

# Decision

## Distribution ring-fencing class waiver for Reliability and Emergency Reserve Trader (RERT) services via voltage management

December 2022

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## Shortened forms

Shortened Form	Extended Form
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
DNSP	Distribution Network Service Provider
NEM	National Electricity Market
NER	National Electricity Rules
NEO	National Electricity Objective
RERT	Reliability and Emergency Reserve Trader

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# Contents

<b>1</b>	<b>Executive summary</b> .....	<b>1</b>
<b>2</b>	<b>Background</b> .....	<b>3</b>
2.1	What is ring-fencing? .....	3
2.2	What is RERT? .....	3
<b>3</b>	<b>Assessment</b> .....	<b>5</b>
3.1	Stakeholder views .....	5
3.2	National Electricity Objective .....	7
3.3	Potential for cross-subsidisation .....	9
3.4	Potential for discrimination .....	9
3.5	Benefits and costs of DNSP complying with ring-fencing obligations .....	10
3.6	Other matters .....	11
3.7	Conclusion .....	12
<b>4</b>	<b>Decision</b> .....	<b>13</b>

# 1 Executive summary

The Reliability and Emergency Reserve Trader (RERT) is a function conferred on the Australian Energy Market Operator (AEMO) to maintain power system reliability and system security. AEMO uses RERT to maintain power system reliability and system security during Lack of Reserve events (for example, during the lead up to the June 2022 National Electricity Market suspension and during heat waves when the system is under stress).

AEMO has identified a need for increased amounts of RERT services in the future. They consider this is particularly necessary in light of the forecast reliability gaps for all mainland regions from 2022-23 to 2031-32.<sup>1</sup>

Distribution network service providers (DNSPs) have the ability to provide an additional form of efficient and low-cost reserve services via voltage management. However, DNSPs are prohibited from providing RERT services to AEMO under the Ring-fencing guideline (electricity distribution) (the Guideline).

On 29 September 2022, the AER received a letter from AEMO requesting that the AER urgently consider granting a long-term class waiver for DNSPs to provide RERT services via voltage management before the peak demand months of January, February and March 2023. On 2 November 2022, we published an initiation notice seeking stakeholder feedback on the class waiver.

Our decision is to grant a ring-fencing class waiver, effective from 14 December 2022 to 15 April 2025, to allow DNSPs to contract with AEMO to provide RERT services via voltage management. The class waiver exempts DNSPs from their obligations to comply with clause 4.2 of the Guideline (functional separation) in relation to the provision of RERT services via voltage management.

We consider the class waiver is necessary to meet AEMO's needs to procure sufficient RERT to address forecast reliability gaps. We also consider that consumers will benefit from allowing AEMO to procure low-cost RERT services from DNSPs as this will result in lower RERT charges passed on to consumers. However, the AER is concerned by the potential long-term impacts of a class waiver that have been raised by stakeholders. Therefore, the AER has reduced the timeframe of the waiver from 5 years to 28 months. The AER will facilitate a longer consultation period prior to a variation or extension of this class waiver, assuming the need remains.

We also note that revenue earned by DNSPs from the provision of RERT services will be unregulated revenue. We acknowledge stakeholder concerns that consumers are unlikely to benefit from this revenue because it is unlikely to trigger the Shared Asset Guideline. The AER will consider undertaking a review of the Shared Asset Guideline as part of its 2023/24 work program.

This class waiver is subject to the following pre-conditions and conditions:

## **Pre-conditions:**

The scope of the class waiver is limited to:

- DNSPs that negotiate with AEMO to enter into, and/or enter into, a RERT Panel Agreement with AEMO for the provision of short notice reserve via voltage management pursuant to rule 3.20.2 of the National Electricity Rules and clause 6 of the RERT Guidelines.<sup>2</sup>
  - DNSPs must not contract with AEMO to recover payments for pre-activation of reserve.

<sup>1</sup> AEMO, *2022 Electricity Statement of Opportunities*, August 2022: [https://aemo.com.au/-/media/files/electricity/nem/planning\\_and\\_forecasting/nem\\_esoo/2022/2022-electricity-statement-of-opportunities.pdf?la=en#:~:text=The%20Electricity%20Statement%20of%20Opportunities,new%20investors%2C%20and%20jurisdictional%20bodies](https://aemo.com.au/-/media/files/electricity/nem/planning_and_forecasting/nem_esoo/2022/2022-electricity-statement-of-opportunities.pdf?la=en#:~:text=The%20Electricity%20Statement%20of%20Opportunities,new%20investors%2C%20and%20jurisdictional%20bodies).

<sup>2</sup> AEMC Reliability Panel, *Reliability and Emergency Reserve Trader Guidelines, Final guidelines*, 21 August 2020, clause 6: [https://www.aemc.gov.au/sites/default/files/2020-08/Updated%20Amended%20Panel%20RERT%20Guidelines%20-%2018%20August%202020%20-%20Final%20for%20publication\\_0.pdf](https://www.aemc.gov.au/sites/default/files/2020-08/Updated%20Amended%20Panel%20RERT%20Guidelines%20-%2018%20August%202020%20-%20Final%20for%20publication_0.pdf).

