Updating the Ring-fencing Guidelines for Stand-Alone Power Systems and Energy Storage Devices

Issues Paper

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AUSTRALIAN ENERGY REGULATOR

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Request for submissions

Interested parties are invited to make written submissions to the Australian Energy Regulator (**AER**) regarding this paper by the close of business, 21 December 2020.

Submissions should be sent electronically to: AERringfencing@aer.gov.au

Alternatively, submissions can be mailed to:

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The AER prefers that all submissions be publicly available to facilitate an informed and transparent consultative process. Submissions will be treated as public documents unless otherwise requested.

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- provide a non-confidential version of the submission in a form suitable for publication.

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Enquiries about this paper, or about lodging submissions, should be directed to the Consumers and Markets branch of the AER on 1300 585 165 or AERRingfencing@aer.gov.au

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Shortened forms

Shortened Form	Extended Form
ACCC	Australian Competition and Consumer Commission
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
ASP	Accredited Service Provider
CCA	Competition and Consumer Act
COAG	Council of Australian Governments
DER	Distributed Energy Resources
Distribution Guideline	Ring-fencing Guideline Electricity Distribution - Version 2, October 2017
DNSP	Distribution Network Service Provider
ENA	Energy Networks Australia
ESCRI	Energy Storage for Commercial Renewable Integration
FCAS	Frequency Control Ancillary Services
NECA	National Electrical Communications Association
NEL	National Electricity Law
NEM	National Electricity Market
NER	National Electricity Rules
NSP	Network Service Provider
RESP	Related Electricity Service Provider
SAPN	SA Power Networks
SAPS	stand-alone power system - historically this was a local generation unit. Today solar PV and battery storage are providing cost-effective means of local energy services

Shortened Form	Extended Form
TNSP	Transmission Network Service Provider
Transmission Guideline	Transmission Ring-fencing Guidelines as published by the ACCC in 2002 and updated by the AER in 2005

1 Introduction

Electricity distribution and transmission businesses are subject to ring-fencing requirements under the Electricity Distribution Ring-fencing Guideline (the **Distribution Guideline**)[1] and Transmission Ring-fencing Guideline (the **Transmission Guideline**).[2] In August and November 2019 we commenced reviews of the Distribution Guideline and Transmission Guideline respectively.

This issues paper continues our review of the Distribution Guideline and provides an updated timeline for our review of the Transmission Guideline. In particular, we are seeking stakeholder feedback on:

- Refining the Distribution Guideline to reflect the changing nature of services offered by distribution businesses, including via new technology such as stand-alone power systems (**SAPS**) and storage devices.
- Clarifying and improving relevant obligations to make the Distribution Guideline clearer and simpler to understand.

In recent years, new kinds of electricity services and new areas of competition have emerged due to technological change and market reform. In some cases these new technologies operate at the boundary between regulated and unregulated electricity markets. In particular, there has been increasing interest in:

- SAPS that provide electricity to a consumer (or group of consumers) without being physically connected to the national electricity system.
- Energy storage devices, such as grid-scale batteries, that could be used by network service providers (**NSP**) to offer both regulated and unregulated services.

These technologies are challenging the existing regulatory frameworks. Legislative changes are being considered which may result in new rules for SAPS, and consideration is being given to whether legislative changes are required for energy storage devices.[3] Similarly, our approach to ring-fencing must be compatible with these technologies. In this paper we discuss possible changes to ring-fencing to support and enable the adoption of these new technologies by NSPs. At the same time, we must ensure the deployment of these technologies by NSPs does not stifle the development of competition in emerging markets created by these technologies.

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1 AER, *Ring-fencing Guideline Electricity Distribution - Version 2*, October 2017.

2 In 2002 the ACCC published a Decision, Guidelines and Ring-fencing Guidelines, see <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/ring-fencing-guidelines-transmission-2002>. The Guidelines underwent a minor update in 2005 when the AER assumed responsibility for regulation of electricity transmission in the NEM and published: *Compendium of Electricity Transmission Regulatory Guidelines*, 1 August 2005, see <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/compendium-of-electricity-transmission-regulatory-guidelines-august-2005>.

3 AEMC, *Electricity network economic regulatory framework review - Final Report*, October 2020; SA Government Department of Energy and Mining, *National Energy Laws Amendment (Stand-Alone Power Systems)*, 6 July 2020.

1.1 What is ring-fencing?

Ring-fencing is the identification and separation of business activities, costs and revenues for delivering network services on a monopoly basis, from the delivery of other services.

Ring-fencing benefits consumers by addressing the potential risk of:

- Consumers paying more than they should for regulated services because an NSP cross-subsidises the cost of its unregulated services by attributing costs to its regulated services; and
- NSPs discriminating in contestable markets in favour of their affiliated entities. This behaviour could diminish the benefits created by a competitive market, such as long-term downward pressure on prices and greater consumer choice.[4]

In order to realise these benefits, the National Electricity Rules (**NER**) allow us to place requirements on distribution and transmission NSPs to ring-fence monopoly services from contestable services. This is achieved through:

- Legal separation of the transmission and distribution services of network businesses from affiliates providing other services.[5]
- Specialised accounting and transaction records.
- Functional separation that keeps regulated monopoly business activities apart from contestable business activities. For example, by requiring network businesses to have separate branding and restricting certain specialist staff being shared with affiliates.
- Information firewalls and access controls to secure commercially sensitive information.

Ring-fencing aims to drive effective competition where it is feasible, to open up new markets to competition and to provide effective regulation where competition is unattainable. Ensuring regulated monopolies do not have an unfair advantage over unregulated competitors is an important element of ensuring the development of competitive markets. That said, ring-fencing obligations should represent a targeted, proportionate and effective regulatory response to the potential harm faced by consumers. The benefit, or likely benefit to consumers of a distribution network service provider (**DNSP**) complying with an obligation, should outweigh the cost to the DNSP of complying with that obligation.

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4 Note: affiliated entity is also referred to as a Related Electricity Service Provider (RESP) in the *Ring-fencing Guideline Electricity Distribution - Version 2*, October 2017 and other supporting documentation.

5 The term 'other services' is defined as services other than transmission or distribution services in the *Ring-fencing Guideline Electricity Distribution - Version 2*, October 2017.

1.2 Reviews of the ring-fencing guidelines

We commenced separate reviews of the Distribution and Transmission Guidelines in 2019. Ring-fencing issues related to distribution and transmission services are similar but not the same, which is why we are reviewing the guidelines separately.

In August 2019, we held workshops in Melbourne and Sydney to discuss the Distribution Guideline with stakeholders. The workshop slides, meeting notes and stakeholder submissions are available on the AER website.[6] We received 11 submissions from stakeholders, on a wide range of issues. The issues raised in submissions are discussed later in this paper.

Our review has also been informed through our ring-fencing compliance work. Since the commencement of the Distribution Guideline in 2018, we have responded to complaints, enquiries, breaches and ring-fencing waiver applications. The issues that have arisen through our compliance activities have informed the possible Distribution Guideline amendments we explore in this paper.

Our response to the energy sector challenges arising from the COVID-19 pandemic has meant this review has been conducted over a longer timeframe than initially intended. This was to allow businesses and other stakeholders to focus on more immediate issues.

We intend to engage stakeholders before we prepare amendments to the Distribution Guideline. After receiving submissions in response to this paper, all stakeholder feedback and views gathered from submissions and our usual work will then be used to inform a draft ring-fencing guideline to be published next year.

