria.

Baringa suggests that if the ESC is inclined to grant the licence, conditions should be imposed to mitigate these potential risks and unintended consequences. In short, Baringa raises concerns about competition, transparency, cost allocation, and alignment with existing regulatory frameworks.

3.2 Does the granting of a transmission licence raise competition concerns?

Baringa's concerns about the effect of a transmission licence on competition for contestable transmission services arises from:

- concerns about bundling of non-contestable distribution services and contestable transmission services; and
- the potential for an unfair advantage by leveraging distribution services when competing for transmission services.

We consider these points in further detail below before considering how the granting of a transmission licence to Powercor affects these concerns.

3.2.1 Concerns about bundling of non-contestable distribution services and contestable transmission services

Baringa raises concerns about the potential for the granting of a transmission licence to allow Powercor to bundle non-contestable distribution services with contestable transmission services in a way that may not be clear to customers, thereby affecting competition for contestable transmission services.

As Baringa claims:⁶

While a bundled offer may be a simple offer for the customer, it risks detracting from, rather than enhancing competition for, contestable services.

Baringa claims that this bundling could occur because Powercor would be both the monopoly provider of distribution services in its area, and a potential provider of transmission services within the same geographic area.

Baringa goes on to claim that this situation could lead to customers not being aware of contestability opportunities, and in particular those who are not well-versed in the intricacies of the electricity market.⁷ Customers might find it difficult to distinguish between the services that are part of Powercor's regulated monopoly (distribution services) and those that are open to competition (certain transmission services). This lack of clarity could potentially hinder customers' ability to make informed decisions about their service options and could inadvertently restrict competition in the market for transmission services.

Further, Baringa claim that if Powercor presents bundled services that combine both distribution and transmission elements, it might be difficult for customers to separate these components and evaluate them against standalone transmission service offers from other providers.⁸ This could potentially give Powercor an unfair advantage in the market for transmission services and ultimately lead to less efficient outcomes for consumers. Baringa emphasise the importance of maintaining clear delineation between contestable and non-contestable services to ensure fair competition and informed customer choice.

In our opinion, the concerns for competition that Baringa raise are overstated. In circumstances where contestable transmission services are provided through a competitive tender process administered by AEMO (or VicGrid in the future), then there is no opportunity for bundling to arise.

The only circumstance where Powercor might, at least in principle, bundle a non-contestable distribution service and a contestable transmission service would be when a large customer, such as a data centre, initially connects to the distribution network but later requires an upgrade to transmission-level connection. In this example, Powercor could potentially provide the non-contestable distribution connection service and offer to bundle this with contestable transmission services for the upgrade, though the customer would retain the right to seek competitive options for the transmission component.

⁶ Baringa, *Powercor's transmission licence application*, June 2024, p. 5.

⁷ *Ibid*, p. 26.

⁸ *Ibid*, p. 46.

That said, we believe that this theoretical risk is mitigated by Powercor's tender policy which addresses competition concerns about bundling non-contestable distribution and contestable transmission services by establishing clear procedures for competitive procurement of transmission services.

The policy commits Powercor to conducting a competitive tender process for separable augmentations to transmission connection assets, mirroring the contestability regime for shared network augmentations. For augmentations to the declared shared network, the policy affirms Powercor will follow the existing NEL and NER requirements, and that it is committed to:⁹

...conducting a competitive tender process to determine who will construct Separable Augmentations to the connection assets that form part of the declared transmission system.

Importantly, the policy defines 'Separable Augmentations' for transmission connection assets using criteria similar to those in the NER for shared network augmentations, ensuring contestability where practically feasible. By explicitly committing to competitive processes for contestable transmission works, whether shared network or connection assets, the policy creates a clear delineation between Powercor's role as a monopoly distribution service provider and its potential role in contestable transmission services. This approach helps ensure that Powercor cannot leverage its distribution monopoly to unfairly advantage its transmission business, thereby maintaining a level playing field for competition in contestable transmission services.

Finally, any concerns about the application of Powercor's tender policy, and competition more broadly, could be the subject of future regulatory reviews of competition for contestable transmission services. Such a threat of review and potentially more heavy-handed regulation provides a strong incentive for Powercor to ensure that it delivers on the commitments of its tender policy.

