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Australian Energy Regulator

Submitted via email to **AERringfencing@aer.gov.au**

21 December 2020

Dear Arek

Updating the Ring-fencing Guidelines for Stand-Alone power Systems and Energy Storage Devices, Issues Paper, November 2020

AGL Energy (**AGL**) welcomes the opportunity to respond to the Australian Energy Regulator's (**AER**) Issues Paper on Updating the Ring-fencing Guidelines for Stand-Alone Power Systems and Energy Storage Devices.

As an energy and telecommunications retailer with 4.2 million customer accounts across Australia, AGL is uniquely placed to provide the customer voice in distributed energy resources (**DER**) regulatory design. AGL supports an energy market system that empowers consumers to take control of their energy consumption and costs.

AGL is a market leader in the development of innovative products and services that enable consumers to make informed decisions on how and when to use their DER assets to optimise their energy load profile and better manage their energy costs. Our current DER product and services include our leading-edge Virtual Power Plant[1], Peak Energy Rewards demand response program,[2] retail offer for electric vehicle (**EV**) owners[3] and EV subscription service.[4] Through our EV Orchestration Trial[5], we are also seeking to understand how EVs could help the wider energy system by 'orchestrating' vehicle charging through smart chargers, Vehicle to Grid chargers and API technology.

Our feedback on the Issues Paper is based on our experience and knowledge of energy consumers' engagement with DER products and services. We also share our customer insights knowledge through our ongoing involvement in a range of industry forums focused on DER integration and the emerging market for new technologies such as stand-alone power systems (**SAPS**) and energy storage devices.

[1] For further information regarding AGL's Virtual Power Plant, currently available to customers in New South Wales, Queensland, South Australia and Victoria please refer to https://www.agl.com.au/solar-renewables/solar-energy/bring-your-own-battery?cide=sem-r&gclid=EAIaIQobChMIicjKmKuP5wIVyjUrCh2eXwvVEAAYASAAEgLZRPD_BwE&gclsrc=aw.ds.
[2] See further AGL Peak Energy Rewards, available at https://www.agl.com.au/newcampaigns/peakenergyrewards.
[3] See further, AGL EV Plan, available at https://www.agl.com.au/electric-vehicles.
[4] See further, AGL Electric Vehicle Subscription, available at https://www.agl.com.au/get-connected/electric-vehicles/ev-subscription.
[5] See further, AGL Electric Vehicle Orchestration Trial, available at https://arena.gov.au/projects/agl-electric-vehicle-orchestration-trial/.

Strategic direction

The Electricity Distribution Ring-fencing Guideline (**Ring-fencing Guideline**) provides a fundamental safeguard to ensure a level playing field so that new participants and business models can fairly compete in delivering cost effective energy solutions. Against the backdrop of technology advancements that can provide multiple services both in contestable markets and to support the ongoing security and operation of local distribution networks, we believe a market-based approach is best placed to support efficient outcomes, including energy storage solutions, for the benefit of all consumers.

Accordingly, we believe the policy focus should be on strengthening and improving the effectiveness of the ring-fencing framework and implementing complementary reforms to support the development of a more mature market for distribution network services. Complementary reforms should require distribution networks to openly and transparently procure network services and provide relevant data and information to other market participants about applicable system and voltage constraints.

Nevertheless, in the context of the deployment of SAPS generation services, we recognise that in some circumstances a regulated approach may prove more efficient than competitively procuring services. We consider that the regulatory framework should provide some flexibility to support timely deployment in these circumstances with appropriate safeguards to protect the emerging DER markets.

Key recommendations

AGL recommends the following:

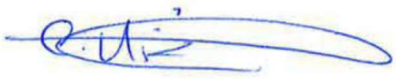
1. The provision of contestable network services delivers the best outcomes for consumers when natural monopoly network businesses use completely separated entities to participate in contestable markets on a fair and non-discriminatory basis. AGL recommends that distribution networks not be permitted to procure and operate storage devices through their regulated asset base. Rather they should procure them through an open tender process, where an appropriately ring-fenced affiliate competes with other market participants to secure the provision on storage devices.
2. The Ring-fencing Guideline should be complemented by further regulatory reform to support the development of a more mature market for distribution network services, including:
    - Extending contestability to front-of-the-meter (**FTM**) distribution connected energy storage assets, by prohibiting direct ownership by network businesses, in order to enable efficient deployment as well as co-optimisation of value streams for the benefit of all consumers through orchestration; and
    - Reflecting the UK reform program in delivering flexible network services through open market procurement, better and more transparent price signals for flexible action, and enhanced visibility on opportunities to provide non-network solutions.
3. Develop an exemption in the Ring-fencing Guideline to accommodate situations where a distribution network providing generation services to a SAPS is proven to be more efficient framed with thresholds to provide additional safeguards in terms of absence of alternative and only permitted to a particular cap of a distribution networks revenue cap.