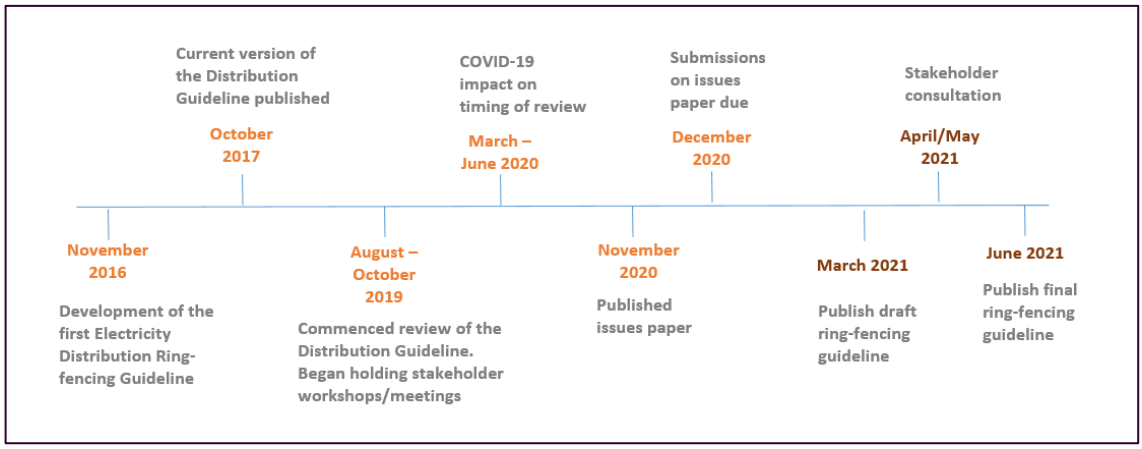
6 AER, *Electricity ring-fencing guideline review - August 2019*, <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/electricity-ring-fencing-guideline-review-august-2019>.

1.3 What is the timing for the reviews?

There are separate review timelines for the Distribution Guideline and Transmission Guideline, as noted in the figures below.

Distribution Guideline

Figure 1. Distribution Guideline review timeline

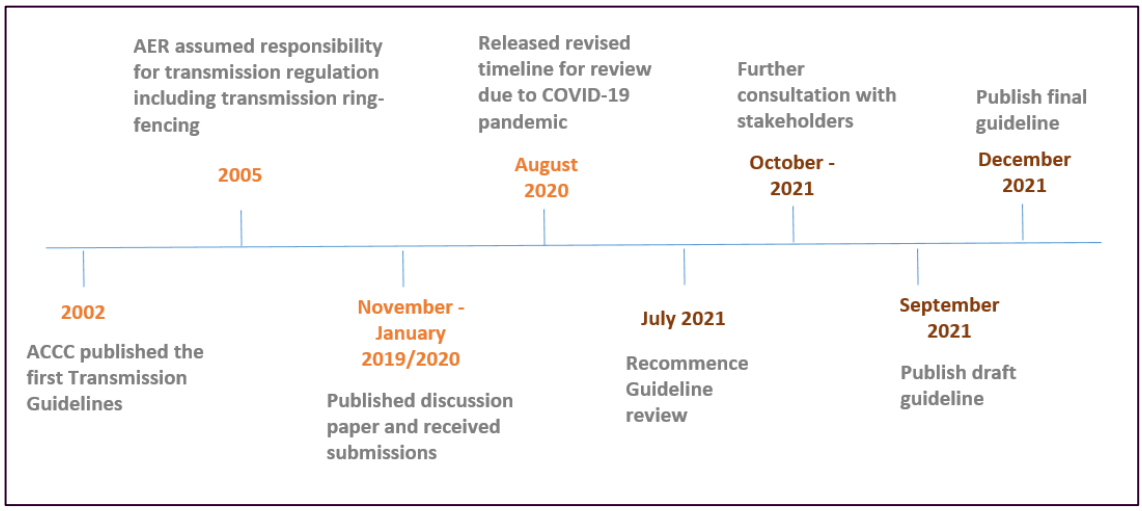


Transmission Guideline

Our review of the Transmission Guideline will continue once the Distribution Guideline has been settled. The Transmission Guideline requires a fundamental review, given it has not been revised since 2005. The Transmission Guideline is not required to mirror the Distribution Guideline. However, we are required to consider the need for consistency between the guidelines where this is practicable.[7]

The timeline below sets out the revised timeframes for reviewing the Transmission Guideline. Some issues raised in this paper (such as storage devices), will be relevant to the Transmission Guideline. Relevant submissions in response to this issues paper may be referred to in the Transmission Guideline review.

Figure 2. Transmission Guideline review timeline



1.4 Structure of this paper

This issues paper discusses the following:

- Section 2 – the interaction between ring-fencing and distributed energy resources. In particular:
    - How DNSP delivery of SAPS under the new framework might work, including the possibility of including automatic ring-fencing exemptions to allow DNSPs to provide SAPS generation systems without the need for a waiver.
    - The ring-fencing treatment of energy storage devices operated by DNSPs and the role that DNSPs could play in the use of storage devices to offer electricity services in contestable markets.

7 National Electricity Rules, r 6.17.2(c).

- Section 3 – a range of general improvements to the Distribution Guideline, including current staff sharing; information access; breach reporting; and annual compliance reporting obligations.

1.5 What do we want to know from stakeholders?

We seek stakeholder views on a number of aspects of electricity ring-fencing arrangements. To encourage stakeholder input, we have included questions throughout this paper, which are summarised in the table below.

Table 1. Summary of consultation questions

Questions	
Question 1	Do stakeholders agree that in some circumstances an exemption would be preferable to requiring DNSPs to apply for a ring-fencing waiver?
Question 2	Are there other types of exemptions we should consider?
Question 3	In regard to the exemptions above, or any others, what is an appropriate threshold?
Question 4	Should exemptions for SAPS be defined in specific detail or are generic exemptions, which would apply more broadly, preferable?
Question 5	How can we be sure that DNSPs using exemptions are complying with the Distribution Guideline?
Question 6	In the above criteria do the exemption thresholds satisfy the Distribution Guideline criteria of benefits outweighing costs?
Question 7	What other benefits, harms or risks should we consider?
Question 8	If NSPs use storage devices to offer services in contestable markets, how can any potential harms be managed?
Question 9	How should we weigh these benefits and harms to determine if a waiver should be granted? What are the priorities?
Question 10	Should we distinguish between direct and indirect uses of storage devices?
Question 11	Should we clarify the scope of clause 3.1(d)I of the Distribution Guideline?

Questions	
Question 12	Can improved staff sharing registers provide the transparency of staff sharing that is needed?
Question 13	Will changing the term 'confidential information' to 'ring-fenced information', make ring-fencing obligations in relation to information sharing clearer?
Question 14	Will reporting all breaches in relation to substantive Distribution Guideline clauses in 10 business days improve the overall timeliness of breach reporting and reduce the administrative burden on DNSPs?
Question 15	Will calendar year compliance reporting minimise the administrative burden on DNSPs?
Question 16	Are the current Distribution Guideline obligations, in relation to branding and cross promotion, proportional to the potential harms? If so, how might the branding and cross-promotion obligations in the Distribution Guideline be amended to make them more targeted?

2 Updating the Distribution Guideline for SAPS and Storage Devices

The energy market has seen substantial technological development in the past few years, which has led to substantial changes in the economics of energy storage and SAPS. Ring-fencing aims to regulate monopoly network services from competitive services such as electricity generation and retailing. Energy storage devices and SAPS blur these boundaries and our approach to ring-fencing may need to adapt to ensure consumers can benefit from the use of these technologies.

Both SAPS and storage devices are great examples of innovation within the energy market. DNSP-led SAPS are in a more advanced stage of development with deployment imminent upon finalisation of a suitable compliance framework. DNSP investment in storage devices is still in a trail phase.

Initially, we anticipate most DNSP-led SAPS will be relatively small to address customer supply issues, while DNSP storage devices will be relatively large in order to address network supply constraints. Over time we expect to see both large and small scale SAPS and storage devices.