3.2.2 Concerns about unfair advantages in competing for transmission projects

We understand that Baringa is concerned that Powercor may also have an unfair competitive advantage if it obtains a transmission licence for a geographic area due to information asymmetries and its ability to leverage existing distribution assets.¹⁰

As the distribution network service provider in the area, Powercor has detailed and localised information about network conditions, load patterns, and future growth projections. Baringa argues that this information could give Powercor an edge when competing for transmission projects, as other bidders may not have access to the same level of information.

Baringa also suggests that Powercor could leverage its existing distribution infrastructure (such as poles or easements) to offer lower-cost transmission solutions compared to competitors who would need to build new infrastructure. While this could reduce costs in some cases, Baringa claims it could also create barriers to entry for other transmission service providers, potentially limiting competition in the long term.

Baringa states that:¹¹

Granting Powercor's licence, whether defined by geographic area or asset, would provide an advantage for them against the pool of potential providers that connecting parties could seek bids from.

In our opinion, the granting of a licence to Powercor does not create a competitive advantage. The key reason is that there are, in principle once the ESC agrees to a geographic-based transmission licence, no barriers to other competitive transmission operators also obtaining a geographic area or asset licence. It follows that, Powercor having a licence therefore cannot create a unique circumstance or advantage against

⁹ CitiPower and Powercor, *Tender Policy – CitiPower and Powercor contestability of connection and augmentation guideline*, February 2024, section 11.1, p. 9.

¹⁰ *Ibid*, p. 31.

¹¹ *Ibid*.

other competitors, because the granting of such a licence does not foreclose on others obtaining the same licence.

This highlights the importance of the ESC granting Powercor's licence to remove barriers that might otherwise lead to a competitive advantage for AusNet Transmission, who does not need to apply for a transmission licence when competing for contestable transmission projects.

In our opinion, the concerns raised by Baringa about Powercor using information asymmetries and leveraging existing distribution assets for contestable transmission services are largely misplaced and do not present significant threats to competition.¹²

First, information asymmetries are a common feature in many competitive markets and often drive innovation and efficiency. In this context, Powercor's intimate knowledge of its distribution network and local conditions can lead to more efficient and cost-effective solutions for transmission services, ultimately benefiting consumers. This localised knowledge and experience is not an unfair advantage, but rather a legitimate competitive strength that other providers could potentially develop or acquire over time, particularly those involved in constructing and operating networks in other geographic areas, or through building an understanding of the distribution and transmission power system in Victoria.

Second, the ability to leverage existing distribution assets for transmission services is not inherently anti-competitive, but rather a potential source of economic efficiency. If Powercor can use its existing infrastructure to lower the cost of providing transmission services than building entirely new assets, this represents a more efficient use of resources. This type of vertical integration and asset utilisation is common in many industries and often leads to cost savings that can be passed on to consumers.

Last, it is important to note that robust regulatory frameworks already exist to prevent anti-competitive behavior and ensure fair competition. The ring-fencing guidelines enforced by the Australian Energy Regulator (AER) are specifically designed to address concerns about cross-subsidisation and discrimination in vertically integrated network businesses. These guidelines require appropriate separation of regulated monopoly services from contestable activities, ensuring that any use of shared assets or information is done on an arm's length basis.

Additionally, Powercor's proposed tender policy for transmission services further reinforces its commitment to fair competition. Therefore, rather than stifling competition, allowing Powercor to participate in contestable transmission services with its existing advantages could actually enhance competition by introducing a strong, efficient competitor to the market.

3.2.3 The granting of a transmission licence to Powercor does not affect the competition outcomes

Finally, the granting of a transmission licence to Powercor does not fundamentally alter competition outcomes for contestable transmission projects because holding such a licence is not a prerequisite for offering to provide contestable transmission services. This is a crucial point that is often misunderstood in discussions about Powercor's licence application.

Under the current regulatory framework in Victoria, any entity can participate in competitive tenders for contestable transmission projects, regardless of whether they hold a transmission licence at the time of bidding. The licence is only required for the actual operation of transmission assets, not for participating in the competitive process to build and own those assets. In practice, when a non-licence holder wins a contestable project, they typically apply for and obtain a transmission licence before commencing operations, but after being selected as the preferred provider.