- If the DNSP's RERT Panel Agreement with AEMO ceases, the DNSP will no longer qualify for the class waiver (unless, and until, the DNSP commences negotiation to enter into a further RERT Panel Agreement with AEMO). For clarity, this class waiver expires on 15 April 2025, and will not apply to any RERT Panel Agreement (pre-existing or otherwise) beyond this date.
- DNSPs that meet the precondition of providing the AER with a copy of the RERT Panel Agreement entered into with AEMO.
  - Where possible, the RERT Panel Agreement should be emailed to [AERringfencing@aer.gov.au](mailto:AERringfencing@aer.gov.au) immediately, or if it is being negotiated, within 20 business days of the agreement being finalised. The AER will treat this information as commercially sensitive and note our policies regarding information privacy and disclosure of information.

**Conditions:**

The class waiver is subject to the following conditions:

- DNSPs participating in the class waiver must provide the AER with quarterly performance reports, where RERT has been provided in that quarter, detailing:
  - the number of instances the DNSP provided short notice reserve to AEMO in a quarter (i.e. the number of times the reserve was activated by AEMO);
  - the volume (MW) of reserve provided in each instance that the DNSP provided short notice reserve to AEMO; and
  - the revenue received for each instance that the DNSP provided short notice reserve to AEMO.

These quarterly performance reports will be published on the AER website.

- DNSPs must notify the AER if the DNSP receives:
  - notification from a customer about any adverse impacts of the DNSP's provision of RERT services via voltage management; or
  - any other customer complaints relating to the quality of supply that may be associated with the provision of RERT services via voltage management.

## 2 Background

### 2.1 What is ring-fencing?

Ring-fencing, in relation to DNSPs, refers to the separation of distribution services provided by a DNSP from the provision of unregulated or contestable services by a DNSP, or an affiliated entity. Ring-fencing operates to separate regulated activities from competitive business activities to support competitive markets. The Guideline is made under rule 6.17 of the National Electricity Rules (NER) and sets out obligations that apply to a DNSP should it wish to provide unregulated or contestable services. These obligations aim to support electricity consumers by addressing the potential risk of:

- consumers paying more than they should for regulated network direct control services because a DNSP cross-subsidises the cost of its unregulated services by attributing those costs to its direct control services; and
- DNSPs discriminating in contestable markets in favour of their affiliated entities. This may diminish the benefits created by a competitive market, such as downward pressure on prices in the long-term, and greater consumer choice.

Ring-fencing aims to promote effective competition where feasible, open new markets to competition, and provide effective regulation where competition is not feasible.

The Guideline recognises that strict adherence to ring-fencing obligations might, in some circumstances, result in outcomes that are not in the long-term interest of consumers. Therefore, the Guideline makes provision for ring-fencing class or individual waivers.<sup>3</sup> Waivers provide the ring-fencing framework with the flexibility to support opportunities for genuine innovation.

Under clause 5.3A of the Guideline the AER may, of its own initiative, in its absolute discretion, and at any time, grant a class waiver from certain obligations in the Guideline for multiple DNSPs, and may do so:

- for a term the AER considers appropriate; and
- subject to any conditions the AER considers appropriate.

### 2.2 What is RERT?

RERT is a function conferred on AEMO to maintain power system reliability and system security. RERT is an out-of-market backstop typically comprising demand response loads or diesel peaking electricity generation plants that are used to address emergency situations where there is insufficient supply to meet demand. It is important that AEMO has access to various RERT panel members as required to ensure the security of the energy market during Lack of Reserve events.

To access contracted RERT services, AEMO maintains a panel of RERT providers. The RERT panel allows AEMO to run an expedited tender process in short and medium notice situations, as the tendering process is pre-agreed. The panel of RERT providers includes large loads, retailers and unscheduled batteries. No payment is received for being on the panel for short notice RERT, only for actual provision of services.

DNSPs have the ability to provide RERT services via voltage management. Voltage management is performed using control equipment installed in DNSP substations.

On 29 September 2022, the AER received a letter from AEMO requesting that the AER urgently consider granting a long-term class waiver for DNSPs to provide RERT services via voltage management to increase reserves to address forecast reliability gaps.<sup>4</sup> AEMO has forecast reliability gaps for all mainland regions from 2022-23 to 2031-32, with South Australia having a gap against the interim measure as early

<sup>3</sup> A DNSP may apply for an individual waiver under clause 5.3 of the Guideline.

<sup>4</sup> Letter from AEMO dated 26 September 2022 (received 29 September 2022):

[https://www.aer.gov.au/system/files/Attachment%20A\\_%20Letter%20from%20AEMO%20dated%2026%20September%202022%20%28received%2029%20September%202022%29\\_Redacted.pdf](https://www.aer.gov.au/system/files/Attachment%20A_%20Letter%20from%20AEMO%20dated%2026%20September%202022%20%28received%2029%20September%202022%29_Redacted.pdf).

as 2023-24 and Victoria in 2024-25.<sup>5</sup> If the market does not provide reserves to address these reliability gaps, then AEMO may be required to use RERT. AEMO has requested a long-term class waiver to provide certainty for the RERT contracting process, which can take several months to finalise. Putting a waiver in place now will allow it to be used this coming summer as well as allowing negotiation with additional voltage management providers over the remainder of the waiver period.