2.1 Stand-alone Power Systems

A SAPS can be described as an electricity system arrangement that is not physically connected to the national grid.[8] The NER and the National Electricity Law (**NEL**) only apply to the interconnected grid that forms the National Electricity Market (**NEM**). By definition, SAPS are not physically connected to the NEM and are not captured by the economic regulatory framework in the NER and NEL.

At present, SAPS consumers are not afforded the consumer protections and reliability standards available to NEM-connected customers. As a result, consumers cannot generally access the potentially lower costs of supply that SAPS can provide due to the restrictions in the NER placed on recovery of SAPS-related costs by DNSPs.

SAPS can have significant benefits including improved reliability and greater resilience compared with traditional network systems. DNSPs will most likely deploy SAPS in areas of the network that are generally more susceptible to outages. The increased reliability of SAPS could result in fewer outages for shorter periods of time. Increased resilience is achieved when customers are able to maintain supply even when maintaining or restoring electricity supply is challenging.

8 Australian Energy Market Commission, *Updating the Regulatory Frameworks for Distributor-led Stand-alone Power Systems*, May 2020, p i.

For DNSPs, SAPS are attractive because these systems may be less costly compared with traditional poles and wires. Cost savings are likely be gained for all consumers, not just those connected to a SAPS. However, reduced network cost should benefit all customers through lower costs over time.[9]

2.1.1 What is the proposed framework for DNSP involvement?

A regulatory framework for DNSP-led SAPS was developed by the Australian Energy Market Commission (**AEMC**) and recommended to the Council of Australian Governments (**COAG**) Energy Council in May 2020. DNSP-led SAPS are referred to as Priority 1 SAPS by the AEMC.[10] The AEMC's recommended framework would enable DNSPs to deploy SAPS to consumers as if they were still connected to the grid. Through COAG, Australian Governments are now developing legislation to enact a framework for SAPS based on the AEMC recommendations.

The AEMC also made recommendations for the regulatory framework which should apply to third-party SAPS (Priority 2).[11] This paper focuses solely on Priority 1 of the AEMC's proposed regulatory framework in relation to DNSP-led SAPS.

The AEMC refers to its regulated SAPS delivery model as the 'NEM continuation model' because it retains the separation of network, retail and generation services. This provides several advantages in that customers will:

1. Continue to pay retail bills to their existing retailer.
2. Retain their existing access to retail choice.
3. Retain customer protections attached to the retailer-customer relationship.

The AEMC framework splits a SAPS into two components: a SAPS distribution system and a SAPS generation system.

The distribution system component of a SAPS will be regarded as a distribution service under the new rules and would be treated like any other part of a distribution system. The SAPS generation system, however, would need to be provided by a third party (or a DNSP affiliate). This is because DNSPs are prevented from providing these types of

9 Australian Energy Market Commission, *Updating the Regulatory Frameworks for Distributor-led Stand-alone Power Systems*, May 2020, p ii.

10 Priority 1 is focused on the development of a national framework for customer that move from grid-connected supply to SAPS provided by DNSPs. See: Australian Energy Market Commission, *Final Report - Review of the Regulatory Frameworks for Stand-Alone Power Systems - Priority 1*, 30 May 2019, p v.

11 Priority 2 is focused on the development of a national framework to support the supply of electricity from SAPS provided by parties other than DNSPs. See: Australian Energy Market Commission, *Final Report - Review of the Regulatory Frameworks for Stand-Alone Power Systems - Priority 2*, 31 October 2019, p iii.

electricity services under our ring-fencing framework. For a DNSP to provide the generation system of a SAPS, a ring-fencing waiver will be required.

Alternatively, we could include SAPS generation system exemptions in our Distribution Guideline, which are effectively 'automatic ring-fencing waivers'. The question is when should a DNSP be automatically exempted compared with the usual process of seeking a ring-fencing waiver by application (that may be subject to a public consultation process)? We are therefore seeking stakeholder views on the circumstances that DNSPs can, or should, play in the delivery of SAPS generation systems to consumers.

The SAPS framework adopted by the Australian Government may differ from the AEMC's recommendation. This paper, therefore, seeks comment on a SAPS framework that is not yet settled.

Early stakeholder consultation presents some risk that the final SAPS framework may differ from the AEMC's recommendation, however, we see benefits in doing so. In particular, we will be better placed to quickly make any adjustments to our Distribution Guideline to accommodate the final framework.

The final SAPS framework ultimately adopted by Governments may also have implications for other aspects of regulation developed and implemented by the AER, such as the:

- Regulatory Investment Test for Distribution (**RIT-D**)– after a destructive bushfire, a DNSP thinking about a SAPS as an alternative to poles and wires replacement, may need to undertake a RIT-D.
- Service Classification Guideline – due to the proposed change in the definition of a distribution service.

It should be noted that upon finalisation of the SAPS framework, state governments will need to individually opt-in to the framework. Only those DNSPs in jurisdictions that have opted in will be able to implement the SAPS regulatory framework. This is because the proposed new rules under the framework are necessary to enable capital and operating expenditure on SAPS to be recovered from distribution customers. This is not possible under the rules as they currently stand. If the rules are successfully adopted the review of the Distribution Guideline aims to ensure SAPS can be deployed by DNSPs.

2.1.2 SAPS waivers versus exemptions

A ring-fencing waiver can be granted where compliance with the Distribution Guideline is not in the best interests of consumers. Waivers tend to be very specific. A waiver might be granted to a particular DNSP, in regard to a specific clause, for a specific purpose and for a specified period of time. For example, we granted Ergon Energy a

waiver earlier this year allowing it to offer field service to Powerlink until mid-2025 due to the absence of other service providers where Powerlink operates.

In its report to the COAG Energy Council, the AMEC noted the AER might streamline the ring-fencing waiver process by introducing new DNSP-led SAPS generation exemptions. Unlike waivers that must be individually applied for, exemptions would be built into the Distribution Guideline. No separate decision would be required by the AER as the Distribution Guideline would set out the eligibility requirements and conditions of the exemptions. An exemption is already included in the Distribution Guideline with respect to 'regional offices', which allows a DNSP to avoid the staff and office sharing restrictions in remote locations, in certain circumstances.

We appreciate that for some types of SAPS the time and cost necessary to apply for a waiver would be disproportionate and wasteful. Consider, for example, a small SAPS to replace a network connection to a water bore or remote streetlight. Indeed for very small SAPS it may be impractical to physically identify or separate the generation from distribution components of a SAPS. For small SAPS, Essential Energy argued it would find it difficult to locate a service provider willing to offer SAPS generation services that it can procure on an ongoing basis (that is offer installation, operating and maintenance, and fault correction).[12]

We support the argument for building exemptions in relation to DNSP-led SAPS into the Distribution Guideline. Allowing a DNSP to provide a generation service for the SAPS, in certain circumstances, is likely to be the most practical outcome for DNSPs and consumers. This raises the question of what these circumstances for SAPS ring-fencing exemptions should be.

2.1.3 Stakeholder views

A number of issues were raised in submissions to the AEMC in developing its proposed SAPS framework, which we have summarised below. We have taken these submissions into account in considering the types of exemptions that could be incorporated into the Distribution Guideline, as discussed in **Section 2.1.5.**

Should waivers be granted for the life of SAPS?

Energy Networks Australia argued that waivers should be granted for the life of a SAPS.[13] According to the ENA, this would provide DNSPs security around future projects. It would also provide reassurance to customers on a SAPS about the longevity of the arrangement and owners would receive a return on long-term assets

12 Essential Energy, *Regulatory Frameworks for Distributor-led Stand-alone Power Systems - Response to Draft Rules*, 14 February 2020, p 10.