This means that Powercor's acquisition of a transmission licence would not give it any additional ability to compete for contestable projects that it does not already possess. The licence will simply allow Powercor to

¹² Ibid, p. 32.

streamline its process for operating transmission assets if it wins contestable projects, rather than having to apply for individual licences for each project. Therefore, the granting of a transmission licence to Powercor does not create any new competitive advantage or market power in the contestable transmission services market. It merely puts Powercor on an equal footing with other transmission licence holders in terms of operational readiness, without affecting the underlying competitive dynamics of the bidding process for contestable projects.

3.3 Does the granting of a transmission licence to Powercor affect transparency about contestability for transmission services?

Baringa raises concerns about the effect of granting a transmission licence to Powercor might affect transparency about contestability for transmission services. Baringa claims that these concerns result from:

- customers that might be unfamiliar with the electricity regulatory system being unaware when engaging with Powercor that some transmission network services are contestable; and
- its belief that the process of the ESC assessing an asset specific licence provides oversight of the activity of the business engaged in transmission services, and also facilitates customer engagement.

We consider these points in further detail below.

3.3.1 Risks that customers unfamiliar with the electricity system may be unaware of the contestability of services

Baringa raises concerns about the risk that customers unfamiliar with the electricity system might not be aware of the contestability of certain transmission services, and that Powercor would not have an incentive to make them aware.¹³

The report suggests that many customers, especially those new to the market or dealing with larger connections for the first time, may not fully understand which services are contestable (ie, open to competition) and which are not. In the context of Powercor holding both distribution and transmission licences for the same geographic area, customers might incorrectly assume that all services offered by Powercor are part of its regulated monopoly, when in fact some transmission services could be procured from other providers.

Further, Baringa points out that Powercor, as the initial point of contact for many customers in its distribution area, may not have a strong incentive to proactively inform customers about contestable options from other providers.¹⁴ This could potentially lead to situations where customers unknowingly forgo opportunities to seek competitive bids for contestable transmission services, ultimately reducing competition and potentially leading to higher costs or lower service quality for customers.

In our opinion, concerns about the familiarity of customers with the contestability arrangements in the transmission sector in Victoria are not relevant to a consideration about the granting of a transmission licence to Powercor. Should the ESC consider these concerns be valid, and in our opinion they are not, then they would apply in circumstances irrespective as to whether Powercor has a transmission network licence, given they can offer to provide contestable transmission services currently, through a commitment to obtain a licence if successful in being engaged to undertake the service.

In our opinion, concerns about the understanding of customers with contestability arrangements in the transmission sector in Victoria are not valid given the nature of the businesses that Powercor (or any transmission network provider) would be dealing with when considering connection network services. Companies engaged in connecting large loads or supply are commercial entities for which undertaking appropriate due diligence and engaging advisers to assist with connection arrangements, is part of the

¹³ Ibid, p. 26.

¹⁴ Ibid, p 30 and 34.

ordinary course of their activities given the size of the investments involved (often over \$10 million). It follows that we do not believe that these concerns are valid in the circumstances of contestable transmission network services in Victoria.

We do not believe that the transmission licensing framework is how best to address concerns that connection applicants may not be aware of contestability arrangements in Victoria.

It follows that any concerns about transparency and awareness by customers of contestability opportunities are best dealt with through other regulatory mechanisms, if these concerns are considered material. In our opinion, Powercor's tender policy is appropriate for addressing concerns about transparency of contestability and so should be considered sufficient in addressing any concerns that might arise in this area. That said, it would be appropriate in the future to consider other regulatory arrangements applicable to all transmission network service providers, should concerns about transparency arise.

3.3.2 Lack of oversight and engagement when Powercor commences operating a specific transmission asset

Baringa argues that the current system, which requires transmission companies other than AusNet to apply for licences for specific assets, enables thorough regulatory scrutiny and public input on each proposed project, by acting as a de-facto process for market engagement.¹⁵ This process, they contend, allows for detailed examination of the project's impacts and the applicant's capability to own and operate the asset, ensuring oversight on projects, transparency and stakeholder participation which would be eroded by a geographic specific licence. Further, Baringa warns it might limit opportunities for public input on specific projects, which they deem particularly crucial for large or controversial transmission developments.

Relevantly, concerns about a lack of oversight and engagement through the licensing process would currently apply to AusNet, who is not required to obtain an asset specific licence. The time and costs associated with licensing on an asset specific basis currently creates a barrier to entry in the provision of contestable transmission services.

Regardless, we disagree with Baringa's concerns about the potential for a lack of oversight and engagement under a geographic transmission licence. This licence does not change the regulatory framework for transmission projects that require for planning and other approvals. This provides appropriate and commensurate regulatory and public scrutiny of specific transmission projects.