Allowing DNSPs to contract with AEMO to provide contracted RERT services via voltage management will increase the number of providers available to the RERT panel. This should increase competition in the provision of RERT services which may help to both improve reliability and reduce RERT charges which are passed on to consumers through electricity bills.

<sup>5</sup> AEMO, *2022 Electricity Statement of Opportunities*, August 2022, p. 5.



## 3 Assessment

The Guideline sets out classes of services that must be ring-fenced from the DNSP. The provision of contracted RERT services is not classified as a direct control service, but is an 'other distribution service' as defined in the Guideline.<sup>6</sup> 'Other distribution services' are subject to functional separation requirements in clause 4.2 of the Guideline, unless subject to a class or individual waiver.

In assessing whether to grant a ring-fencing class waiver, the AER must have regard to:

- the National Electricity Objective (NEO);
- the potential for cross-subsidisation and discrimination if the class waiver is granted or refused; and
- whether the benefit, or likely benefit, to electricity consumers of the DNSP complying with the obligations (including any benefit or likely benefit from increased competition) would be outweighed by the cost to the DNSP of complying with that obligation.<sup>7</sup>

In assessing the merits of a class waiver, we have considered each factor listed above, as well as stakeholder feedback outlined below.

### 3.1 Stakeholder views

On 2 November 2022, we sought stakeholder feedback on granting a class waiver to allow DNSPs to contract with AEMO to provide RERT services via voltage management. On 9 November 2022, we held a verbal feedback session, at which stakeholders were invited to provide verbal feedback in lieu of a written submission.<sup>8</sup> We also received 12 written submissions.<sup>9</sup>

DNSPs and Energy Networks Australia (ENA) supported granting the class waiver. However, CitiPower/Powercor/United Energy submitted that the waiver should be for 10 years. ENA, Powercor and Energex/Ergon suggested the scope of the class waiver should not be limited to voltage management and should include any means available to DNSPs. Ausgrid, Endeavour Energy and Essential Energy noted that some flexibility may be required with the proposed customer complaint condition because customer complaint management systems vary between networks.

We also consulted with five members of the AER Customer Consultative Group on the proposed class waiver. The members indicated they were generally comfortable with the proposed class waiver. The Council on the Ageing commented that customers may not notice the impacts of voltage management and therefore may not make complaints regarding quality of supply to DNSPs.

Energy Users Association of Australia (EUAA) and ENGIE Australia and New Zealand were largely supportive of the class waiver but noted some concerns which are summarised below.

Several current RERT providers (Shell Energy, Origin, Flow Power and Red Energy/Lumo Energy) opposed the class waiver. A joint submission opposing the class waiver was also provided by Solar Edge, Enphase, Tesla, Sonnen, Redback, SMA and Selectronic. Concerns with the proposed class waiver included:

- The risk of creating a perverse incentive for DNSPs to maintain voltage at an elevated level in anticipation of a RERT event (but still within the technical boundaries required by voltage standards

<sup>6</sup> AER, *Ring-fencing Electricity Distribution Guideline (Version 3)*, November 2021, cl. 1.4 defines 'other distribution services' as meaning distribution services other than direct control services.

<sup>7</sup> AER, *Ring-fencing Electricity Distribution Guideline (Version 3)*, November 2021, cl. 5.3.2.

<sup>8</sup> Verbal feedback was provided by Energy Users Association of Australia (EUAA), Australian Energy Council, Flow Power, Ausgrid, Essential Energy, AGL, CitiPower / Powercor / United Energy, Origin, Energy Australia, Shell Energy, Evoenergy.

<sup>9</sup> Written submissions were received from Shell Energy, Endeavour Energy/Ausgrid/Essential Energy, SA Power Networks, Origin Energy, Energy Networks Australia, Energex/Ergon, Powercor/UE/CitiPower, EUAA, Flow Power, Red Energy/Lumo Energy, Solar Edge/Enphase/Tesla/Sonnen/Redback/SMA/Selectronic/Fronius and ENGIE Australia & New Zealand.

and quality of supply obligations). By maintaining an elevated voltage level, DNSPs would be able to provide greater voltage reduction services and therefore receive more revenue through RERT.<sup>10</sup>