13 Energy Networks Australia, *Regulatory Frameworks for Distributor-led Stand-alone Power Systems - Response to Draft Rules*, 13 February 2020, p 6.

like the traditional distribution network. Waivers of ring-fencing obligations are typically granted for the current and following regulatory control period.[14] If the DNSP requests an extension to the waiver then we would review the waiver before the commencement of the following regulatory control period. This is consistent with our reassessment of service classification at the time a Determination is made, which in turn affects the ring-fencing of services.

If exemptions are adopted as part of the SAPS framework, they would be introduced into the Distribution Guideline and provide DNSPs a greater degree of permanency than waivers. Exemptions would last until such time the Distribution Guideline was revised. If an exemption was altered or removed, it is likely we would grandfather exemptions applied to existing SAPS.

What happens if a third party provider of a SAPS closes down?

Public Interest Advocacy Centre submitted that processes should be in place to address the possible situation that a SAPS third party owner suddenly leaves the market.[15] An exemption in the Distribution Guideline could allow the DNSP to immediately take over the responsibility and ownership of the SAPS, so that the consumer does not experience an interruption of service. We agree the SAPS framework should have arrangements in place for the potential business failure of SAPS service providers.

What happens in an emergency situation?

Ausgrid suggested an exemption allowing DNSPs to operate or maintain a SAPS in an emergency, where a third party had installed the SAPS.[16] We agree that this situation should be addressed.

Tendering for SAPS services

Firm Power suggested a process for public tenders could be costly in terms of resources.[17] It was suggested that a standard process be identified setting out the competitive tender requirements for DNSPs and third parties. We note that DNSPs will play a key role in creating the opportunities for third parties to compete for offering SAPS-related services to DNSPs. At the same time DNSPs and their affiliates will have a commercial interest in providing many of these SAPS services themselves. This

14 AER, *Ring-fencing Guideline Electricity Distribution - Version 2*, October 2017, cl 5.3.4(b).

15 Public Interest Advocacy Centre, *Submission to Draft Rules for Distributor-Led Stand-alone Power Systems*, 13 February 2020, p 2.

16 Ausgrid, *Ausgrid Submission - AEMC Review of the Regulatory Arrangements for Stand-Alone Power Systems - Draft Report*, 13 February 2020, p 4.

17 Firm Power, *Submission on Updating the Regulatory Frameworks for Distributor-led Stand-alone Power Systems,* 13 February 2020, p 6.

highlights the need for DNSPs to develop and implement competitive tendering processes that satisfy the non-discrimination obligations of the Distribution Guideline.

Taking into account previous stakeholder views we have developed preliminary views on exemption thresholds that may be most applicable in practice.

2.1.4 How should we set thresholds for SAPS ring-fencing exemptions?

Exemptions would allow a DNSP to install a SAPS if it met certain requirements, without having to apply to the AER.

In the absence of exemptions, DNSP would have to submit waiver applications to offer SAPS generation services. Waivers could also be sought in more general circumstances rather than individually. Nevertheless we are concerned that the process of waiver applications, consultation and decision making could be unduly burdensome on all parties. Consequently, we are seeking to simplify the process for DNSPs to provide SAPS generation services, by creating exemptions in the Distribution Guideline.

Question 1: Do stakeholders agree that in some circumstances an exemption would be preferable to requiring DNSPs to apply for a ring-fencing waiver?

2.1.5 Preliminary Views

There are two approaches we could take to SAPS generation exemptions. We could define exemptions narrowly around very specific situations or we could generically define the exemptions.

A generic exemption would give a DNSP more discretion and flexibility in getting a SAPS generation service up and running. However, this approach would give a DNSP far greater latitude to deploy its own SAPS generation systems. This might hamper opportunities for alternative providers of SAPS generation systems.

Increased monitoring of DNSPs may be required to ensure appropriate use of these exemptions. This might be achieved by requiring DNSPs to maintain a register with detailed information on the SAPS generation services being provided under an exemption. This generic approach to exemptions would facilitate more rapid deployment of SAPS as DNSP would be less constrained. However, a disadvantage of this approach is that information about how the exemptions are being used will be obtained after the fact.

If we were to take a narrower approach to defining SAPS generation exemptions, we would need to define these circumstances. This could result in issues caused by

inadequately defining an exemption, or failing to identify all the circumstances in which exemption ought to apply.

It is possible that any exemptions that we decide to include in the Distribution Guideline may fall somewhere in between these two approaches, or may have elements of both, and may not be easily classified as adopting one or the other.

We have identified a number of possible types of defined exemptions for SAPS generation services below. The exemptions listed are not intended to be exhaustive. For each exemption, an objective and measurable threshold would be required.

We acknowledge that some exemptions and their thresholds such as remoteness, population density and access present weaknesses but have listed them for completeness and to address stakeholder feedback. Defined exemptions would require less and more flexible monitoring in the short to medium-term thereby encouraging DNSP-led SAPS. This approach could be revisited as the SAPS market develops where we could set a higher threshold for obtaining an exemption. However, this might be some years away.

Defined exemption thresholds may be set with respect to:

- **Remoteness** – with the threshold set with respect to the distance of a SAPS from nearby population centres of given size.
    - This exemption would allow for a SAPS generation service to be provided when the SAPS is beyond a certain distance away from a population centre. For example, to use the regional office exemption in the Guideline, a DNSP may provide a SAPS generation service when it is 100km away from a population of a given size. The question is: what distance and what population size are appropriate?
- **Population density** – with a threshold based on when the person per unit area falls below a defined level.
    - This exemption would allow for a SAPS generation service to be provided when the population density is sufficiently low. What level of population density would be an appropriate threshold?
- **Access** – where installation will face difficult terrain or other access issues.
    - This would allow a DNSP to provide a SAPS generation service where the terrain is too difficult to build anything else or it results in poorer reliability and/or higher costs to serve relative to the SAPS alternative. For example, where a significant section of the connection would sit within a national park or wilderness. The question is: how can we define 'difficult terrain' objectively?
- **Cost** – with a threshold based on a particular cost.

- This would a DNSP to provide SAPS generation services where the SAPS is a small size and has a low cost (in absolute terms). The question is: what cost is 'low cost'?

- **Up to a specified cap** – a DNSP would be allowed to earn revenue from SAPS up to a given percentage of a DNSP's revenue cap.
    - This exemption would allow a DNSP to provide SAPS generation services up to a specific cap such as 1 per cent of annual revenue. For example, a DNSP would be unrestricted in its choices to deploy and earn revenue from a SAPS up to a given cap. The cap would mean that only a portion of the DNSP's network would be able to be displaced by the SAPS. This mirrors the Transmission Guideline, which currently allows a transmission network service provider (**TNSP**) to undertake retailing and/or generation activities up to a specified limit.
- **Type of SAPS** – certain type of SAPS systems, such as streetlights or for agricultural purposes.
    - This exemption would allow a DNSP to provide a SAPS generation service under specific identified applications of SAPS systems, such as streetlights. It could be limited so that it only applied below a threshold (kW) size in generation capability.
- **Absence of alternatives** – where no offers have been received for a third party SAPS generation service below a threshold size (kW) of a particular SAPS.
    - This exemption would allow a DNSP to provide SAPS generation services in a situation where there is no other market alternative. However this exemption could be limited so that it only applied below a threshold (kW) size in generation capability.
- **Emergency response** – in response to a natural disaster or fault that caused disruption of service, a DNSP could provide temporary support or simple fault repair.
    - This exemption would allow a DNSP to provide SAPS generation services from a temporary or existing SAPS under special circumstance of natural disaster. This is already provided for in the Distribution Guideline as 'an event that is beyond the DNSP's reasonable control'.
- **SAPS provider of last resort** – when a SAPS provider leaves the market, a DNSP could take over ongoing responsibility.
    - To prevent existing customers of a SAPS being left without support, a DNSP could, under this exemption, provide support to customers for a given period of time (for example, 12 months).
- **Efficiency** – when the DNSP's price for installing a SAPS system is materially lower than anything available in the market.