Importantly, transmission planning and approvals processes (such as the regulatory investment test for transmission, etc) are the appropriate regulatory mechanisms for providing market engagement and scrutiny of proposed transmission projects. In our opinion, the transmission licensing framework is not the appropriate regulatory mechanism for obtaining public scrutiny of proposed transmission projects.

3.4 Are there risks that Powercor will inappropriately allocate costs between distribution and transmission customers to obtain a competitive advantage in providing transmission services?

Baringa raises concerns about the potential for inappropriate cost allocation between distribution and transmission customers under Powercor's proposed geographic-based transmission licence.¹⁶ They suggest that the blending of distribution and transmission services within a single entity, albeit within different ring-fenced divisions, could create opportunities for costs to be misallocated, either intentionally or unintentionally, between these two distinct customer groups.

A key issue for Baringa is the potential for costs associated with transmission services to be incorrectly attributed to distribution customers, or vice versa. Baringa argue that this risk might be particularly acute

¹⁵ Ibid, p. 42.

¹⁶ Ibid, p. 5.

given that the nature and use of assets may change over time. For example, distribution assets might be repurposed or upgraded to support transmission services, raising questions about how the costs of these assets should be allocated. They emphasise that without clear and robust mechanisms to ensure proper cost attribution, there is a risk that one group of customers could end up cross-subsidising services provided to another group.

Finally, Baringa also claim that this cost allocation concern becomes more problematic where distribution customers upgrade to a transmission exit, without contributing to the distribution costs associated with the original connection.¹⁷ The Baringa report stresses the importance of establishing clear principles and processes for cost allocation to ensure that all customers are treated fairly and that the economic signals provided by network pricing remain efficient and cost-reflective.

As a matter of regulatory principle, it is important that costs are appropriately allocated between network services, and in particular between non-contestable distribution services and transmission services. It follows that the regulatory framework that governs cost allocation is an important element of the overall framework.

The NERs require distribution and transmission network providers to develop a cost allocation method, in line with the cost allocation principles, and the AER's cost allocation guidelines.¹⁸ In addition, the businesses are required to provide independently audited accounts to the AER. In combination, these elements of the regulatory framework aim to ensure that costs are appropriately allocated between network services, and between regulated and unregulated activities.

In our opinion, the granting of a transmission licence to Powercor does not change the importance or application of cost allocation principles in the regulatory framework. These principles are fundamental to ensuring fair competition and preventing cross-subsidisation between regulated monopoly services and contestable activities, regardless of whether an entity holds both distribution and transmission licences.

It follows that the granting of a transmission licence to Powercor should not be affected by concerns about cost allocation between distribution and transmission services.

Cost allocation principles are embedded in the regulatory framework administered by the Australian Energy Regulator (AER) and apply to all network service providers, including those that operate in both distribution and transmission. These principles require that costs are appropriately allocated between different services and customer classes, ensuring that regulated services do not subsidise competitive activities and vice versa. The existence of robust cost allocation principles and their enforcement by the AER is what prevents potential anti-competitive behavior, not the presence or absence of a particular licence.

The granting of a transmission licence to Powercor does not alter these fundamental regulatory requirements. Powercor would still be obligated to comply with all applicable cost allocation principles and ringfencing guidelines, regardless of whether it holds a transmission licence. The licence itself does not confer any special exemptions from these regulatory obligations.

In short, the regulatory safeguards against improper cost allocation and cross-subsidisation remain in place and would continue to be enforced, ensuring that competition in contestable transmission services remains fair and undistorted by Powercor's position as a distribution network service provider.

3.5 Concern the loss of a mechanism for resolving technical or operational needs at shared sites

Baringa argues that a geographic -based transmission licence could create difficulties in resolving technical and operational needs at shared sites, such as switchyards, which results from the application of

¹⁷ Ibid, p. 34 and p. 54.

¹⁸ National Electricity Rules, Chapter 6, Part F, and Chapter 6A, Part G.

contestability for transmission services.¹⁹ The problem, Baringa explains, arises where a transmission operator is selected to provide network augmentation within a brownfield area, which can lead to changes to operating responsibility for some assets, or a need to share access to a site.