- Uncertainty around voltage management and its impacts on consumers, particularly large energy users with significant assets.<sup>11</sup>
- Consumers will not benefit from the RERT revenue received by DNSPs, despite DNSPs using network assets to provide the service.<sup>12</sup> EUAA noted that even if the revenue does not trigger the Shared Asset Guideline, the cumulative revenue earned over all DNSPs could be material. Some stakeholders submitted that RERT services provided by DNSPs should be a regulated service or at a cost-reflective price.<sup>13</sup>
- Risk of decreasing competition in RERT market, including by creating a competitive disadvantage for current RERT providers,<sup>14</sup> as well as prospective RERT providers such as technology vendors that work with Consumer Energy Resources and prospective voltage management providers (noting that it is unclear whether other market participants can currently provide voltage management services).<sup>15</sup>
- A five-year class waiver is too long and longer consultation is required to consider potential adverse impacts.<sup>16</sup>
- Interaction between DNSPs providing RERT at a distribution level and other RERT providers within that distribution network also providing RERT. A DNSP might benefit from double counting or diminish the amount of load another RERT provider has aggregated.<sup>17</sup>
- Voltage management is difficult to measure.<sup>18</sup>

<sup>10</sup> Shell Energy, *Submission on ring-fencing class waiver for RERT via voltage management*, 16 November 2022, p. 2; Flow Power, *Submission on ring-fencing class waiver for RERT via voltage management*, November 2022, p. 3; Solar Edge, Enphase, Tesla, Sonnen, Redback, SMA and Selectronic, *Submission on ring-fencing class waiver for RERT via voltage management*, November 2022, p. 2; ENGIE Australia and New Zealand, *Submission on ring-fencing class waiver for RERT via voltage management*, 22 November 2022, p. 1.

<sup>11</sup> Shell Energy, *Submission on ring-fencing class waiver for RERT via voltage management*, 16 November 2022, pp. 1-2; Solar Edge, Enphase, Tesla, Sonnen, Redback, SMA and Selectronic, *Submission on ring-fencing class waiver for RERT via voltage management*, November 2022, p. 1; Verbal feedback from Energy Australia.

<sup>12</sup> EUAA, *Submission on ring-fencing class waiver for RERT via voltage management*, 16 November 2022, p. 1; ENGIE Australia and New Zealand, *Submission on ring-fencing class waiver for RERT via voltage management*, 22 November 2022, p.1; Red Energy and Lumo Energy, *Submission on ring-fencing class waiver for RERT via voltage management*, 21 November 2022, p. 1.

<sup>13</sup> Flow Power, *Submission on ring-fencing class waiver for RERT via voltage management*, November 2022, pp. 3-4; ENGIE Australia and New Zealand, *Submission on ring-fencing class waiver for RERT via voltage management*, 22 November 2022, p. 1; Verbal feedback from Australian Energy Council. Ausgrid, Endeavour Energy and Essential Energy also submitted that RERT services should be a regulated service: *Submission on ring-fencing class waiver for RERT via voltage management*, 16 November 2022, pp. 2, 4-5.

<sup>14</sup> Flow Power, *Submission on ring-fencing class waiver for RERT via voltage management*, November 2022, p. 3; Red Energy and Lumo Energy, *Submission on ring-fencing class waiver for RERT via voltage management*, 21 November 2022, pp. 1-2; Solar Edge, Enphase, Tesla, Sonnen, Redback, SMA and Selectronic, *Submission on ring-fencing class waiver for RERT via voltage management*, November 2022, p. 2; Shell Energy also stated that there is already a competitive market for RERT: *Submission on ring-fencing class waiver for RERT via voltage management*, 16 November 2022, p. 1.

<sup>15</sup> Flow Power, *Submission on ring-fencing class waiver for RERT via voltage management*, November 2022, p. 3; Solar Edge, Enphase, Tesla, Sonnen, Redback, SMA and Selectronic, *Submission on ring-fencing class waiver for RERT via voltage management*, November 2022, p. 2; Origin, *Submission on ring-fencing class waiver for RERT via voltage management*, 16 November 2022, p. 1.

<sup>16</sup> Origin, *Submission on ring-fencing class waiver for RERT via voltage management*, 16 November 2022, p. 1; Flow Power, *Submission on ring-fencing class waiver for RERT via voltage management*, November 2022, pp. 3-4; Red Energy and Lumo Energy, *Submission on ring-fencing class waiver for RERT via voltage management*, 21 November 2022, p. 1; Solar Edge, Enphase, Tesla, Sonnen, Redback, SMA and Selectronic, *Submission on ring-fencing class waiver for RERT via voltage management*, November 2022, p. 1.

<sup>17</sup> Red Energy and Lumo Energy, *Submission on ring-fencing class waiver for RERT via voltage management*, 21 November 2022; Verbal feedback from Flow Power.

<sup>18</sup> Shell Energy, *Submission on ring-fencing class waiver for RERT via voltage management*, 16 November 2022, pp. 1-2. Verbal feedback from AGL.

Some stakeholders suggested that if the class waiver is granted:

- The revenue DNSPs receive from RERT should be published in the interests of transparency for the RERT market.<sup>19</sup>
- DNSPs should be required to notify all customers in impacted areas of the network in advance of undertaking voltage management and provide customers with clear instructions for contacting their DNSP if they become aware of any adverse impact.<sup>20</sup>
- The waiver should be for a shorter period (0.5-2 years).<sup>21</sup>

We have addressed the views and concerns of stakeholders in our assessment below.