- This exemption could apply in situations where the price of a third-party SAPS is excessively and prohibitively higher than what a DNSP could provide a similar SAPS generation service for. The question is: how much higher is 'excessively and prohibitively higher'?

Question 2: Are there other types of exemptions we should consider?

Question 3: In regard to the exemptions above, or any others, what is an appropriate threshold?

Exemptions would, make the offering of SAPS generation services by DNSPs less transparent. Where an exemption applies, a DNSP could deploy a SAPS system without reference to the AER or any other party.

Question 4: Should exemptions for SAPS be defined in specific detail or are generic exemptions, which would apply more broadly, preferable?

Question 5: How can we be sure that DNSPs using exemptions are complying with the Distribution Guideline?

For a Distribution Guideline waiver to be granted the benefits of granting the waiver must outweigh the costs. This is the minimum criteria that must be satisfied before a waiver is granted.

Question 6: In the above criteria do the exemption thresholds satisfy the Distribution Guideline criteria of benefits outweighing costs?

Other observations

For safety reasons, a DNSP may replace part of its network with a SAPS because, for example, the area has a high bushfire risk. It should be noted that just because a DNSP has a sound reason for seeking to replace a network with a SAPS does not imply that a waiver or exemption should be permissible That is, a high bushfire risk, that suggests that a DNSP-led SAPS may be required, does not necessarily imply that SAPS generation cannot be provided by a third party.

2.2 Storage Devices

The purpose of this section of the paper is to examine the regulatory treatment of energy storage devices operated by distribution and transmission network service providers (NSPs). When used by NSPs, energy storage devices (including batteries) can create complex ring-fencing issues as they can be used to offer electricity services in contestable markets as well as in support of services that are provided by NSPs. Storage devices operate across the sometimes blurry boundary between regulated and unregulated markets.

A 'community battery' is a good example of how a network storage device might be deployed to offer contestable services. The high cost of individual storage systems creates a market for community scale storage devices as an alternative. Community batteries can reduce network congestion and capacity issues without the need for traditional network solutions. They provide economies of scale and therefore lower costs to customers looking to store their solar. Community batteries also provide a storage option for customers that live in apartments or don't own their home.

Ring-fencing addresses a specific situation where a DNSP may purchase a storage device for a regulated network purpose, such as managing network congestion, but also have some excess capacity that could be used to offer services in contestable markets. With respect to ring-fencing, the question is not only 'how' NSPs might be able to use storage devices to provide services in contestable markets but also whether there are circumstances in which benefits of granting a waiver might outweigh the costs? Unlike SAPS, there is currently no proposed regulatory framework specifically for storage devices. Storage devices are still relatively new to the electricity supply chain. Fewer than 100 000 devices have been installed to date in Australia[18]. We can expect this number to rise significantly, including those installed by network businesses in the future.

The Distribution and Transmission Guidelines adopt different approaches to NSPs using storage devices to provide electricity services in contestable markets. At present, there is nothing to stop TNSPs using batteries to offer such services (up to a cap). DNSPs, on the other hand, must obtain a waiver to provide services other than distribution services.[19] These differences reflect the respective ages of the guidelines rather than intentionally different approaches.

2.2.1 What is 'value stacking'?

Studies on the economics of energy storage devices have highlighted how using storage to provide multiple services across the electricity supply chain can significantly improve the competitiveness of storage.[20] This concept is sometimes referred to as 'value stacking'. Potentially, the same storage device can be used for multiple purposes. For example:

- in support of network services (such as to manage peaks in demand at zone substations)
- to offer wholesale energy services to the NEM

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18 Renew economy, *Australians installed 22,661 home battery systems in 2019*, 16 April 2020.

19 AER, *Ring-fencing Guideline Electricity Distribution - Version 2*, October 2017, cl 3.

20 Rocky Mountain Institute's study, *The Economics of Battery Energy Storage*, 2015, identified that batteries deployed for a single primary purpose rarely provide net economic benefit, particularly where that primary purpose is network services (pp 7-9); see also National Renewable Energy Laboratory, *Grid-scale battery storage*, 2019, pp 4-5.

- to offer Frequency Control Ancillary Services (**FCAS**)
- to store electricity on behalf of end users, or for supply to end users (sometimes referred to as 'community batteries').

NSPs can own storage devices outright. NSPs can also lease storage devices from third parties, or otherwise obtain the right to use third party devices. Similarly, NSPs can lease their own storage devices to third parties, or grant third parties rights of use over those devices.

There are some current examples of arrangements between NSPs and third parties for the use of storage devices:

- ElectraNet leases capacity from the Energy Storage for Commercial Renewable Integration battery at the Dalrymple substation to AGL Energy. AGL Energy uses the battery to sell electricity into the wholesale market and to sell FCAS services into the FCAS market. ElectraNet uses the battery to provide regulated prescribed transmission services.
- AusNet Services (transmission) leases the Ballarat terminal substation battery to EnergyAustralia, who uses the battery to provide generation and load services in the wholesale market. At this stage, AusNet Services does not use the battery to provide any prescribed transmission services.

The AEMC's Final Report on the Electricity Network Economic Regulatory Framework 2020 Review highlighted DNSP submissions that noted ring-fencing is currently 'preventing them from offering customers any sort of battery access service'.[21] Stakeholders submitted that the 'current ring-fencing arrangements must be re-examined to assess whether they are flexible enough to allow businesses to innovate and trial new services in collaboration with their customers'.[22] Ring-fencing restrictions can be overcome through waivers.[23]

Our ring-fencing framework needs to be able to accommodate storage devices, including value stacking, if this results in consumer benefits. Storage devices including batteries can provide significant efficiencies as an alternative to traditional network investment and these are likely to increase over time. However, the potential for harm (discrimination and cross-subsidisation) that ring-fencing is designed to prevent may arise when an NSP invests in storage devices – see **section 2.2.3** below.

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21 Ausgrid, *Ausgrid Submission - AEMC Electricity Networks Economic Framework Review*, July 2020, p 5.

22 Australian Energy Market Commission, *Final Report - Electricity Network Economic Regulatory Framework 2020 Review*, 1 October 2020, p 10.

23 Some battery applications, like 'community batteries', also run into tariff related issues where customers seeks to export to a DNSP battery and subsequently retrieve that electricity at a later date. Therefore, ring-fencing alone is not the only constraint to some storage device applications.

2.2.2 Should NSPs use storage devices to provide contestable services?

Under the current ring-fencing arrangements, a DNSP is only able use storage devices to provide distribution services.[24] However, this restriction could be relaxed to allow a DNSP to offer other services in contestable markets if it obtains a ring-fencing waiver. For example, if a DNSP wants to use a community battery to provide both network services for its own purposes and to offer energy storage services to customers, a ring-fencing waiver would be required.

The risk a DNSP will cross subsidise its activities in contestable markets is addressed in three ways: legal separation; the requirement to maintain separate accounts; and the application of the cost allocation principles to other services a DNSP's affiliated entity provides.

If we grant a waiver that allows a DNSP to offer services other than distribution services, we lose some transparency provided through legal separation of a DNSP from an affiliated entity and our ability to verify whether a cross subsidy exists is compromised. This is because our compulsory information-gathering powers do not extend to these other services a DNSP might offer. We need to weigh these risk of harm against the potential benefits that consumers may obtain from storage devices. We might also be able to seek other ways to mitigate the risk of cross-subsidies or rely on the existing cost allocation methods and accounts separation.