Baringa's concern arises because of a claim that the asset-specific licensing approaches creates a mechanism and time to allow entities that are planning to operate at a shared site to work through these practical matters, including technical specifications, safety protocols, access arrangements, and other operational matters specific to each site.

In our opinion, concerns about how to manage technical or operational needs at a shared site are not best addressed through an asset specific licensing system. To the extent that these concerns need regulatory intervention, then they should be dealt with directly through the contestability or other regulatory frameworks.

In addition, the granting of a transmission licence to Powercor seems unlikely to exacerbate these problems, assuming that they currently arise. We would expect that industry practices will evolve and should be the first best approach to addressing management of shared sites, with regulatory intervention only considered if there are particular concerns that cannot be resolved through the direct interactions of the entities involved.

3.6 Concerns about the alignment of geographic transmission licensing with the current and future framework for transmission service provision in Victoria

Baringa argues that Powercor's proposed geographic -based transmission licence could create inconsistencies and confusion in relation to the current national regime for transmission services in Victoria.²⁰ They contend that Victoria's unique transmission regulatory arrangements, which differ from other states in the National Electricity Market, could be further complicated by the granting of a geographic licence to Powercor. Baringa also suggests that the geographic licence approach might not align well with existing frameworks for contestable augmentations and connections to the declared shared network, potentially leading to confusion among market participants and regulators.

Further, Baringa raises questions about how Powercor's proposed licence would interact with the upcoming Victorian Transmission Investment Framework (VTIF).²¹

We disagree with Baringa's concern that the granting of a transmission licence to Powercor is inconsistent or causes confusion, with the current or future transmission planning and investment arrangements in Victoria. The proposed licence does not alter the existing regulatory framework for transmission services in Victoria, including arrangements for contestable augmentations and connections to the declared shared network. These frameworks will continue to operate as they do currently, regardless of the geographic nature of Powercor's licence.

Further, we do not share Baringa's view that the proposed licence creates additional complexity or uncertainty in relation to the upcoming Victorian Transmission Investment Framework (VTIF). The transmission licensing process is separate from and does not impact on the development or implementation of the VTIF. The VTIF will apply equally to all transmission network service providers in Victoria, regardless of whether the licence is geographic-based or asset specific. In our opinion, granting a geographic transmission licence to Powercor would not affect the efficient operation and development of the transmission network under current or future regulatory frameworks.

In contrast, by reducing barriers to participation in the contestable market for transmission services in Victoria, we believe that competition will be enhanced which is entirely consistent with reforms to the transmission planning and investment framework in Victoria. This is particularly the case given that the

¹⁹ Baringa, *Powercor's transmission licence application*, June 2024, p. 37.

²⁰ *Ibid*, p. 5.

²¹ *Ibid*, p. 41.

granting of a transmission licence to Powercor does not foreclose on other entities in the future seeking and being granted a transmission licence for the same geographic area.

4. The need for licence conditions to address Baringa's concerns

Baringa discusses potential licence conditions and broader regulatory reforms that it believes should be considered if Powercor's transmission licence application is approved. In this section, we summarise these points and provide our own opinions on the need for additional licence conditions to address the concerns.

4.1 Is there a need for additional licence conditions to address Baringa's concerns?

Baringa raises several licence conditions, that it believes should be included in Powercor's transmission licence if approved. These include:

- expressly stating that the transmission network licence is granted on a non-exclusive basis for the defined geographic area;
- inclusion of a mechanism to identify the specific assets that Powercor is permitted to use to transmit electricity, such as a register that would allow Powercor to update the ESC, and the public more broadly, as to the assets that it is operating through its licence;
- requiring Powercor through a condition in its distribution licence to:
 - > disclose information to connection applicant's explaining which elements of the connection service are contestable;
 - > articulate and delineate the nature and terms of any distribution services and the nature and terms of any proposed transmission services;
 - > refrain from making, or promoting, bundled offers which combine distribution services and transmission services; and
- requiring Powercor to provide access to transmission service providers to its distribution assets.

In our opinion, there is no need to include a non-exclusivity clause in the licence as it is redundant because the existing regulatory framework already ensures that transmission services remain contestable, regardless of licensing arrangements. It follows that it remains open to the ESC to grant a licence to any entity that satisfies the licence requirements for the same geographic location that Powercor has applied for.