4. Provide a formal mechanism for future review of active exemptions for SAPS to understand whether the economic and technological outlook has fundamentally changed, necessitating transition towards a competitive procurement approach.

We elaborate our feedback in the **Attachment**.

Should you have any questions in relation to this submission, please contact Kurt Winter, Regulatory Strategy Manager, on 03 8633 7204 or KWinter@agl.com.au.

Yours sincerely



Con Hristodoulidis

Senior Manager, Regulatory Strategy

ATTACHMENT

1. Stand-Alone Power Systems

AGL agrees that in some circumstances an exemption would be preferable to requiring distribution networks to apply for a ring-fencing waiver in order to accommodate situations where a distribution network providing generation services to a SAPS is proven to be more efficient than procuring those services from the competitive market.

We recommend the AER takes a strict approach to defining SAPS generation exemptions rather than providing a generic exemption. In our view, a strict approach more closely aligns with the policy intent of the Ring-fencing Guideline to mitigate the risk of consumers paying more than they should for regulated services and to guard against distribution networks discriminating in contestable markets in favour of their affiliated entities.

We also note the potential shortcomings of a generic exemption identified in the Issues Paper, including the need for increased monitoring of networks to ensure appropriate use of the exemptions and the inability to obtain information about the exemptions until after the fact. These shortcomings would be avoided by establishing a strictly defined exemptions threshold.

AGL supports the proposed efficiency threshold as an overarching criterion for SAPS generation exemptions. We recommend this be complemented with the following criteria, to provide additional safeguards:

- ***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; and
- ***Up to a specified cap*** - a distribution network would be allowed to earn revenue from SAPS up to a given percentage of a distribution network's revenue cap.

An overarching efficiency threshold would mirror the network investment assessment approach that is intended to be applied by networks in transitioning towards SAPS, as defined in the AEMC's recommended regulatory framework.[6] In determining whether the efficiency threshold has been met, the supporting cost methodology should be designed to ensure that all inputs are truly cost-reflective and have not been adjusted on account of cross-subsidisation. This approach would mitigate networks discriminating against contestable market offers.

We also consider that certain bespoke exemptions may be appropriate as follows:

- ***Emergency response*** - in response to a natural disaster or fault that caused disruption of service, a distribution network could provide temporary support or simple fault repair. However, we do not consider that distribution networks should be able to rely upon this exemption to facilitate longer-term solutions to these affected sites. Rather, the same efficiency threshold should be applied to adequately test the opportunity for cost effective competitively sourced solutions.
- ***SAPS provider of last resort*** - when a SAPS provider goes into insolvency, a distribution network could take over ongoing responsibility for a defined period of up to 12 months.

[6] See further AEMC Review of the regulatory frameworks for stand-alone power systems, available at https://www.aemc.gov.au/market-reviews-advice/review-regulatory-frameworks-stand-alone-power-systems.

We do not consider it appropriate to set an exemption threshold based on remoteness, population density, type of SAPS, access or cost. In our view, these thresholds contain a high degree of arbitrariness. There is a risk that distribution networks could utilise these thresholds to deliver solutions that are not necessarily in the consumers' best interests. We also consider that particular use cases intended to be accommodated by these exemption thresholds would be better served by alternative criteria, including an overarching efficiency threshold, that would at least facilitate opportunities to test competitive-based solutions.

2. Storage Devices

AGL welcomes the AER's consideration of the regulatory treatment of energy storage devices by distribution networks. As we highlighted in our submission to the AEMC's 2020 Electricity Network Economic Regulatory Framework Review,[7] there is an urgent need to consider the ownership and control framework for FTM distribution connected energy storage assets to deliver optimal economic outcomes for consumers.

AGL does not support changes to the Ring-fencing Guideline to enable distribution networks to use FTM storage devices to provide services, as these solutions are part of the emerging DER markets. Whilst the Issues Paper highlights distribution networks' concern that ring-fencing is currently preventing them from offering customers any sort of battery access service, we consider that insufficient attention has been given to the desirability of distribution networks providing services that can be provided by other market participants. In our view, allowing network businesses to offer these solutions through their regulated asset base presents unacceptable risks of networks undertaking inefficient cross-subsidised investments in infrastructure and negatively impact on the growth of emerging solar battery products and BTM services, the cost of which would be borne by the broader consumer base.

We believe a preferable approach would entail regulatory reform to support the development of a more mature market for distribution network services, in which distribution networks openly and transparently procure network services and provide relevant data and information about the system and voltage constraints. This will promote competitive tension in the provision of both BTM and FTM services.