2.2.3 What are the perceived benefits, harms and risks when NSPs provide other services using storage devices?

There are benefits from allowing NSPs to use storage devices to offer both network services (for their own purpose) as well as offering other contestable services to consumers. We consider the benefits and costs in the sections below.

What are the benefits?

NSPs are well positioned to use storage devices

NSPs may be best positioned to facilitate the use of network-located batteries due to their knowledge and understanding of network needs compared to third-party non-network option providers. Where NSPs contract with third-party owned storage devices to access network services, this creates transaction costs (in the form of information provision and contracting arrangements) that can increase the overall cost of a single project compared to a scenario where all services are provided on a vertically integrated basis by a single party.[25] Of course, these transactions costs will not be

[24] Although uncommon in practice, a DNSP is also able to provide transmission services.

[25] For example, ITP Renewables' draft report, *Business Models and Regulatory Considerations for Storage on the*

entirely avoided by providing a service 'in-house'. Further, an alternative view is that third parties may be better placed to optimise the ‘value stack’ amongst alternative users of a storage device.

Location – NSPs can optimise siting of storage devices to maximise value.

NSPs may be able to maximise locational value to the network from storage devices due to their detailed understanding of current and future network needs and access to network infrastructure. For example, sometimes an optimal location to site a storage device might be embedded within network infrastructure, such as inside a substation or on a power pole.

Access – NSPs as platform providers.

Arguably NSPs are in a better position to provide access to efficiently located storage assets for third-party contestable service providers on a neutral basis, and in doing so support competition.

What are the harms and risks?

The following section considers the harms and risks when NSPs provide electricity services in contestable markets using storage devices. It is important to consider that this market is in the early stages of development, so that any decision on access may have a material and lasting impact on how the market develops.

Cost allocation – risk of cross-subsidies

There is no obvious or straightforward method for allocating the cost of a storage device across different uses, in particular regulated and unregulated uses. Storage can provide network and non-network market services simultaneously, or switch the services it provides within milliseconds. Moreover, the split of network and market services provided by a storage device could change substantially over time. This also creates a risk that customers of the regulated network may cross-subsidise provision of unregulated storage services by an NSP. For example, an NSP might initially purchases a battery with an intended use of 80 per cent network use and 20 per cent other uses. Over time these shares might change resulting in a cross subsidy, because the share of the initial cost recovered from network customers does not change.

Risk allocation – NSPs may push commercial risk onto customers of the regulated network.

NSPs face less commercial risk than unregulated businesses. Where NSPs compete with other parties in competitive markets for energy services, shifting commercial risk to customers of the regulated network creates an uneven playing field and may harm

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Distribution Network, August 2020, prepared for the Energy Security Board, notes contractual complexity as potentially inhibiting value stacking in virtual power plants. However, the report also notes the value of streamlined contracting between non-network option providers and DNSPs in potentially overcoming this issue.

developing markets for energy storage. Customers of the regulated network may therefore also face increased network costs as a result of this risk-shifting behaviour.

Access to commercially sensitive information about the network and competitors.

NSPs hold information about the network that would be of commercial value to an entity offering services into electricity markets, or seeking to sell network services to the NSP. Where NSPs are permitted to provide other electricity services (such as storage leasing services) there is potential for the network business to use this information access to its advantage. While ring-fencing limits flow of confidential electricity information between the NSP and other parties (including affiliates), misuse of information where an NSP was permitted to directly provide other electricity services would be difficult to detect. For example, a NSP is uniquely placed to locate a storage device where the demand for non-network services are most greatly valued on its own network. This gives the NSP or its affiliate a commercial advantage compared to any third party providers.

Discrimination – NSPs control network investment, access and pricing.

NSPs approve and set the conditions for new connections to the network and the ongoing technical operation of generation/load through connection agreements, and can disadvantage competitors by increasing the risk and cost of the connection process. For example, TNSPs provide physical access to the wholesale market for generators and can constrain generator access through their management of physical network constraints and planned network upgrades. NSPs can optimally site storage devices in regard to location, ease of connection, and supporting network investment, and restrict access to such optimal sites by third parties. NSPs are also responsible for designing and setting consumer network tariffs. As such, they could use these processes to deter competition in the deployment of energy storage devices behind the meter and at the grid-scale.

Market development – NSPs using storage to provide electricity services in contestable markets could deter investment by third parties.

Third parties may avoid investment in storage to sell network services to NSPs, because they perceive that they will not be competitive with network-owned storage or be in a position to sign favourable network support contracts with NSPs. This could limit the degree to which third parties are willing to invest in storage overall, because they may perceive that they cannot provide an important part of the value stack (network services) to NSPs on an equal basis.

Question 7: What other benefits, harms or risks should we consider?

Mitigating factors

Some of the potential harms listed above are potentially reduced or mitigated by other aspects of the Distribution Guideline. For example, to ensure that its non-discrimination obligations are met, a DNSP may need to put firewalls and IT access controls in place to prevent information sharing between the different business areas of the DNSP, or between the DNSP and their affiliate. Staff sharing arrangements may also assist (see **section 3.1.1** below). Adequate assurance and transparency that DNSPs are fully complying with these obligations is an important component of any such mitigation.

Question 8: If NSPs use storage devices to offer services in contestable markets, how can any potential harms be managed?

2.2.4 Weighing the benefits and harms

We encourage NSPs to explore innovations in the use of storage devices. We support trials where the key objective is to develop and share increased knowledge about the use of storage devices and their application.

We are aware that numerous DNSPs are running battery trials to explore the potential of storage devices for network and other purposes. Some have sought waivers (for example United Energy) while others are conducting virtual trials that do not require ring-fencing waivers (for example Ausgrid).

So far we have not received waiver applications to use storage devices to provide electricity services in a contestable market on an ongoing basis, however we anticipate this will not always be the case. We therefore need to consider our approach to weighing the benefits and harms and if or how any potential harms might be minimised.

Question 9: How should we weigh these benefits and harms to determine if a waiver should be granted? What are the priorities?

Other issues

TNSP use of storage devices

TNSPs are not restricted from using storage devices under the Transmission Guideline in the same way as DNSPs. The Transmission Guideline only restricts a TNSP from offering generation and retail electricity services. Consequently, a TNSP can provide storage services. Further, the Transmission Guideline allows a TNSP to provide retailer or generator services up to a cap that is set at five per cent of annual revenue.

Although this paper is focussed on the Distribution Guideline, we will return to these transmission related issues in 2021 when we re-commence the review of the Transmission Guideline. We will take the issues considered here into account.

Indirect versus direct involvement of DNSPs in the provision of services using storage devices

Take the example where a storage device being used by a DNSP has some excess capacity that could be used to offer FCAS (which is an unregulated service offered in competitive markets). There are two ways in which a DNSP might use the excess capacity of a storage device. The first way would involve allowing a third party or an affiliate to use the excess capacity of the storage device. For example, a DNSP might lease or otherwise agree that another party is permitted to use the storage device to provide a contestable service, such as FCAS. The DNSP is, therefore, not directly providing the FCAS. Rather, the DNSP is involved, indirectly, in the use of the storage device to offer a contestable service. The second way would involve the DNSP directly using the excess capacity of the storage device to offer FCAS. In this situation, no third party or affiliate would be involved.

How do these direct and indirect uses of storage devices by DNSPs compare? In both examples, the storage device is used to provide FCAS. Both examples require a departure from the general prohibition in the Distribution Guideline on a DNSP offering any non-distribution service. Leasing or otherwise allowing third parties to use storage devices does not satisfy the definition of a distribution service. Similarly, FCAS services are not distribution services.