The provision of information on the assets to which the transmission licence applies is consistent with good practice, to ensure that parties are aware as to which entity to contact if seeking a connection or other transmission service. That said whether there is a need for such a register to be a licence condition, administered by the ESC, is an open question. In our opinion, it does not seem that the administrative costs likely outweigh the benefits, and so Powercor simply committing to provide information on the assets it operates, should be sufficient to address concerns in this area.

Information disclosure requirements are not necessary as a licence condition for Powercor's proposed geographic transmission licence, as robust transparency measures are already embedded in the existing regulatory framework. The National Electricity Rules and various guidelines issued by the Australian Energy Regulator (AER) mandate extensive information disclosure and ringfencing requirements for network service providers. These existing provisions are designed to prevent anti-competitive behavior, ensure clear delineation between regulated and unregulated services, and promote transparent customer communication.

Further, Powercor has already submitted a comprehensive tender policy as part of its licence application, which outlines its commitment to fair and transparent processes for contestable services. In our opinion, this policy, combined with existing regulatory obligations, sufficiently addresses concerns about information

asymmetry and customer awareness of contestable services. Adding redundant information disclosure requirements as a licence condition would create unnecessary regulatory burden without providing additional benefits to customers or the market. The focus should instead be on ensuring compliance with and enforcement of existing transparency and competition regulations.

Finally, the suggestion to provide access to distribution assets as a means of promoting transmission competition, as proposed by Baringa, would constitute a major regulatory reform that goes well beyond the scope of a transmission licence condition. Baringa does not provide substantial evidence demonstrating that lack of access to distribution assets is likely to be a material barrier to transmission competition. Without clear evidence of a significant problem, imposing such a far-reaching requirement could introduce unnecessary complexity and risks to the electricity network. It could also have unintended consequences for network reliability, safety, and efficiency.

It follows that given the potential for wide-ranging impacts and the lack of demonstrated need, the ESC should be cautious before considering the implementation of such a requirement. Any changes of this magnitude should only be considered after thorough industry consultation and comprehensive impact assessments.

4.2 The need for wider regulatory reforms to address Baringa's concerns?

Baringa proposes several wider regulatory reforms that go beyond the scope of transmission licensing conditions.

One area of focus is pricing-related reforms. The report suggests implementing an exit fee for distribution customers who disconnect early to upgrade to the transmission network. This fee would be designed to prevent cross-subsidisation between distribution and transmission customers. The report also recommends improving cost allocation mechanisms, particularly in cases where a DNSP uses existing distribution assets to connect transmission customers. These reforms are proposed to ensure fair cost recovery and prevent distribution customers from bearing costs related to transmission services.

In our opinion, there may be merit in examining the need for an exit fee for distribution customers who disconnect early as a consequence of upgrading to a transmission service, to the extent that this occurs frequently and so is a material concern. There may also be merit in giving further consideration to the practical application of cost allocation mechanisms to ensure that no cross subsidisation arises. That said, these wider regulatory matters should not prevent the ESC from the granting of a transmission licence to Powercor.

Baringa also identifies the need for broader regulatory reforms including preventing DNSPs from over-building distribution assets to gain advantages in transmission services. The report suggests strengthening AER oversight of DNSPs' capital expenditure forecasts, updating cost allocation methodologies, and implementing mechanisms to reallocate costs and adjust the Regulatory Asset Base when distribution assets are used for transmission services.

Additionally, Baringa recommends improving coordination of operational arrangements at critical sites where multiple transmission operators may be involved, to ensure safety, security, and reliability in these shared environments. The report emphasises that while these reforms are outside the ESC's direct remit, the ESC could play a role in engaging with other regulatory bodies to initiate necessary reviews and reforms.

In our opinion, the current regulatory framework has been effective at ensuring that DNSPs have not over-built the distribution system over the last 20 years. The ongoing focus on cost efficiency and strengthening the role of the consumer in the regulatory framework, combined with ongoing reforms to improve incentive arrangements has led to efficiency improvements over time. It follows that there is no basis for a comprehensive strengthening of AER oversight in the regulatory framework.

In addition, in our opinion the wider regulatory reforms to promote contestability in transmission service provision in Victoria raised by Baringa is a matter that goes well beyond the considerations that are relevant

to the ESC's assessment of Powercor's application for a transmission licence. It follows, that the ESC should disregard these considerations as part of its assessment of Powercor's application.



HOUSTONKEMP

Economists

Sydney

Level 40
161 Castlereagh Street
Sydney NSW 2000

Phone: +61 2 8880 4800