We would recommend the AER and other policymakers consider the recent experience of the UK Government and Ofgem in enabling greater flexibility to deliver a secure, affordable and clean energy system.[8] Competitive-based solutions are at the heart of the UK's approach and since 2017, substantial progress has been made to deliver flexibility network services through open market procurement, better and more transparent price signals for flexibility action, and provision of transparent network data has enhanced visibility on opportunities to provide non-network solutions.

As the AER elaborates in its Issues Paper, the key complexity associated with the regulation of energy storage is how best to facilitate 'value stacking' from these assets to provide multiple services across the electricity supply chain, including optimising self-consumption, wholesale energy and ancillary services, and network support services.

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[7] See AGL submission in response to AEMC Electricity network economic regulatory framework review, Approach Paper, June 2020 (6 July 2020), Available at https://thehub.agl.com.au/-/media/thehub/documents-and-submissions/2020/agl-submission_-2020-electricity-network-economic-regulatory-framework-review_final.pdf?la=en&hash=C141E66BF14BE5D9350C8D8F362F1BE8.

[8] See further UK Government and Ofgem, Smart Systems and Flexibility Plan (2017), Available at https://www.gov.uk/government/publications/upgrading-our-energy-system-smart-systems-and-flexibility-plan; ENA, Six Steps for Delivering Flexibility Services (2019), Available at https://www.energynetworks.org/industry-hub/resource-library/open-networks-flexibility-commitment-2019.pdf.

Recent research undertaken by Oakley Greenwood for TEC found that under current regulations, third parties like retailers/aggregators are best placed to appropriately share with consumers the multiple value streams that adhere to FTM distribution connected batteries because of their ability to interact across the energy supply chain, including the wholesale market.[9] The Oakley Greenwood study did not specifically consider a network ownership model due to the significant competitive advantage (i.e. market discrimination of emerging DER markets) such investments would provide local distribution networks. The report relevantly states:

> [I]t is difficult to see why this would facilitate outcomes that are in the long-term interests of consumers, particularly when (a) the majority of the services provided by a battery (and which are discussed in this report) are offered for sale into a competitive market (e.g., the wholesale market, FCAS market and/or retail market); (b) the ownership, operation and maintenance of a grid-connected battery does not exhibit any natural monopoly features; and (c) such treatment in effect means that a distribution business is conferred a monopoly right to provide battery services, as a result of the monopoly power that they have as a provider of a completely different service – i.e., network services.
>
> To do so would in effect mean that we are limiting competition in upstream and downstream markets, simply due to the natural monopoly characteristics of the distribution system.[10]

In our view, the question of whether networks should be permitted to use storage devices to provide services in contestable markets adheres to a more fundamental policy question concerning the role of distribution networks into the future. It is our view networks' role is to support the grid integration and market participation of new technologies such as energy storage but not own or operate these contestable services through their regulated asset base.

As the market for distribution services continues to develop alongside technology innovations including FTM distribution connected energy storage assets, we believe ring-fencing provides a fundamental safeguard to ensure a level playing field so that new participants and business models can fairly compete in delivering cost effective solutions. Indeed, as the AER has observed, "ring-fencing promotes good consumer outcomes by creating better conditions for contestable markets to emerge and develop, to deliver new services to customers". Moreover, as Rod Sims, Chairman of the Australian Competition and Consumer Commission, has observed, light-handed regulation of monopoly infrastructure "is not only ill-conceived in economic theory, it has failed in practice."[11]

We have carefully considered the benefits and risks identified in the Issues Paper and believe the harms and risk substantially outweigh the suggested benefits. We note the following in particular:

- The identified benefits of network knowledge and ability to optimise the siting of storage to maximise value results from the current information asymmetry between distribution networks and the competitive market and does not validate that a network solution would be more efficient per se. With appropriate reforms to ensure visibility on opportunities to provide non-network solutions the market would be better

[9] See Oakley Greenwood, Financial Viability of Community Scale Battery Ownership Models (2020), Available at https://energyconsumersaustralia.worldsecuresystems.com/Report%20community%20battery%20ownership%20models%20Feb2020.pdf.

[10] See Oakley Greenwood, above note 9, at page 6.