In both examples, cost allocation issues are problematic. As noted earlier, we do not have compulsory information gathering powers in regard to non-distribution services. This means our ability to monitor compliance with the cost allocation methods and rules are limited. A means to overcome this might be through an agreement by a DNSP to voluntarily provide cost allocation information. However, these voluntary arrangements may be insufficient at times when compliance is being questioned.

Indirect use of a storage device raises fewer concerns compared with direct uses when considering the potential harms. The direct provision of FCAS by a DNSP raises possible concerns about discrimination. For example, a DNSP might be tempted to invest in network capacity to maximise its particular use of the storage device. Access to ring-fenced information access would also be very difficult control if a DNSP is able to directly offer contestable services using its own storage device. On the other hand, in the 'indirect involvement' scenario, there is also the potential for DNSPs to set prices for the use of storage devices by third parties in a manner that gives rise to cross-subsidies of its distribution services and/or discrimination in favour of the DNSP’s affiliates.

Question 10: Should we distinguish between direct and indirect uses of storage devices?

Effect of clause 3.1(d)i

Clause 3.1(d)i of the Guideline states that the prohibition on a DNSP providing services other than distribution services does not prevent the DNSP granting another legal entity the right to use assets of the DNSP in providing transmission services, distribution services or other services, where those assets are also used by the DNSP to provide distribution services or other services, but only where doing so does not materially prejudice the provision of direct control services by the DNSP.

The intent of this clause was to facilitate the 'shared asset' rules that were introduced in 2012. These rules allow DNSPs to earn unregulated revenue from its assets, as long as this usage does not 'materially prejudice' use of the asset for provision of regulated services. As part of the shared assets rules, a revenue sharing arrangement provides a benefit to distribution customers. The effect of the shared asset rules is to encourage DNSP to take advantage of underutilised assets and for consumer benefit.

Importantly, the shared asset rules apply to assets that already form part of the regulated asset base and are being paid for by consumers of distribution services. Energy storage devices that are intended to be used for both regulated and unregulated purposes are subject to the rules relating to cost allocation. The shared asset rules only apply to assets that were acquired for regulated purposes but that are subsequently found to have excess capacity. This excess capacity can then be used to earn unregulated revenue from other uses. In the absence of clause 3.1(d)i, such sharing would be prohibited under the Distribution Guideline.

One interpretation of clause 3.1(d)i is that it is not confined to shared assets, but has a broader operation that enables a DNSP to allow other parties to use a DNSP's storage devices, even where those assets are not 'shared assets' for the purposes of the shared asset rules.

We seek stakeholder views on whether clause 3.1(d)i should be amended to clarify that it only applies to the use of shared assets under the shared asset guideline, or whether it should be amended to make it clearer that it also applies to other circumstances in which third parties might use a DNSP’s assets to provide distribution services, transmission services or other services.

Question 11: Should we clarify the scope of clause 3.1(d)I of the Distribution Guideline?

3 Improving the Distribution Guideline

Based on our experience in implementing the Distribution Guideline and stakeholder feedback we have received, the Distribution Guideline largely works well. We are proposing incremental improvements to certain obligations. These improvements are intended to make the Distribution Guideline clearer and less administratively complex. Based on general feedback and written submissions last year, most stakeholders indicated their support for updating the Distribution Guideline.

This section seeks stakeholder feedback on strengthening certain obligations and reducing the administrative burden associated with others. Specifically, we have presented our preliminary view and seek stakeholder feedback on:

- strengthening the transparency of staff sharing arrangements between a DNSP and its affiliates
- removing confusion associated with the term 'confidential information' as defined in the Distribution Guideline
- simplifying and improving the overall timeliness of DNSP breach reporting
- improving the practicality of DNSP annual compliance reporting.

While we have identified sections of the Distribution Guideline that could be improved, we do not consider major changes to the operation of the Distribution Guideline are required at this time.

3.1 Staff sharing

The Distribution Guideline imposes staff sharing restrictions on a DNSP to ensure it does not confer a competitive advantage on its affiliate providing contestable electricity services. Information about a DNSP's network, customers or services could provide an affiliate with an unfair advantage in the market. The obligation therefore requires staff with:

- access to information about the DNSP's network and its customers ('electricity information'); and
- an opportunity to use that information in way that would provide a discriminatory advantage to the DNSP's affiliate,

not to be shared with the DNSP's affiliate providing contestable electricity services.[26]

The issue with the current requirement is that determining whether a staff member has an opportunity to use electricity information can be a complex, fact-specific and fact-intensive exercise. There is also insufficient transparency regarding a DNSP's decision

[26] AER, *Ring-fencing Guideline Electricity Distribution - Version 2*, October 2017, cl 4.2.2(a), 4.2.2(b).

to share staff with an affiliate. For example, the National Electrical Communications Association (**NECA**) submitted that affiliated businesses are taking advantage of current staff sharing arrangements.[27] NECA also identified the need for a greater level of transparency.

Through our ring-fencing compliance activities, we have seen issues arise with interpreting this provision. In particular, we have observed issues and breaches in relation to staff secondments and sharing of procurement staff.[28] We consider these arrangements are not adequately transparent in DNSPs' staff sharing registers on their website.

To address these concerns, we have considered a number of options. In 2019, we considered narrowing the definition of 'electricity information' to 'sensitive electricity information'. This was suggested by Ausgrid as a way of narrow the definition and thereby of defining, more prescriptively, the staff that can and cannot be shared.[29]

In subsequent discussions, some DNSPs indicated it would be difficult to prescriptively define this term. As an alternative, ENA, on behalf of DNSPs, has now suggested using the staff sharing registers to provide greater transparency of staff sharing arrangements (including identifying those staff who are not to be shared).

Our preliminary view

We consider that retaining the current approach in the Distribution Guideline, but requiring detailed reporting of staff sharing arrangements between the DNSPs and their affiliates, is the best overall approach. This would include comprehensive and timely updates to the current staff sharing registers that a DNSP is required to establish and maintain.[30] We consider this approach may be more effective than tightening the definition of 'electricity information', as some fact-specific complexity will always remain.

Question 12: Can improved staff sharing registers provide the transparency of staff sharing that is needed?

3.2 Information Access and Disclosure

We consider that the circumstances in which a DNSP can share electricity information are often misunderstood. Currently, a DNSP must keep 'confidential information'

27 National Electrical and Communications Association, *Electricity Distribution Ring-fencing Guideline review submission*, 14 October 2019, p 3.
28 See AER, *Electricity Distribution Ring-fencing Annual Report 2018-19*, 14 April 2020, p 5.
29 Ausgrid, *Electricity Distribution Ring-fencing Guideline review submission*, 23 September 2019, p 5.
30 AER, *Ring-fencing Guideline Electricity Distribution - Version 2*, October 2017, cl 4.2.4(b).

confidential, except in limited circumstances.[31] 'Confidential information' under the Distribution Guideline means 'electricity information' acquired or generated by a DNSP.[32] A DNSP is able to share this information with an affiliate as long as it provides access to that confidential information to other legal entities on an equitable basis.[33]

A DNSP creates, and has access to, a great deal of information about its network, some of which has commercial value to businesses operating in contestable electricity markets (for example, load aggregation). The intent of the Distribution Guideline is to ensure where a DNSP shares this information, it does so on an equal basis with all legal entities, not just with its affiliate(s). The Distribution Guideline is not intended to create the presumption that information will not be shared.

We consider that the true intention of the Distribution Guideline in regard to information access and disclosure is not well understood. We have previously received enquiries from accredited service providers (**ASPs**) concerned about DNSPs withholding information on the basis that it is defined as 'confidential information' under the Distribution Guideline. We also consider that this confusion is maintained, in part, by the general under-use of the information register process to share information.[34]

DNSPs have indicated that there has also been confusion between the term 'confidential information' and the concept of personal information (such as information about individual employees). The information to which the Distribution Guideline applies does not include personal information, and legislative protections that are applicable to personal information are unlikely to apply to the vast majority of 'confidential information' as currently defined in the Distribution Guideline.

