

Our Ref: D17/11588

February 2017

Rainer Korte
Executive Manager Asset Management
ElectraNet
PO Box 7096
Hutt Street Post Office
Adelaide SA 5000Dear Mr Korte **Re: Regulatory Treatment of Battery Storage Project**

I write in response to your letter to Michelle Groves, dated 21 December 2016, seeking the AER's views on the regulatory treatment of ElectraNet's proposed installation of an Energy Storage Device (ESD) on its transmission network, through the Energy Storage for Commercial Renewable Integration South Australia (ESCRI-SA) Project. Michelle referred your letter to me for response. The views below reflect those of AER staff.

I note that the existing transmission ring-fencing approach will likely be superseded in the relatively near future by a new guideline closely modelled on our Electricity Distribution Ring-fencing Guideline developed during 2016. Our comments therefore are largely informed by the approach that we have developed for the distribution ring-fencing guideline.

As I understand it, you propose to separate the use of the ESD to provide regulated transmission services from the provision of other (unregulated) services. Such an approach would likely mean that ElectraNet's ESD proposal broadly complies with key elements of the relevant rules and guidelines.

Importantly, however, the way the costs of the ESD asset should be allocated between different uses will be critical in meeting the objectives of the ring-fencing regime to address any cross-subsidisation concerns. Indeed, this is a key issue for the treatment of any assets which have multiple purposes and are intended to be split in this way. This is discussed further below.

You indicated that expenditure on the ESD is consistent with least cost, technologically neutral provision of transmission services. If so, this would satisfy chapter 6A provisions relating to efficient capital expenditure. However, this will require a full assessment in the reset before any AER views can be formed.

Further, it appears the ESD would need to be subject to the regulatory investment test for transmission (RIT-T). Based on the information provided, we do not consider any of the exemptions listed in clause 5.16.3 of the NER, which would preclude the application of the RIT-T and consultation procedures, would apply. In particular, the capital cost of the ESD exceeds the RIT-T cost threshold of \$6 million¹ and is not being fully recovered through unregulated charges². The primary benefit of

¹ NER clause 5.16.3(a)(2).

² NER clause 5.16.3(a)(7).

the RIT-T is that it ensures the most efficient investment option is selected to address the identified need, including whether the ESD is the best solution. If ElectraNet has a different view on the application of the RIT-T, then I would be interested in ElectraNet's reasons for this position and it would be something we would take up separately with you.

As noted above, I am particularly interested in ElectraNet's intended cost allocation approach. From the information provided, it is not clear how ElectraNet intends to split the cost between prescribed (non-contestable) services and other services. For example, what particular allocator will be used to link the ESD costs to ElectraNet's categories of services and how are these allocators derived.

Given that the ESD is a new type of asset being piloted in transmission services, I note that there is uncertainty surrounding how the asset will actually be used and the implied value in the different uses to which it is put. The initial cost allocation may over time be shown to incorrectly allocate costs to ElectraNet's categories of services. How does ElectraNet propose to make an appropriate adjustment if there is a change to the way this asset is used? As an example of this, what would happen if increased spot price volatility increases the chances of the ESD being completely depleted by AGL and not able to be used to provide network services at times when the network is congested? This relationship between market outcomes and consumer benefits highlights the importance of transparency in cost allocation as well as on the operation of ring-fencing and the application of the RIT-T.

I also note that ElectraNet's Cost Allocation Methodology (CAM) was last approved in 2008. It is unclear how a new asset like this will be treated by ElectraNet under its existing CAM or whether amendments to the CAM will need to be made. In accounting for the ESD asset in its regulated asset base, you should clarify which asset classes ElectraNet proposes to attach the asset to. Also, to comply with appropriate ring-fencing arrangements, ElectraNet would need to establish, maintain and keep accounting records which demonstrate how it has allocated attributed ESD costs between its prescribed transmission services and its lease to AGL (unregulated service).

In circumstances where the Shared Asset Guideline would apply to the ESD asset, such as where the use of the asset has changed compared to its initial cost allocation, what steps will ElectraNet take to ensure that use of the asset for other (unregulated) services does not materially prejudice the use of the asset for prescribed purposes?³ For example, as outlined above, the use of the ESD by AGL means that at times it may be unable to provide backup supply to consumers.

I look forward to your response in regards to the matters noted above, particularly how ElectraNet proposes to approach the expected allocation of these assets in its forthcoming regulatory proposal.

If you have any queries regarding this matter please contact Moston Neck or Dale Johansen in the first instance. Moston can be contacted on (07) 3835 4669 or alternatively via email on [moston.neck@aer.gov.au](mailto:moston.neck@ aer.gov.au). Dale Johansen's direct number is 07 3835 4679 and email [dale.johansen@aer.gov.au](mailto:dale.johansen@ aer.gov.au).

Yours sincerely



Chris Pattas
General Manager, Networks

³ Consistent with the Shared Asset Principles, NER clause 6A.5.5(c)