

# Decision

## Distribution ring-fencing class waiver for DNSP-led projects funded under the Australian Government's Community Batteries for Household Solar Program

February 2023

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## Shortened forms

Shortened Form	Extended Form
AER	Australian Energy Regulator
ARENA	Australian Renewable Energy Agency
DNSP	Distribution Network Service Provider
NEM	National Electricity Market
NER	National Electricity Rules
NEO	National Electricity Objective
RAB	Regulatory Asset Base

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Note: Terms defined in the National Electricity Law, National Electricity Rules or the Guideline have the same meaning as set out in those instruments.

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# 1 Executive summary

The Australian Government has announced the Community Batteries for Household Solar Program (the program) which will allow eligible program proponents to apply for funding to cover capital costs for 400 new community batteries on low voltage networks across Australia. It is expected that program participants will include Distribution Network Service Providers (DNSPs) who may look to use the batteries for both network and non-network purposes.

Due to concerns regarding the potential for cross subsidisation, discrimination and the subsequent impacts on competition in the market for battery services, the Distribution Ring-fencing Guideline (the Guideline) (version 3) 2021 restricts DNSPs from leasing new energy storage devices to another legal entity without a waiver from the AER.

Our decision is to grant a ring-fencing class waiver, effective from 3 February 2023 to 30 June 2041, to waive clauses 3.1, 4.2.1 and 4.2.2 of the Guideline for battery assets funded under the Australian Government's Community Batteries for Household Solar Program (administered by the Business Grants Hub or ARENA) that come within the classes and meet the criteria set out in section 4 (Decision) of this document.

Part 5 of the Guideline provides that the AER may grant an individual or class waiver having regard to the National Electricity Objective (NEO), the potential for cross-subsidisation and discrimination, and whether the costs of complying with the relevant obligations outweigh the benefits to electricity consumers. Our class waiver process was intended for situations where multiple projects of a similar nature qualify for a waiver of obligations under the Guideline.

We have determined that a class waiver is appropriate for batteries funded under the program to give stakeholders reasonable regulatory and investment certainty concerning the uses and revenue streams of their proposed batteries and to ensure these batteries deliver intended benefits for consumers. This also avoids layering additional cost and time onto the program through assessing numerous individual applications given these projects are alike in nature and outcomes and consumer impacts are likely to be similar.

The class waiver is limited to batteries funded under the program because we have a clear understanding of the objectives, oversight and consumer benefits to be delivered. We do not have sufficient visibility of the potential costs and benefits of other battery projects, whether funded by DNSPs or through other possible future funding schemes, to determine whether other projects should be covered by this class waiver. We look forward to the opportunity to incorporate lessons from this waiver into our consideration of future waivers for batteries as this aspect of the electricity market develops.

We consider that our design of the class, criteria and controls that a DNSP must meet to be eligible for this class waiver are sufficiently rigorous to mitigate the potential threats to competition that could arise from DNSPs leasing community batteries.

Critical to our consideration are the steps we have taken to ensure that the benefits of supplying battery services will be shared with regulated network customers. This will effectively reduce the cost of providing regulated network services from the battery, through a lower allocation of costs to the Regulated Asset Base (RAB), which is funded through electricity bills for all customers. The requirement to apportion and apply these benefits on a forecast basis will ensure these benefits are delivered to network customers up-front. The transparency provided via annual reporting on actual revenue from battery services will also allow us to assess the effectiveness of this approach to inform future treatment of similar assets.

In addition, the class waiver requires DNSPs to provide us with key information on the contracting arrangements for leasing of battery capacity, including: the name of the contracting party or parties; the volume of capacity leased to that party or parties; the price the capacity is leased for; and which party controls the operation of the battery and on what terms. This information will be received by the AER on a confidential basis. It will allow us to ensure there is no potential for discrimination through the terms of the leasing arrangements, mitigating potential impacts on the developing competitive market for batteries and battery services.

The AER considers that allowing DNSPs to operate community batteries on the terms of this waiver is in the long-term interests of consumers because it enables low-risk battery projects to be developed without adversely impacting competition in the emerging battery market.

More information on the application of this waiver is available in our Guidance note. Further discussion of our policy position on batteries more broadly is available in our [explanatory statement](#) to our Guideline (version 3).

