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Mark Feather
General Manager
Australian Energy Regulator

by email: AERringfencing@aer.gov.au

Dear Mark

Distribution ring-fencing class waiver for projects funded under the Commonwealth Government's Community Batteries for Household Solar Program – Initiation Notice

AusNet welcomes the opportunity to provide this submission to the Australian Energy Regulator's (**AER**) initiation notice on the distribution ring-fencing class waiver for projects funded under the Commonwealth Government's Community Batteries for Household Solar Program.

The electricity distribution sector is in the midst of an evolution that is led by our customers and communities, through their investment in consumer energy resources (**CER**), including rooftop solar, batteries and electric vehicles, and increasing demand for distributed energy solutions such as microgrids and standalone power systems (**SAPS**). Community batteries, along with other storage solutions, will play an important role in enabling local renewable energy solutions, maximising the value from customers' CER investments, and accelerating Australia's transition to net zero.

Distributors are well placed to own, operate and manage grid-scale energy storage, and play a leading role in driving innovation and new use cases in network management. While energy storage use cases are still being trialled at an industry level, local network benefits from energy storage identified to date include:

- management of peak and minimum demand
- voltage and power quality management
- network reliability and resilience
- export hosting capacity management
- grid support and system strength
- phase load and export balancing.

In 2014, AusNet invested in its first community battery—a 1MW battery currently located in Mallacoota. The battery is primarily providing reliability support for the local community during severe weather events. The Mallacoota battery is the first of its kind in Victoria, providing valuable learnings and experiences that will inform future investment in similar assets for AusNet and other distributors.

We are currently exploring other opportunities for battery investment, including for management of network constraints and, in the near future, as part of microgrids and SAPS. However, as the economic case for community batteries is still uncertain, we welcome the support of government programs like the Community Batteries for Household Solar Program and other jurisdictional community programs.

In our submission we outline how the class waiver will benefit energy consumers and foster the growth of, and competition in, the battery market in Australia. We propose cost allocation principles for the class waiver which we consider provide an appropriate balance between the need for flexibility in regulatory arrangements to unlock new business models and allow for value stacking, while retaining strong customer protections. We also identify matters for further consideration by the AER regarding demand management incentives and arrangements for jurisdictional funding programs.

In addition to our submission, we support the Energy Networks Australia (**ENA**) submission to the initiation notice.

Benefits of the class waiver

While community batteries are demonstrating new network management use cases, the key significance of batteries is the ability to 'value stack' use cases across various parts of the energy sector, through the provision of regulated and contestable services by the same asset. However, under the current electricity distribution ring-fencing framework, distributors are precluded from leasing out the battery's spare capacity for provision of contestable services, essentially limiting the benefit electricity customers can unlock from network-owned batteries.

We are therefore supportive of the AER's proposal to grant a class waiver that would allow distributors to lease the spare capacity of network-owned community batteries funded under the Commonwealth Government's Community Batteries for Household Solar Program. If granted under the right cost allocation principles (principles discussed below), we expect the class waiver to result in:

- faster and more cost-effective roll-out of community batteries, without the costly administrative burden of individual ring-fencing waiver applications, for both the AER and networks
- maximising the use of all available batteries on the grid, which will improve efficiency and lower whole-of-system costs. The impact of the global supply shortages of batteries and battery components will also be lower
- increased competition in the contestable services offered by community batteries, by increasing the number of assets that can compete in those markets, potentially lowering costs
- increased competition in the retailer market, by allowing retailers to lease (rather than purchase) batteries to provide retailer services. This is particularly important given the characteristics of the retail market in Australia where a small number of vertically integrated larger retailers (gen-tailers) own a significant portion of generation assets, and smaller retailers with fewer customers typically do not own, or do not have the ability to own, a large portfolio of generation or storage assets
- customers of regulated networks sharing in the value being extracted from the leasing of the battery.

In summary, as the battery market is still in its infancy and is faced with high costs and supply shortages, allowing distributors to value stack their network-owned community batteries will foster competition and facilitate a more rapid roll-out of community batteries, meeting the Commonwealth Government objectives under the Community Batteries for Household Solar Program and delivering long-term benefits for all energy consumers.

Additionally, with the current cost of living and energy price crisis, it is more important than ever that our regulatory framework allows for the necessary flexibility to unlock new business models, encourage innovation in service offerings, expand the benefits that customers can extract from regulated assets, and impose downward pressure on electricity prices today and in the future.

Proposed cost allocation principles under the class waiver

We support a cost allocation methodology that is based on anticipated customer benefits from the use of the battery for distributors' direct control services. That is, the costs allocated to the regulatory asset base (**RAB**) are equal to the net present value of the customer benefits from providing direct control services. This is consistent with our current cost allocation methodology and the principles of the ex-ante incentives-based regulatory framework. The RAB allocation can be reduced through government funding or upfront third-party contributions—for example, if the residual cost (total cost net of government funding), is lower than the value of customer benefits, the residual cost would be allocated to the RAB.