## 3.2 National Electricity Objective

The NEO promotes efficient investment in, and efficient operation and use of, electricity services for the long-term interests of consumers of electricity with respect to price, quality, safety and reliability and security of supply of electricity. The NEO is the guiding principle that underpins all decision-making in the NEM framework and is a requirement we must consider in deciding whether to grant a class waiver under clause 5.3A of the Guideline.

We strongly encourage competition in the NEM, where such competition is feasible. Our position does not change for the provision of RERT services, particularly when the costs of RERT are directly passed through to NEM electricity consumers.

We consider that granting a class waiver to allow DNSPs to contract with AEMO to provide RERT services via voltage management will support promotion of the NEO by:

- allowing AEMO to contract with more efficient and cost-effective RERT panel members, which will reduce the costs of RERT services passed on to customers;
- providing AEMO with greater availability and diversity of RERT panel members, which will provide for greater reliability, safety and security of the national electricity system.

These considerations are particularly important given AEMO's urgent request for the class waiver in light of its concerns about reliability. AEMO forecasts reliability gaps for all mainland regions from 2022-23 to 2031-32, with South Australia having a gap against the interim reliability measure as early as 2023-24 and Victoria in 2024-25. The Electricity Statement of Opportunities forecasts a greater need for reserves in the National Electricity Market. AEMO has noted that if the market does not provide these reserves, AEMO may be required to use RERT to meet the additional need for reserves. The AER notes that RERT is an out-of-market backstop used in emergency situations. It is important for AEMO to have access to sufficient RERT providers to meet any worst-case scenario reliability shortfalls that cannot otherwise be met by the market. Therefore, the AER considers that the class waiver is necessary to provide additional low-cost reserves to AEMO to promote the reliability of the supply of electricity whilst also minimising impacts on the price of electricity for consumers. The class waiver mitigates the risk of leaving AEMO with insufficient reserve in emergency situations.

We note that stakeholders raised concerns that are relevant to elements of the NEO such as the quality and reliability of the supply of electricity. We address these concerns below.

- Some stakeholders expressed concern about the uncertainty of voltage management, its impacts on consumers (particularly large energy users), and the risk of loads tripping off the network because of voltage management. These issues have implications for the quality and reliability of the

<sup>19</sup> Flow Power, *Submission on ring-fencing class waiver for RERT via voltage management*, November 2022, p. 4; EUAA, *Submission on ring-fencing class waiver for RERT via voltage management*, 16 November 2022, p. 1.

<sup>20</sup> Flow Power, *Submission on ring-fencing class waiver for RERT via voltage management*, November 2022, pp. 4-5.

<sup>21</sup> Origin, *Submission on ring-fencing class waiver for RERT via voltage management*, 16 November 2022, p. 1; Flow Power, *Submission on ring-fencing class waiver for RERT via voltage management*, November 2022, pp. 3-4; Red Energy and Lumo Energy, *Submission on ring-fencing class waiver for RERT via voltage management*, 21 November 2022, p. 1; Solar Edge, Enphase, Tesla, Sonnen, Redback, SMA and Selectronic, *Submission on ring-fencing class waiver for RERT via voltage management*, November 2022, p. 1.

supply of electricity. The AER emphasises that this class waiver does not affect any of the quality of supply obligations of DNSPs pursuant to jurisdictional supply codes and their associated compliance frameworks. There is an expectation from AEMO and the AER that DNSPs will not provide RERT services in parts of their networks that would result in adverse outcomes for consumers. The AER will notify the technical regulators and ombudsman in each jurisdiction about the issuing of the class waiver and the concerns raised by stakeholders relating to voltage management.

- We also note that while some stakeholders queried whether consumers would complain about impacts of voltage management on a residential level, larger energy consumers may be more likely to complain about quality of supply to DNSPs. Flow Power suggested that the AER should require DNSPs to notify all customers in impacted areas of the network in advance of undertaking voltage management and provide customers with clear instructions for contacting their DNSP if they become aware of any adverse impact. The AER considered including this condition to address stakeholder concerns, however we note that this condition was not consulted on explicitly and some DNSPs may not have the ability to easily notify all customers of their participation in RERT. In addition, it is unclear whether the impacts of voltage management would be material enough to justify such a requirement and whether such a condition is justified given existing quality of supply obligations. Relatedly, the costs to DNSPs of implementing such a condition are also unclear. Therefore the condition has not been included.
- However, to address the risk of potential unforeseen consequences of long-term provision of voltage management, the AER has reduced the period of the class waiver from 5 years to 28 months (until 15 April 2025). We discuss the length of the waiver and the rationale for a 28-month waiver period further below.
- Stakeholders also raised concerns about DNSPs maintaining voltage at an elevated level in the lead up to a RERT event to provide greater voltage reduction services and therefore receive more revenue through RERT. DNSPs maintaining an unnecessarily elevated voltage level could have the following implications:
  - Increased need for voltage reduction services, therefore increased RERT revenue for DNSPs and increased RERT costs passed on to consumers.
  - Reduced network capacity for residential solar PV production.