## 2 Background

### 2.1 What is ring-fencing?

Ring-fencing, in relation to DNSPs, refers to the separation of distribution services provided by a DNSP from the provision of unregulated or contestable services by a DNSP or an affiliate of the DNSP. Ring-fencing operates to separate regulated activities from competitive business activities to support competitive markets. The Guideline<sup>1</sup> is made under rule 6.17 of the National Electricity Rules (NER) and sets out obligations that apply to a DNSP should it wish to provide unregulated or contestable services. These obligations aim to support electricity consumers by addressing the potential risk of:

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

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

The Guideline recognises that strict adherence to ring-fencing obligations might, in some circumstances, result in outcomes that are not in the long-term interest of consumers. Therefore, the Guideline makes provision for ring-fencing class or individual waivers<sup>2</sup>. Waivers provide the ring-fencing framework with the flexibility to support opportunities for genuine innovation.

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

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

### 2.2 Community Batteries for Household Solar Program

The Australian Government has announced the Community Batteries for Household Solar Program which will allow eligible program proponents to apply for funding to cover capital costs for 400 new community batteries on low voltage networks across Australia. This program will be administered in two tranches:

- the Business Grants Hub which will fund 58 community batteries in specific locations; and
- ARENA which will administer the funding program for the remaining batteries.

While the delivery of the program outcomes will be monitored and assessed by the relevant program administrator, the intended outcomes of the program<sup>3</sup> are:

- put downward pressure on household electricity costs;
- contribute towards lowering emissions;
- provide a net benefit to the electricity network, having regard to matters such as network constraints;
- store solar energy for later use or sharing, and support further solar installations; and
- allow households that cannot install solar panels to enjoy the benefits of renewable energy through shared community storage.

We expect that some DNSPs may receive funding through the program and may seek to lease spare battery capacity to third parties to realise additional value from the batteries.

<sup>1</sup> AER, *Ring-fencing Guideline – Electricity Distribution – Version 3*, November 2021.

<sup>2</sup> A DNSP may apply for an individual waiver under clause 5.3 of the Guideline.

<sup>3</sup> Grant opportunity guidelines, Community Batteries for Household Solar Program – Delivery of Election Commitments Stream 1.

<https://business.gov.au/grants-and-programs/community-batteries-for-household-solar-stream-1>

## 3 Assessment

The Guideline sets out classes of services that must be ring-fenced from network services provided by the DNSP. Granting the right to use new energy storage devices to another legal entity is specifically prohibited under the Guideline<sup>4</sup>.

In developing version 3 of the Guideline, published in 2021, the AER carefully considered the potential costs and benefits of permitting DNSPs to provide non-network battery services, such as leasing battery capacity not required to provide network services. For the reasons set out in 2021, the AER concluded that this form of activity, by DNSPs, did have the potential to hinder competition in the growing market for battery services, and created a risk that regulated network customers could be required to bear costs in excess of the prudent and efficient cost of providing network services. As a consequence, the AER concluded that DNSPs should not be permitted to supply battery services unless granted a waiver under the Guideline. This remains the AER's position. The AER has created a streamlined process for assessing individual waiver applications for community battery projects. This decision is concerned with a separate class waiver for community battery projects specifically funded under the program.

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

- the National Electricity Objective (NEO);
- the potential for cross-subsidisation and discrimination if the class waiver is granted or refused; and
- whether the benefit, or likely benefit, to electricity consumers of the DNSP complying with the obligations (including any benefit or likely benefit from increased competition) would be outweighed by the cost to the DNSP of complying with that obligation.<sup>5</sup>

In assessing the merits of a class waiver, we have considered each factor listed above, as well as stakeholder feedback provided through our consultation process.

### 3.1 Stakeholder views

On 2 December 2022, we sought stakeholder feedback on a proposal to grant a class waiver to allow leasing of DNSP-owned battery projects funded under the program. On 13 December 2022 we held a verbal feedback session, and we also received 19 written submissions to our submissions process that ended in January 2023.

The broad categories of comments received are highlighted below. Further stakeholder comments are summarised in relevant sections of this decision.

#### Alignment with the Guideline

Stakeholders including Acacia Energy, Village Zero Sandringham, AGL and Nexa Advisory submitted that the streamlined waiver process, developed in 2021, was a more appropriate means to deal with DNSP requests to waive obligations to allow them to lease out batteries and the proposed class waiver was a departure from the intent of the Guideline.<sup>6</sup> They noted the AER's concerns during the development of the streamlined process that each waiver should be assessed on its merits. Origin Energy also noted that the AER has had limited experience in assessment of battery waiver applications, suggesting setting a class waiver at this point in time is premature.<sup>7</sup>

<sup>4</sup> AER, *Ring-fencing Electricity Distribution Guideline (Version 3)*, November 2021, cl 3.1(d)(i).

<sup>5</sup> AER, *Ring-fencing Electricity Distribution Guideline (Version 3)*, November 2021, cl. 5.3.2.

