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23 July 2026

Ms Anna Collyer
Chair
Australian Energy Market Commission
GPO Box 2603
Sydney NSW 2001

Submitted electronically

Dear Ms Collyer,

Re: Electricity network regulation review - Package 1

Red Energy and Lumo Energy (Red and Lumo) welcome the opportunity to submit to the Australian Energy Market Commission's (the Commission's) Package 1 of the *Electricity Network Regulation Review (ENRR)*, which focuses on the service classification and ring-fencing framework.

The National Electricity Market is undergoing a major transition driven by widespread electrification, renewable integration and substantial investments in Consumer Energy Resources (CERs). Retailers and other competitive service providers are increasingly responding through the development of innovative retail offers and related services.

At the same time, some stakeholders are suggesting the traditional boundaries between regulated and competitive services provided by Transmission and Distribution Network Service Providers (TNSPs and DNSPs) have become increasingly blurred. We welcome this review as an opportunity to reconfirm the importance of effective competition as a driver of innovative, efficient and customer-focused solutions and also to assess the ongoing effectiveness of current service classification and ring-fencing frameworks.

In our view, the structural framework for service classification can accommodate these shifts. The Australian Energy Regulator (AER) undertakes a detailed assessment of potential services that a DNSP might offer and evaluates the potential for the exercise of market power by a monopoly service provider.

However, we see opportunities for reform of the ring-fencing framework with the aim to have a net benefit for consumers. More specifically, reform to the ring-fencing framework through stricter requirements on networks and through adequate monitoring and enforcement will produce better outcomes for consumers, and promote competition, thereby supporting innovation and the energy transition.

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On the other hand, we cannot be certain that some of the waivers granted in recent years will deliver a net benefit. More specifically, the nature and extent of the problem that some waivers have sought to overcome has not been clear, nor has there been strong evidence that a network has considered all non-network alternatives or even that it is proposing the most efficient solution. A notable example is an apparent preference for community batteries, where large scale or household level battery investments are frequently lower cost alternatives.

Furthermore, we recommend further scrutiny of whether some networks are adhering to their regulatory obligations relating to the connection of CER and other infrastructure to their networks. This may be the basis for some concerns about the timeliness and the scale of CER connections to the distribution network.

A further issue is that we do not consider there has been sufficient *ex post* evaluation of the broader impact of the waiver, in terms of any cross subsidisation of a competitive service offering or of a detrimental impact on competition. This issue is most pronounced where DNSPs have sought direct ownership and control of what have generally been viewed as contestable services, including generation assets and EV charging infrastructure, and to participate in competitive markets.

We note some specific examples below:

- The AER introduced a streamlined battery waiver assessment process on 3 November 2021, bypassing the comprehensive public consultation traditionally required for functional separation waivers under the *Electricity Distribution Ringfencing Guideline* (the Guideline). This streamlined mechanism allowed DNSPs to own community batteries and lease out excess capacity to third parties, whereas previously, any waiver from the Guideline's functional separation requirements required a full consultation process.

- A reliance on non-prescriptive cost allocation guidelines that were developed in 2008. These grant DNSPs the flexibility to allocate costs between regulated and contestable services from community batteries. This effectively enables a degree of cross-subsidisation of competitive services. While the cost allocation guidelines were designed to prevent such outcomes, a DNSP could effectively cross-subsidise its contestable services if it managed to over-allocate community battery costs to its regulated business stream.

Together, these factors raise questions about the ongoing effectiveness and suitability of the ring-fencing framework to the energy transition. As such, we support the recent rule change proposal by NEXA Advisory (ERC0435), which seeks to overcome some of these deficiencies and to deliver better outcomes for consumers. In our view, the NEXA proposal delivers a targeted and balanced policy response, ensuring the ring-fencing guideline remains aligned with its core purpose.

Electricity Distribution Ring-Fencing Guideline (Guideline) Post-2016

The *Electricity Distribution Ring-Fencing Guideline* consolidated various existing state-based frameworks and reflected the view that in the absence of complete structural separation, a robust ring-fencing mechanism based on legal, accounting, and functional separation served as the most effective defense against cross-subsidisation and discriminatory practices in contestable energy markets. The AER initially adopted a cautious stance toward ring-fencing operations, confining legal separation waivers to precise and highly specific situations, such as when a DNSP was legally obligated to offer particular services.