To address these concerns, AEMO has confirmed it can monitor and audit DNSP performance for such behaviour.<sup>22</sup> AEMO has access to data to track voltage and performance requirements of DNSPs providing RERT services via voltage management and can identify if DNSPs' voltage is trending higher than would be expected in the lead up to a RERT event. AEMO has agreed to report any unusual, elevated voltage levels to the AER. The AER will consider any such reports by AEMO in any potential consultation on variation or extension to this class waiver.

- Some stakeholders were also concerned about the potential for DNSPs to benefit from double counting or diminish the amount of load another RERT provider has aggregated within the distribution network. AEMO has informed the AER that it will consider the interaction between DNSPs providing short notice RERT and other participants within the distribution network providing short notice RERT. AEMO will put in place additional measures or controls to account for possible interactions between reserve providers.<sup>23</sup> This would avoid payments for RERT services where the contracted amount was not completely provided by a DNSP.

<sup>22</sup> Letter from AEMO dated 24 November 2022 (received 25 November 2022).

<sup>23</sup> Letter from AEMO dated 24 November 2022 (received 25 November 2022).

### 3.3 Potential for cross-subsidisation

In deciding whether to grant a class waiver, we must consider the potential for cross-subsidisation if the waiver is granted. That is, consider whether there is potential for a DNSP to use revenues from provision of distribution services to cross-subsidise provision of other services.<sup>24</sup>

The provision of contracted RERT services via voltage management is an 'other distribution service'. That is, it is a distribution service other than a direct control service. Therefore, there is no requirement for DNSPs to be legally separated to provide contracted RERT services.

While the ring-fencing guideline does not require legal separation of regulated distribution services from other distribution services, DNSPs are required to comply with cost allocation principles. The ring-fencing guideline in conjunction with the cost allocation guideline and individual DNSPs' cost allocation methodologies (as approved by the AER) prevent cross-subsidisation of different categories of distribution services.

We acknowledge that Flow Power and Solar Edge, Enphase, Tesla, Sonnen, Redback, SMA and Selectronic raised concerns that DNSPs would be able to cross-subsidise their provision of RERT services by using regulated electricity supply assets that have already been paid for by consumers. Stakeholders submit that because of this, DNSPs' provision of RERT would have a short run marginal cost close to zero and therefore would undercut other RERT providers. This may reduce competition in the RERT market in the long run.

We note that RERT is a contestable market and it would not be desirable for competition in the RERT market to be diminished. To address any potential negative long-term impacts on the RERT market, the AER has reduced the proposed length of the class waiver from 5 years to 28 months. During the 28-month period of the class waiver, the AER will monitor the impacts of DNSP participation in the RERT market for unforeseen adverse consequences. This information will be taken into account before any variation or extension to the class waiver.

### 3.4 Potential for discrimination

The ring-fencing guideline prohibits a DNSP from discriminating between itself (or an affiliated entity of the DNSP) and a competitor (or potential competitor). Functional separation provisions exist in the guideline to prevent discrimination.

We consider that there is limited opportunity for a DNSP to discriminate in favour of itself in competing to provide contracted RERT services via voltage management.

Our understanding of the market information presented to us by stakeholders is that currently, only DNSPs are able to use voltage management to provide RERT services. Ausgrid, Essential Energy and Endeavour energy submitted that DNSP staff do not have an opportunity to share electricity information with other parties in a manner that would unfairly or materially impact competition because other parties are incapable of offering the same service to AEMO.<sup>25</sup>

We understand from Flow Power and Solar Edge, Enphase, Tesla, Sonnen, Redback, SMA and Selectronic that there may potentially be alternative means of providing RERT services in the future using Consumer Energy Resources and that there may be prospective voltage management providers. However, currently there are no voltage management providers that are at risk of discrimination by DNSPs. To address any potential risk of discrimination against prospective voltage management providers in the future, the AER has reduced the length of the class waiver from 5 years to 28 months. Before varying or extending the waiver, the AER will consider the state of the market for voltage management services and whether there is a greater risk of discrimination.

<sup>24</sup> AER, *Ring-fencing Electricity Distribution Guideline (Version 3)*, November 2021, cl. 5.3.2(a)(iii).

<sup>25</sup> Ausgrid, Essential Energy, Endeavour Energy, *Submission on ring-fencing class waiver for RERT via voltage management*, 16 November 2022, p. 5.

### 3.5 Benefits and costs of DNSP complying with ring-fencing obligations

Overall, we consider that the benefits of granting the class waiver outweigh the costs of DNSPs complying with the obligations of functional separation.<sup>26</sup> Specifically, we discuss above that:

- AEMO has indicated a need for increased RERT providers in light of the forecast reliability gaps over the next 10 years. DNSPs have an efficient and low-cost way of providing RERT that can be accessed to address the imminent reliability gaps in South Australia in 2022-23 and Victoria in 2023-24.
- There is a limited opportunity for discrimination where a DNSP competes to provide RERT services via voltage management.