<sup>6</sup> Acacia Energy, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 10 January, p.3; AGL, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 12 January 2023, p.2; Merri-bek City Council, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 9 January 2023, p.3; Nexa Advisory, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 9 January 2023, p.2; Village Zero Sandringham, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 12 January 2023, p.2

<sup>7</sup> Origin Energy, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 11 January 2023, p.1;



The Australian Energy Council (AEC) noted an expedited waiver process could give effect to the outcomes the Guideline seeks to avoid, and the AER should administer the Guideline in a manner that provides confidence in an enduring and stable framework<sup>8</sup>.

The Clean Energy Council (CEC) suggested the AER should modify the existing streamlined waiver process to include the program and set conditions that ensure the policy intent is met<sup>9</sup>.

### Impacts on competition

Origin Energy indicated that DNSPs can use their economies of scale to potentially offer more cost-effective options than third party providers<sup>10</sup>. Origin noted that in the short term, this may provide cost savings to consumers, but has the potential to displace genuine competition in the longer term. Nexa Advisory indicated that the provisions of the Guideline that prevent DNSPs from leasing excess capacity of a battery are needed to protect consumers, the market and innovation<sup>11</sup>. The AEC noted an incorrect decision by the AER may have significant consequences for long-term competition<sup>12</sup>. AGL noted the waiver is likely to exacerbate barriers to the market for other non-network organisations<sup>13</sup>. Acacia Energy noted that a class waiver risks setting a precedent for deployment of batteries in the future that would likely dampen competition<sup>14</sup>.

### Information asymmetry

A major focus of the verbal stakeholder feedback sessions that the AER facilitated in December 2022 and written submissions was on the information asymmetry between DNSPs and other potential battery owners.

AGL, Simply Energy, SwitchDin, Acacia Energy, Energy Consumers Australia (ECA), Origin Energy, the CEC and others commented that an information asymmetry exists where DNSPs hold critical information relating to the network, including data that identifies optimal locations for batteries<sup>15</sup>. These stakeholders commented that there were issues with accessing this data including resourcing and prioritisation by DNSPs potentially creating delays in provision of data. These stakeholders also noted the current publication of Distribution Annual Planning Reports and related publications (e.g. ENA's Network Opportunity Maps) do not provide sufficient data to underpin the development of battery opportunities.

Acacia Energy noted their "main concern is related to the potential for a DNSP to discriminate against a third-party battery developer on tariffs, connection fees and time to connection, but most critically the advantage the DNSP has in network knowledge and data"<sup>16</sup>.

<sup>8</sup> Australian Energy Council, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 12 January, p.2

<sup>9</sup> Clean Energy Council, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 11 January, p.2

<sup>10</sup> Origin Energy, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 11 January 2023, p.2

<sup>11</sup> Nexa Advisory, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 9 January 2023, p.2

<sup>12</sup> Australian Energy Council, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 12 January, p.3

<sup>13</sup> AGL, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 12 January 2023, p.2

<sup>14</sup> Acacia Energy, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 10 January 2023, p.3

<sup>15</sup> AGL, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 12 January 2023, p.2; Clean Energy Council, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 11 January 2023, p.1; Energy Consumers Australia, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 10 January 2023, p.2; Merri-bek City Council, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 9 January 2023, p.2; Nexa Advisory, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 9 January 2023, p.3; Simply Energy, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 11 January 2023, p.2; SwitchDin, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 12 January 2023, p.4

<sup>16</sup> Acacia Energy, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 10 January 2023, p.2.

## Scope and duration of waiver

The ACT Government's Office for Climate Action (OCA), DNSPs and Energy Networks Australia (ENA) submitted that the waiver should be extended to cover other jurisdictional schemes<sup>17</sup>. The ACT OCA requested the waiver be extended to cover other jurisdictional schemes to provide more options for program delivery. ENA also requested the waiver duration be extended until 2041 to cover batteries that are installed in the final year (2025-26) of the Government's program<sup>18</sup>. Nexa Advisory proposed that if a waiver is granted, it is only applied for a short period of 1-2 years<sup>19</sup>.

## Review of waiver

ECA, Nexa Advisory, and some members of the Customer Consultative Group (CCG) raised the importance of a review of the waiver<sup>20,21</sup>. ECA suggested a review at least biannually, while Nexa Advisory suggested a formal review every 12 months.

## Achievement of program aims

Through our verbal feedback session, our consultation with some members of the CCG, and through written submissions, we received feedback on how DNSP-led battery projects should achieve program aims, particularly providing benefits to consumers including through reduced electricity costs and supporting renewable energy generation.