[11] See further Rod Sims, 'How did the light-handed regulation of monopolies become no regulation?' (Speech at Gilbert and Tobin Regulated Infrastructure Policy Workshop, Melbourne, 29 October 2015), Available at https://www.accc.gov.au/speech/how-did-the-light-handed-regulation-of-monopolies-become-no-regulation.

positioned to deliver cost-effective solutions that optimise multiple value streams. This is evidenced by the regulatory approach adopted by the UK Government and Ofgem which has resulted in substantial progress, including the following:

  - Four UK distribution business established a joint 'flexible power portal'[12] to broadcast opportunities for flexibility of network services and streamline the procurement process in October 2020. Western Power's contracted flexibility has scaled from 35.3 MW in 2018 to 217 MW in 2020 as a result of this approach.[13]
  - UK PowerNetworks publicises its requirements for new network capacity to the market ahead of building network reinforcement and is testing the viability of flexibility network services. By 2023, UK Power Networks estimates its market for flexibility could be over 200 MW.[14]
  - SP Energy Networks' FUSION project is also trialling commoditised local demand-side flexibility through a structured and competitive market.

- The transaction costs associated with distribution networks establishing contractual relationships with competitive market providers of FTM distribution connected energy storage assets would be mitigated through the establishment of a more formal open market procurement process for the deliver flexibility services to local distribution networks services as is being deployed in the UK.
- We do not believe that distribution networks as owners of energy storage would best support access on a neutral basis with the network evolving towards a platform provider, given the risks associated with preferential control of those asset to support network services potentially at the expense of customers' self-consumption needs or even the opportunity to participate in the wholesale energy markets during high price events (which would mitigate against the broader two-side market reforms currently in progress). We consider distribution networks would be better placed to support a competitive solution for multiple services through appropriate communications infrastructure expenditure and more transparent data and price signals for flexibility action.
- We support the identified complexity and potential risks and harms, including that cross-subsidisation cannot be easily accounted for through an appropriate methodology, distribution networks may push commercial risk onto customers of the regulated network and benefit from commercially sensitive information about the network and competitors.
- We believe there would be a substantial risk of harm in networks discriminating against non-network solutions that could severely impact competitive solutions, deferring investment by third parties in FTM technologies and BTM solutions, which could have otherwise provided network value.
- We do not support the AER distinguishing between direct versus indirect uses of storage devices. We believe competitive solutions for FTM technologies is likely to deliver greater efficiency and networks should be prevented from owning FTM technologies. Accordingly, we do not support the shared asset clause 3.1(d) being clarified to allow for third party access vis-à-vis energy storage.

[12] See further https://www.flexiblepower.co.uk/.
[13] Western Power Distribution, Flexible Power – Knowledge Sharing Presentation, Strategen webinar series (23 September 2020).
[14] See further https://innovation.ukpowernetworks.co.uk/wp-content/uploads/2019/07/futuresmart-flexibility-roadmap.pdf.

Although there is currently no proposed regulatory framework specifically for storage devices, we see strong parallels between the treatment of FTM technology and the ongoing policy discourse on integrating BTM DER into the energy market system for the benefit of all consumers. Given the potential for FTM technologies to also support multiple services, we would recommend a consistent policy approach that focuses on supporting competitive solutions in products and services.

In the context of integrating BTM DER, the policy approach has been advanced most notably through the contestability rule change that limits distribution network businesses' ability to own and control these assets[15] and the Ring-fencing Guideline. Ongoing policy questions also remain on establishing the right competitive-based framework to maximise value from these technologies and allow customers to engage and share in that value, by, among other things:

- Opening the network value pool to competition through enhanced transparency and opportunities for non-network solutions; and
- Providing greater accountability for network constraints management to support improved investment certainty for asset owners and their ability to participate in market.

In light of these policy considerations, we would recommend a broader review of the regulatory framework for FTM distribution connected energy storage assets to ensure that the framework supports efficient investment in these assets for the benefit of all consumers. Among other things, the review should consider:

- Whether contestability should extend to FTM distribution connected energy storage assets, preventing direct ownership by monopoly network businesses, in order to enable efficient deployment as well as co-optimisation of value streams for the benefit of all consumers through orchestration; and
- Whether distribution networks are appropriately incentivised to provide clear data, information and price signals for the provision of services from distribution connected FTM assets.

3. Improving the Ring-fencing Guideline

AGL supports the proposed incremental improvements to certain obligation to make the Ring-fencing Guideline clearer and less administratively complex including:

- Strengthening the transparency of staff sharing arrangements between a distribution network and its affiliates;
- Removing confusion associated with the term 'confidential information' as defined in the Ring-fencing Guideline;
- Simplifying and improving the overall timeliness of distribution networks breach reporting; and
- Improving the practicality of distribution networks' annual compliance reporting.

We would also encourage continued review of the effectiveness of Ring-fencing Guideline to ensure its benefit continues to be realised by consumers.

[15] AEMC 2017, Contestability of energy services, Rule Determination, 12 December 2017, Available at https://www.aemc.gov.au/sites/default/files/content/b0fcc4f6-7bcd-4351-ad8c-4d53e5306dc3/Final-determination.PDF.