Conversely, we consider there are potentially significant benefits that NEM electricity consumers may lose if DNSPs are prohibited from competing to provide RERT services via voltage management. Prohibiting DNSPs from competing would:

- Narrow the field of eligible participants that can participate in RERT.
- Potentially lose the opportunity to realise efficiencies in leveraging existing technology that can provide RERT services to AEMO during a Lack of Reserve event.
- Potentially lose the opportunity to achieve lower RERT costs for consumers.

On the other hand, the costs of DNSPs not complying with ring-fencing obligations include:

- Potential negative impacts on competition in the RERT market.
- Uncertainty around the voltage and power quality impacts on consumers, particularly large energy users.

On balance we consider that there are immediate reliability justifications for granting this waiver and that allowing DNSPs to participate in RERT is likely to drive down costs of RERT passed on to consumers.

The AER however notes stakeholder concerns about ensuring that the waiver does not negatively impact the prospective market entry of future voltage management providers and services. The AER will therefore monitor the RERT market and assess any negative impacts on competition prior to an extension or variation to this class waiver.

We also acknowledge the concerns raised through the consultation in relation to potential power quality impacts associated with AEMO procurement of voltage management services from DNSPs. We note that DNSPs must comply with their quality of supply obligations and DNSPs should not participate in RERT if it will jeopardise the performance of their networks. Some stakeholders raised concerns about DNSPs elevating voltage levels with negative customer impacts. To address these risks, AEMO has provided assurances that it will monitor voltage behaviour by DNSPs and the AER will encourage AEMO to report any concerns regarding their behaviour to jurisdictional technical regulators. Through the waiver conditions, the AER will also have access to information from any customer complaints regarding power quality which can help inform any future extension of the waiver.

In light of concerns around power quality and longer term competition impacts, the AER has decided to reduce the timeframe of the waiver from 5 years to 28 months. We consider that a 28-month waiver will help to address the immediate reliability issues whilst providing AEMO and DNSP RERT providers with contracting certainty through to April 2025.

During the 28-month waiver, the AER will monitor for unintended impacts of DNSPs providing RERT services via voltage management. The AER will consider any unintended impacts prior to granting a longer-term waiver. Before an extension or variation to this class waiver, the AER will facilitate a longer consultation period, during which stakeholders are encouraged to provide any evidence of negative effects of voltage management on consumers.

<sup>26</sup> Specifically, AER, *Ring-fencing Electricity Distribution Guideline (Version 3)*, October 2021, 4.2.1(a), 4.2.2(a) and 4.2.3(a)

## 3.6 Other matters

### ***Rationale for length of the waiver***

As is discussed above, the AER has reduced the period of the class waiver from 5 years to 28 months (until 15 April 2025). This reduced timeframe strikes a balance between satisfying the urgent need for cost-effective RERT as requested by AEMO, providing certainty for contracting between AEMO and DNSPs and minimising the risk of any adverse power quality consequences of DNSP participation in RERT. Additionally, the waiver will expire outside of the peak demand months in Summer and Winter, which was requested by AEMO.

The term of RERT Panel Agreements is generally 12 months, with an option for AEMO to extend the contract for a further 12 months. However, AEMO has informed staff that it can vary the terms of a RERT Panel Agreement to have a fixed end date. Therefore, the length of the class waiver will allow AEMO to negotiate with DNSPs to enter 12-month RERT Panel Agreements in 2023 and 2024, with the option to extend agreements until the end of the class waiver (15 April 2025).

Before varying or extending this class waiver, the AER will consider the information gathered through DNSP quarterly performance reports, any reports from AEMO of unusual voltage levels and any complaints by customers of negative impacts of voltage management. This information will be used to determine whether a longer term waiver is appropriate at the expiration of this class waiver. Prior to varying or extending the class waiver, the AER will also facilitate a longer consultation period with stakeholders to better understand the potential long-term risks of voltage management by DNSPs.

### ***Scope of the waiver***

In response to the suggestion by some DNSPs that the scope of the waiver should be expanded to include all means of providing RERT, the AER has only considered the provision of RERT via voltage management for the purpose of this waiver. Other methods of providing RERT would require further consultation because they would likely pose other competition, policy and legal issues. CitiPower/Powercor/United Energy suggested that the scope of the waiver should be expanded to RERT provided through diesel generators, Virtual Power Plants and shutting down industrial processes. At this stage, the AER considers that these methods of providing RERT are contestable and would require further assessment and consultation before a waiver could be granted. Therefore, the scope of the class waiver is confined to the provision of RERT via voltage management.

### ***Revenue received by DNSPs***

Some stakeholders also indicated that in the interests of transparency, the revenue that DNSPs receive from RERT should be published. The AER has adopted this feedback and will publish the performance reports received by DNSPs on its website. Additionally, given the shorter time frame of the class waiver and stakeholder interest in the revenue DNSPs will receive, the AER has increased the frequency of performance reporting from annually to quarterly.