Subsequently, enforcement of the Guideline appears to have shifted. In particular, we note the streamlined waiver assessment framework (Version 3 of the Guideline) that permitted functional separation waivers for DNSP-owned community batteries. This updated mechanism was intended to provide a functional pathway for DNSPs to lease out surplus community battery capacity to third parties within contestable markets. In doing so, it sought to enable these multi-service assets to unlock additional value and allocate spare capacity back to the market.

The number of successful approvals increased, allowing DNSPs to concurrently deliver both regulated network and contestable services through common assets. The Cost Allocation Guidelines seek to prevent any cross-subsidisation. However, their current form offers the DNSPs some flexibility in how they allocate costs.

We are aware that the AER evaluated some multiple alternative methods before introducing a more nuanced approach in February 2023. The revised mechanism uses a forecast split between regulated and contestable revenues that is established at the time of the investment decision. This specific approach does not allow for adjustments to cost allocations for regulated and contestable services that account for actual revenue outcomes. This is intended to overcome investment uncertainty for DNSPs but instead shifts that uncertainty to competitive service providers. Under this approach, if the revenue recovered from actual contestable revenues exceeded the forecast it will result in a cross-subsidisation of these contestable services. Furthermore, there is not sufficient scrutiny of market outcomes after the event to determine if this has occurred.

A further example is Ausgrid's application to the AER sandboxing framework for its Community Power Network (CPN) trial. This involves expenditure of $110.4m, potentially rising to $186.7m. The Commission will be aware that Ausgrid requested two primary waivers:

- *Revenue Re-opener (NER cl. 6.6.5):* reopening of its revenue determination. The AER rejected this, which prevented the recovery of cost recovery from other customers via regulated charges.
- *Ring-Fencing Relaxation (NER cl. 6.17.1):* Requested to own and operate up to 70 MW of solar and 130 MWh of battery assets. The AER approved this for a period of five years.

The nature and extent of the market failure that Ausgrid is seeking to address remains unclear. Moreover, the AER's rejection of Ausgrid's request to recover costs from existing customers compelled Ausgrid to seek funding from other sources, rather than investing its own capital and placing that at risk. Funding from the Australian Renewable Energy Agency now enables the trial to continue until the next reset period but there remains a risk that Ausgrid will attempt to integrate the project into its Regulated Asset Base during the next regulatory reset.

Alternatively, they may try to include a proportionate share of project assets that provide regulated services into their Regulated Asset Base (RAB). The basis for the first option would be unclear under the Electricity Distribution Service Classification Guideline and the second option would allow DNSPs to cross subsidise their competitive services. Both options would have a significant impact on customer bills and on future investment by competitive service providers. In our view, this project creates a concerning precedent for the efficiency of future investment and for the transition more generally.

As a final point, we note an apparent preference by distribution networks to invest in community batteries. We note a recent ARENA report, which found that *network batteries were more expensive on average than non-network (behind-the-meter) batteries with a weighted average cost of $2.30 compared to $1.33/Wh".*[1] The figure below, which is taken from the report, compares community batteries with other forms of battery investment. This highlights the importance of detailed analysis of networks' expenditure proposals, particularly where there is a strong possibility that assets will eventually be included in the RAB.

[1] ARENA (2025), *Market Snapshot ARENA Community Battery Funding Round 1*, available at https://arena.gov.au/assets/2024/11/ARENA-Community-Battery-Market-Snapshop.pdf