We support in principle the use of the AER's Distributed Energy Resources (**DER**) integration expenditure guidance note for the identification of customer benefits. For clarity, we expect that as battery use cases are rapidly evolving, under the AER's guideline distributors will be able to identify and quantify benefits additional to those in the AER's guidance note, if there is evidence or customer support for that benefit stream. This could include use of willingness to pay studies and similar evidence-based research methods.

We support revenue sharing arrangements for unregulated revenue earned by the distributor in leasing the battery for contestable services. Revenue sharing will ensure customers that have paid for a part of the battery

through the RAB receive a portion of the revenue through network tariff reductions (i.e., distributors' annual regulated revenue reductions) or through other revenue sharing arrangements. This is consistent with the objectives of the Community Batteries for Household Solar Program.

Under the ring-fencing guideline, 'new energy storage' is not considered to be a shared asset for which the AER's Shared Asset Guideline applies. Given the novel nature of value stacking in the case of batteries, we do not propose to extend the application of the Shared Asset Guideline, but rather propose the class waiver set the principles for revenue sharing which can be regulated by the AER, while the actual revenue sharing arrangements should be project-specific for the duration of the government program.

Allowing flexibility in revenue sharing during the roll-out of the program will allow distributors, retailers, the AER, and other stakeholders to test different revenue sharing models for different projects. The approach would be based on actual revenue (rather than forecast) and would allow distributors to better understand the costs involved in the facilitation and implementation of the lease, and how much value customers can extract from net lease revenue in the long run. The learnings from the program can inform future regulatory arrangements for revenue sharing.

We propose the following revenue sharing principles for the class waiver:

- customers should receive a share of the unregulated revenue for any project where they are paying for the portion of the cost through network tariffs (i.e., where the RAB allocation is positive)
- revenue sharing should be based on net revenue, taking into account costs associated with the lease, to allow for prudent cost recovery
- for consistency in the treatment of regulated and unregulated battery portions, the unregulated revenue that can be returned to customers:
    - should not include the portion of the unregulated revenue that is being used to fund the cost of the project (e.g., if there are costs that cannot be funded by the government grant or the RAB allocation)
    - should be aligned with the share of the RAB allocation as part of the total project.
- to limit unforeseen costs to customers, the proposed revenue sharing arrangements can account for otherwise uncompensated costs to the network, including the impacts of the project on the capital efficiency sharing scheme (**CESS**) and the efficiency benefit sharing scheme (**EBSS**), additional tax costs, etc.

Distributors should propose a revenue sharing arrangement a part of their application for the Commonwealth Government funding. Under these principles, projects that have a high share of RAB allocation would likely result in a higher proportion of the lease revenue being returned to customers, thereby allowing customers to extract more value from regulated asset in the long term. The principles also create reputational and project-specific incentives for distributors to propose revenue sharing arrangements that demonstrate the highest benefit for their customer base in their application for funding.

Further considerations for the AER

Demand management incentives and community battery investments

We encourage the AER to consider how the demand management innovation allowance (**DMIA**) and the demand management incentive scheme (**DMIS**) can be utilised to maximise the value customers can extract from investment in community batteries.

DMIA would typically be used to fund projects that are not economically efficient but likely to become efficient in the future, as is presently the case for some community batteries. We propose the AER clarify that DMIA can be used as an additional funding source for projects under the Community Batteries for Household Solar Program, where the RAB allocation and the government funding are insufficient to fund the total cost of the project. Using the DMIA to supplement Commonwealth funding should not disqualify the asset from attracting the class waiver.

The DMIS is a financial incentive for distributors to invest in a non-network solution where efficient, allowing for quantification of 'option value' to account for the flexibility of the non-network solution. Given community batteries are inherently flexible and do not represent traditional network investment, network-owned batteries should qualify for the DMIS, and any DMIS funding received should not preclude the battery from classifying for the class waiver. Allowing distributors to earn financial rewards for investing in flexible solutions provides funding

opportunities for similar projects in the future, or an opportunity for distributors to share a higher proportion of unregulated revenue with customers.

Consideration of other jurisdictional government programs

We also invite the AER to consider how the proposed class waiver can be developed to allow for its application to similar jurisdictional funding programs.

In November 2022, the Victorian Government announced funding for 100 community batteries across the state over the next few years. Depending on the outcome of the Community Batteries for Household Solar Program, the Victorian Government program may result in more community battery investments in Victoria than through the Commonwealth Government program.

For the reasons mentioned above, there is significant and lasting benefit in allowing distributors to value stack community batteries under both programs, without apparent policy differences that would warrant a difference in ring-fencing obligations. If distributors were allowed to lease batteries under the Commonwealth Government's program, but not under the Victorian Government's program, that may create perverse incentives for distributors to prioritise investments under the Commonwealth Government's program purely on the basis of ring-fencing arrangements.

We consider the recently announced Commonwealth and jurisdictional community battery funding programs should be treated consistently with regard to ring-fencing obligations, to avoid perverse incentives and ensure both programs can be delivered while maximising net benefits for consumers.

Please do not hesitate to contact me on [redacted] about the submission.

Sincerely,

[redacted]

Sonja Lekovic
Regulatory Policy Manager
AusNet Services