The AER recognises concerns raised by stakeholders that consumers are unlikely to receive flow on benefits of RERT revenue under the current regulatory arrangements as the amount of revenue that DNSPs receive through RERT is unlikely to trigger the Shared Asset Guideline. Under the Shared Asset Guideline, a DNSP's annual revenue requirement will only be reduced if the average unregulated revenue earned during a regulatory control period through the use of shared assets exceeds 1 per cent of the DNSP's total annual regulated revenue requirement. The AER will consider undertaking a review of the Shared Asset Guideline as part of its 2023/24 work program.

### ***Measurement of voltage management***

Shell and AGL raised concerns about the difficulty of measuring voltage management services. Shell noted that current RERT providers are required to provide NMI level evidence that they are complying with their RERT Panel Agreement, whereas voltage management cannot be measured in a similar way. To address this concern, AEMO has confirmed that DNSPs providing voltage management will be required to have certified testing and calibration to ensure the validity of the measurement devices is equivalent or better

than revenue grade metering.<sup>27</sup> AEMO will assess and verify a DNSP's measurement devices prior to entering into a RERT Panel Agreement. DNSPs use their SCADA system to read voltage data in real time and data from smart meters near substations to demonstrate changes in voltage levels.

### **3.7 Conclusion**

We consider the class waiver is necessary to address AEMO's concerns about reliability and provides benefits to consumers through likely lower RERT costs. However, the AER is concerned by the potential long-term impacts of a class waiver that have been raised by stakeholders including in relation to power quality and competitive entry of prospective voltage management providers. On balance the AER considers that the benefit or likely benefit to consumers of permitting DNSPs to contract with AEMO to provide RERT services via voltage management outweighs the costs of DNSPs not complying with ring fencing obligations and that discrimination risks are limited.

The AER considers that longer consultation would be worthwhile before granting a long-term class waiver. Therefore, the AER has reduced the timeframe of the waiver from 5 years to 28 months. The AER will monitor power quality and competition impacts and will facilitate a longer consultation period prior to a variation or extension of this class waiver, assuming the need remains.

<sup>27</sup> Letter from AEMO dated 24 November 2022 (received 25 November 2022).



## 4 Decision

Our decision is to grant a ring-fencing class waiver, effective from 14 December 2022 to 15 April 2025, to allow DNSPs to contract with AEMO to provide RERT services via voltage management. The class waiver exempts DNSPs from their obligations to comply with clause 4.2 of the Guideline (functional separation) in relation to the provision of RERT services via voltage management.

This class waiver is subject to the following pre-conditions and conditions:

### Pre-conditions:

The scope of the class waiver is limited to:

- DNSPs that negotiate with AEMO to enter into, and/or enter into, a RERT Panel Agreement with AEMO for the provision of short notice reserve via voltage management pursuant to rule 3.20.2 of the National Electricity Rules and clause 6 of the RERT Guidelines.<sup>28</sup>
  - DNSPs must not contract with AEMO to recover payments for pre-activation of reserve.
  - If the DNSP's RERT Panel Agreement with AEMO ceases, the DNSP will no longer qualify for the class waiver (unless, and until, the DNSP commences negotiation to enter into a further RERT Panel Agreement with AEMO). For clarity, this class waiver expires on 15 April 2025, and will not apply to any RERT Panel Agreement (pre-existing or otherwise) beyond this date.
- DNSPs that meet the precondition of providing the AER with a copy of the RERT Panel Agreement entered into with AEMO.
  - Where possible, the RERT Panel Agreement should be emailed to [AERringfencing@aer.gov.au](mailto:AERringfencing@aer.gov.au) immediately, or if it is being negotiated, within 20 business days of the agreement being finalised. The AER will treat this information as commercially sensitive and note our policies regarding information privacy and disclosure of information.

### Conditions:

The class waiver is subject to the following conditions:

- DNSPs participating in the class waiver must provide the AER with quarterly performance reports, where RERT has been provided in that quarter, detailing:
  - the number of instances the DNSP provided short notice reserve to AEMO in a quarter (i.e. the number of times the reserve was activated by AEMO);
  - the volume (MW) of reserve provided in each instance that the DNSP provided short notice reserve to AEMO; and
  - the revenue received for each instance that the DNSP provided short notice reserve to AEMO.

These quarterly performance reports will be published on the AER website.

- DNSPs must notify the AER if the DNSP receives:
  - notification from a customer about any adverse impacts of the DNSP's provision of RERT services via voltage management; or
  - any other customer complaints relating to the quality of supply that may be associated with the provision of RERT services via voltage management.

<sup>28</sup> AEMC Reliability Panel, Reliability and Emergency Reserve Trader Guidelines, Final guidelines, 21 August 2020, clause 6: [https://www.aemc.gov.au/sites/default/files/2020-08/Updated%20Amended%20Panel%20RERT%20Guidelines%20-%2018%20August%202020%20-%20Final%20for%20publication\\_0.pdf](https://www.aemc.gov.au/sites/default/files/2020-08/Updated%20Amended%20Panel%20RERT%20Guidelines%20-%2018%20August%202020%20-%20Final%20for%20publication_0.pdf).