Our preliminary view

We consider that replacing the term 'confidential information' with another term, such as 'ring-fenced information', could reduce confusion among DNSPs and other stakeholders. The definition of the term would remain unchanged. This would remove the association of the term with its use in other contexts. The operation of this section of the Distribution Guideline would remain substantively the same.

Question 13: Will changing the term 'confidential information' to 'ring-fenced information', make ring-fencing obligations in relation to information sharing clearer?

31 AER, *Ring-fencing Guideline Electricity Distribution - Version 2*, October 2017, cl 4.3.2, 4.3.3.
32 AER, *Ring-fencing Guideline Electricity Distribution - Version 2*, October 2017, cl 4.3.1.
33 AER, *Ring-fencing Guideline Electricity Distribution - Version 2*, October 2017, cl 4.3.4.
34 AER, *Ring-fencing Guideline Electricity Distribution - Version 2*, October 2017, cl 4.3.4, 4.3.5.

3.3 Materiality of Breaches

There have been different views among DNSPs, other stakeholders and the AER on the meaning of 'materiality' under the Distribution Guideline. This has led to an inconsistent approach to the timeliness of breach reporting. Some DNSPs have considered serious IT access control breaches under the Distribution Guideline as non-material where we would consider them to be material breaches. In some instances, we have not been made aware of material breaches until it is reported in a DSNP's annual report. This can result in harms to the market or to the end consumer, and it may be too late for the harm caused to be prevented or minimised.

Currently, a DNSP must notify the AER within five business days of becoming aware of a material breach of its obligations under the Distribution Guideline.[35] We have explained to DNSPs that our interpretation of 'material' in the context of a breach is that it means 'something that is more than trivial.' [36]

In our consultations with them, DNSPs have noted the term 'materiality' lacks clarity. For example, TasNetworks sought clarity on the term 'materiality' and believed that the AER's current approach is still open to interpretation.[37] DNSPs also raised concerns about reporting breaches within five business days. CitiPower, Powercor and United Energy stated that reporting breaches to the AER is not a simple process, and that it is therefore difficult to take the necessary steps to report a breach within five business days.[38]

Our preliminary view

To address this issue, we consider that one option would be to require that all breaches (material or not), be reported to the AER within ten business days. However, to avoid creating an unnecessary burden on DNSPs, we consider that breaches of certain administrative clauses do not need to be reported in 10 business days and can be reported in the DNSP's annual compliance report.[39] Administrative clauses would likely include the following:

- submitting annual compliance reports by a certain timeframe;[40]

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35 AER, *Ring-fencing Guideline Electricity Distribution - Version 2*, October 2017, cl 6.3.

36 AER, *Electricity Distribution Ring-fencing Guideline - Compliance reporting best practice manual - Version 2*, July 2019, p 7.

37 TasNetworks, *Electricity Distribution Ring-fencing Guideline review submission*, 23 September 2019, p 2.

38 CitiPower, Powercor and United Energy, *Electricity Distribution Ring-fencing Guideline review submission*, 23 September 2019, p 2.

39 Note the meaning of 'material' would remain the same, however, it will have a much smaller impact on the reporting of serious breaches.

40 AER, *Ring-fencing Guideline Electricity Distribution - Version 2*, October 2017, cl 6.2.2.

- the failure to report a material breach of the Distribution Guideline within the required timeframe.[41]

Question 14: Will reporting all breaches in relation to substantive Distribution Guideline clauses in 10 business days improve the overall timeliness of breach reporting and reduce the administrative burden on DNSPs?

3.4 Timing of Annual Compliance Reports

The timing of annual compliance report submissions for non-Victorian DNSPs currently conflicts with other end of financial year reporting requirements imposed on DNSPs. Currently, DNSPs must submit their annual compliance reports to the AER within four months of the end of the regulatory year to which the compliance report relates.[42] This date is usually 31 October.

In response to our consultation in August 2019, most non-Victorian DNSPs stated they were supportive of changing to calendar year compliance reporting provided there is a transitional period for the next reporting period. For example. DNSPs would submit one compliance report covering an 18 month period, rather than two reports during the period.[43] ENA, in conjunction with other DNSPs, noted annual compliance reports are currently due at a time where numerous other reporting requirements are imposed on DNSPs.[44]

Our preliminary view

The Distribution Guideline should be amended to require all DNSPs to submit annual compliance reports within four months of the end of the calendar year to which the compliance report relates. This would mean that all DNSPs – not just the Victorian DNSPs – would submit compliance reports on 30 April each year. We consider that this approach would reduce the unnecessary administrative burden created by numerous reporting requirements being imposed at the same time.

Question 15: Will calendar year compliance reporting minimise the administrative burden on DNSPs?

41 AER, *Ring-fencing Guideline Electricity Distribution - Version 2*, October 2017, cl 6.3.
42 AER, *Ring-fencing Guideline Electricity Distribution - Version 2*, October 2017, cl 6.2.2(a).
43 Essential Energy, *Electricity Distribution Ring-fencing Guideline review submission*, 23 September 2019, p 3.
44 Energy Networks Australia, *Electricity Distribution Ring-fencing Guideline review submission*, 23 September 2019, p 9.

3.5 Branding

A DNSP must use branding that is independent and separate from the branding used by an affiliate. The branding must be sufficiently different that a reasonable person would not infer from the respective branding that the DNSP and the affiliate are related.[45] The principal objective of this obligation is to avoid confusing customers in regard to services offered by a DNSP that are regulated by us and those offered by an affiliate that are not. Use of the DNSP brand would give an affiliate of the DNSP an advantage over competitors of the affiliate that is unfair and against consumers' interests.

Some stakeholders have suggested the branding and cross promotion obligations in the Distribution Guideline go too far. These stakeholders have questioned whether the provisions in the Distribution Guideline are too broad and therefore not proportionate to the harms they seek to prevent.[46] For example, staff are allowed to be shared between a DNSP and an affiliate as long as the staff to not have access ring-fenced information that is commercially sensitive. The Distribution Guideline requires these workers to wear uniforms that reflect the brand of the business (DNSP or affiliate) they represent, which can vary within a single day. Is this requirement excessive? Is there a better way to ensure customers are not confused about who is proving the services?

More serious branding issues, such as a DNSP or parent company cross promoting an affiliate on their website, could do far more harm. We are not proposing these branding restrictions should be curtailed. However, it is important the Distribution Guideline does not impose unnecessary costs on the DNSP and therefore on customers. The Guideline obligations must be proportional to the actual or potential harm to the competitive market.

Branding and cross promotion were not considered as part of our workshops in late 2019. As such we have not provided a preliminary view and invite stakeholder to provide us with specific suggestions on how the Guideline could be improved.

Question 16: Are the current Distribution Guideline obligations, in relation to branding and cross promotion, proportional to the potential harms? If so, how might the branding and cross-promotion obligations in the Distribution Guideline be amended to make them more targeted?

45 AER, *Ring-fencing Guideline Electricity Distribution - Version 2*, October 2017, cl 4.2.3(a).

46 This was discussed at a private roundtable between the AER and stakeholders in September and December 2019.

4 Next steps

We are very interested in the input of stakeholders on the issues above and feedback will inform our decision-making process when drafting possible amendments to the Distribution Guideline.

We anticipate further policy development in regard to the use of storage devices in the energy sector including by NSPs. The comments and submissions received for our issues paper will therefore not only feed into the review of the Distribution Guideline but into a wider conversation about storage devices currently occurring in the energy sector.

We will follow up this issues paper with further consultation.