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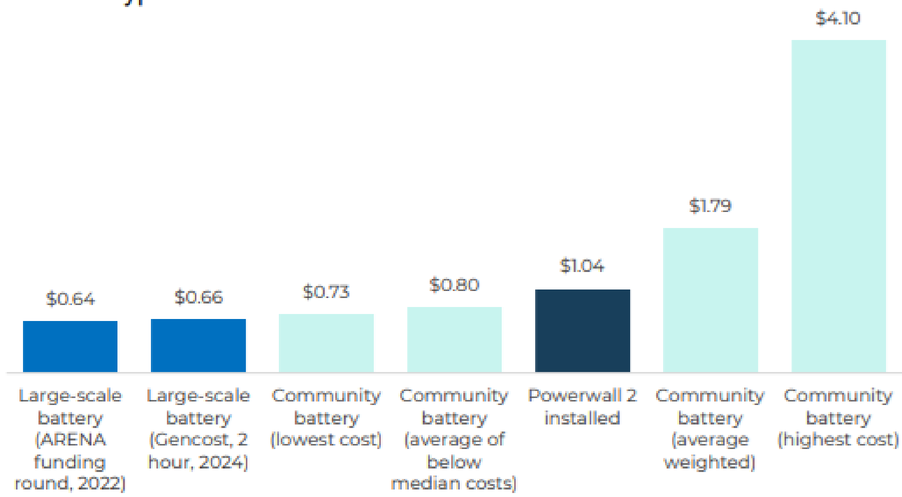
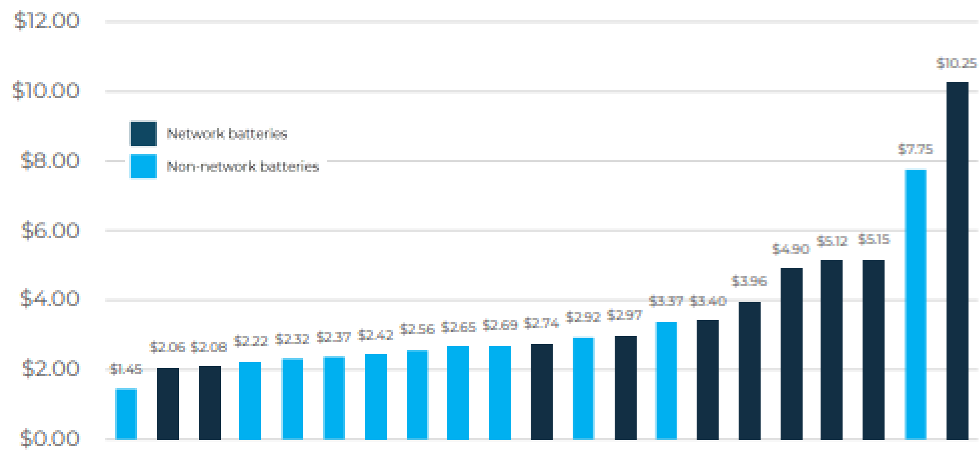
Figure 16: Total project cost ($/Wh) for different types of batteries



The report also compares the relative cost of network and non-network battery investments.

Figure 13: Total project costs ($/W) for each project



Consequently, we see a need to strengthen the ring-fencing regulatory framework. This enhancement will ensure the framework remains fit for purpose and accurately addresses the demands of the evolving operational landscape.

Endorsement of the NEXA Rule Change Proposal

Red and Lumo support the NEXA Advisory rule change proposal as a mechanism for addressing ongoing ring-fencing complexities within a dynamic market environment. By directly embedding ring-fencing requirements into the National Electricity Rules (NER), the proposal would create a rigorous, standardised and transparent framework for all parties.

NEXA proposes a prohibition on DNSPs participating in contestable markets unless there is clear and demonstrable evidence of market failure. Otherwise, DNSPs that manage multi-service assets could potentially cross-subsidise their competitive services. The integration of financial resilience ring-fencing into the NER would be a significant step forward and cultivate a competitive and robust regulatory environment, better equipped to manage future market challenges.

To enhance transparency and reinforce the oversight capabilities of the AER, the proposed rule change also includes a formal complaint mechanism, a public registry for waivers, and a mandate for more rigorous annual compliance reporting. We see these reforms are crucial for fostering third-party confidence in the regulatory framework, as a robust compliance system is fundamental to maintaining equitable competition.

About Red and Lumo

We are 100% Australian owned subsidiaries of Snowy Hydro Limited. Collectively, we retail gas and electricity in Victoria, New South Wales, Queensland, South Australia, and the ACT to over 1.4 million customers. Should you wish to discuss aspects or have any further enquiries regarding this submission, please call Con Noutso, Regulatory Manager, on 0481 013 988.

Yours sincerely

Geoff Hargreaves
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Red Energy Pty Ltd
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