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Anders Sangkuhl
Regulatory Strategy Manager
Essential Energy

Sent by email to: anders.sangkuhl@essentialenergy.com.au

Dear Anders

Thank you for your application of 15 July 2022 requesting a waiver from clause 3.1 of the Ring-fencing Guideline for Electricity Distribution (the guideline) to allow Essential Energy to lease excess capacity from its Sovereign Hills battery.

In our November 2021 Explanatory Statement to the guideline, we identified criteria that a waiver application for an energy storage device needs to meet to be considered through our streamlined waiver process. In this instance, we consider the potential for cross-subsidisation has been sufficiently addressed through Essential Energy's proposed cost allocation methodology, which is subject to AER monitoring and reviewing, as necessary. We also note that Essential Energy has tested the market with 12 participants. Taking into consideration the trial elements of this project, the application has met the criteria for consideration under the streamlined waiver process.

Essential Energy's proposal

We understand that Essential proposes to trial a network battery in the Sovereign Hills area of Port Macquarie, NSW. Essential Energy will own the battery and use it for common distribution services. A non-affiliated third party will use the excess capacity from the batteries for providing frequency control ancillary services and arbitrage services, only when it is not required by Essential Energy.

Essential Energy stated the battery has been specified and sized for their required network purposes, and they will deploy the battery regardless of whether it can be utilised by a third party, as the identified cost of the battery is lower than other investments that would be required.

The purpose of the project is to trial battery use in terms of network and other services, to inform future cost allocation approaches, and to understand how to define the roles of Essential Energy and the third party to inform future contractual arrangements.

AER assessment and decision

The guideline specifies that, in assessing a waiver application, we will have regard to the National Electricity Objective; the potential for cross-subsidisation and discrimination; and the benefit, or likely benefit, to consumers from the distribution network service provider

(DNSP) complying with the obligation, relative to the cost to consumers from the DNSP complying with the obligation.

The AER considers the benefits of this trial include that it creates potential for innovation and market learnings that Essential Energy can use in managing its network business as well as publicly sharing non-commercially sensitive learnings. We also note that Essential Energy indicates that it is using the battery as an efficient alternative to network investment, and that leasing the battery to a third party drives efficient utilisation of the asset through the creation of additional value streams.

A component of this project is included in Essential's Regulatory Asset Base (RAB). We note that in determining the percentage of the asset that should be placed in the RAB versus the percentage allocated to unregulated streams, Essential Energy used estimates of use and network and market revenues that were based on modelling of historical patterns. We consider these principles are appropriate in the current circumstances, however we will monitor actual usage of the battery as against this cost allocation and may review the cost allocation methodology should actual use and revenue not align with forecasts. The data will also inform future cost allocation approaches.

The guideline has a number of obligations to prevent discriminatory behaviour in favour of a particular entity (namely those obligations set out in clause 4.1 and 4.3). These obligations cannot be waived. Essential Energy has undertaken a market testing process and contracted a non-affiliated third party to use the excess capacity from the battery. Due to the arms-length nature of this process, we have assessed Essential Energy as being compliant with the guideline's obligations.

In making this decision we have not viewed Essential Energy's cost allocation methodology, modelling of expected use, or tender documents. However, in similar cases in the future, and particularly where an affiliated entity is contracted to use spare capacity from a battery, we may request such information. On battery use, we are aware of projects already in place that network businesses could take learnings from (for example, ElectraNet's Dalrymple ESCRI-SA battery project). We encourage DNSPs when developing battery projects and waiver applications to demonstrate how they have considered information from other trials. The AER expects to see knowledge of battery use increasing. Regarding tender information, as the market for battery services grows and matures, the AER could request more open market testing from DNSPs.

We have decided to grant a waiver from clause 3.1 of the Guideline to allow Essential Energy to lease the excess capacity from its Sovereign Hills Battery. The waiver is provided for 15 years, until 4 August 2037. The waiver is subject to the conditions below.

Conditions

The following conditions apply with this waiver approval:

- Providing the AER with information on the contractual arrangement between Essential Energy and the third-party retailer. This information includes the contractual terms, conditions and payments. This information should be provided to AERringfencing@er.gov.au within 20 business days of the contract being finalised. Where there are changes in this contractual arrangement, the AER should be notified within 20 business days. We acknowledge the commercially sensitive nature of this information and will treat this information, accordingly, noting our policies regarding information privacy and disclosure of information.

- Ex-post public sharing of information about the battery (e.g., location(s), size, intended purposes and uses, approved cost allocation method, and a key contact for external stakeholders if they wish to discuss the project further) and any useful learnings from the battery usage that will support the battery market.
- Provide on an annual basis a comparison of the uses (volume and frequency) of the battery that confirms and differentiates between Essential Energy's network usage and spare capacity leased to the third party, and an explanation of any differences between forecast and actual usage.
 - This includes the total period of time (to the nearest five-minute increment) that the battery is operating at the direction of Essential Energy and total period (to the nearest five-minute increment) of time that the battery is operating at the direction of the third party.
 - The independent assessor, as part of the annual ring-fencing compliance assessment, is to confirm the comparison is accurate and the appropriate cost allocation was applied between the regulated and unregulated uses of the battery.

If you would like to discuss further, or have any questions, please contact Mark Feather, General Manager, Strategic Policy and Energy Systems Innovation Branch, on (03) 9290 6958 or AERringfencing@ aer.gov.au in the first instance.

Yours sincerely



Justin Oliver
AER Board Member