## Cost Allocation and the treatment of Government funding

Stakeholders had differing views about how to allocate costs between regulated and unregulated activities. In addition, stakeholders had differing views on how to apply Government funding to meet these costs. The ENA and DNSPs proposed a materially different approach to cost allocation and benefit sharing than that outlined by the AER in the initiation notice<sup>22</sup>. Rather than being required to forecast unregulated benefit (leasing revenue) upfront, and use this forecast to reduce the costs borne by customers of the regulated distribution network, distribution businesses instead proposed a revenue sharing approach, similar to that applied in the AER's [Shared Asset Guideline](#)<sup>23</sup> which would share a percentage of actual leasing revenue (after costs) back with customers. More information on the Shared Asset Guideline is outlined below. ECA, on the other hand, proposed that DNSPs should allocate all program funding they receive to reduce the costs paid by regulated network consumers, rather than allowing optionality as to whether the government funding offset regulated or unregulated costs<sup>24</sup>. More detail on this issue is below.

<sup>17</sup> ACT Government, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 10 January 2023, p.1 AusNet, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 18 January 2023, p.4; Citipower, Powercor and United Energy, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 18 January 2023, p.5; Endeavour Energy, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 18 January 2023, p.3, Energy Networks Australia, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 18 January 2023, p.3, Energy Queensland, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 17 January 2023, p.1; SA Power Networks, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 18 January 2023, p.1

<sup>18</sup> Energy Networks Australia, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 18 January 2023, p.8

<sup>19</sup> Nexa Advisory, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 9 January 2023, p.5

<sup>20</sup> Energy Consumers Australia, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 10 January 2023, p.6; Nexa Advisory, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 9 January 2023, p.5

<sup>21</sup> AER staff met with the AER Customer Consultative Group on 12 January 2023.

<sup>22</sup> Ausgrid, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 18 January 2023, p.4; AusNet, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 18 January 2023, p.2; Citipower, Powercor and United Energy, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 18 January 2023, p.5; Endeavour Energy, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 18 January 2023, p.2; Energy Networks Australia, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 18 January 2023, p.3, SA Power Networks, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 18 January 2023, p.4

<sup>23</sup> AER, *Shared Asset Guideline*, November 2013. e

<sup>24</sup> Energy Consumers Australia, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 10 January 2023, p.4;

## 3.2 National Electricity Objective

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

We recognise the ability of DNSPs to contribute to the timely roll-out of projects under the program. However, to determine whether an asset is an efficient investment in the long-term interest of consumers we must balance the benefits of realising the greatest value from the investment with the risks identified to consumers including barriers to entry, discrimination and effects on competition in emerging markets for battery services.

On balance the AER has concluded the class waiver, with the conditions associated with it, would promote the NEO by aiding in the delivery of low-risk battery projects without adversely impacting competition in the emerging battery technology market.

## 3.3 AER analysis - Potential for cross-subsidisation

In deciding whether to grant a class waiver, we must consider the potential for cross-subsidisation if the waiver is granted. That is, to consider the potential for a DNSP to use revenues from provision of distribution services paid for by network customers to cross-subsidise provision of services in other markets if the waiver is granted<sup>25</sup>.

Without appropriate controls, a DNSP may include costs in its RAB that exceed the prudent and efficient costs of providing network services to customers, instead of appropriately allocating costs between the RAB and unregulated businesses. This may also have negative impacts on competition to the extent that the provider of battery services is able to cross-subsidise the provision of battery services through revenue from regulated services.

In our initiation notice we proposed a methodology where the cost funded by regulated revenue would be reduced upfront to reflect the likely unregulated revenue the DNSP will receive from the battery (leasing revenue). This would reduce the share of costs borne by regulated service consumers. This approach was designed to reduce the potential for cross subsidisation and deliver equitable sharing of benefits between the DNSP and its customers.

We received stakeholder feedback on the approach to cross-subsidisation and the AER's proposed methodology.

The AEC noted the risk, even with waiver conditions, that cross-subsidies would still arise<sup>26</sup>. The AEC submitted there would be high variation in battery use in the short and long term, and robust cost allocation methodologies based on actual battery use had not yet been developed. As such, there is a risk that if the cost allocation forecasts do not eventuate in practice (for example, the battery receives more leasing revenue than forecast) then network costs may be overestimated.

ECA commented that the Government grant funding should be allocated as a reduction to the regulated cost (i.e. reduced RAB component), so that all consumers will benefit by having a network battery for less cost<sup>27</sup>. The AER's position is that in this case the allocation of funding under the program is a policy decision for Government. Where Government wishes to use the program funding to reduce the cost of providing regulated services from batteries, it will be appropriate for the funding to be applied to costs which would otherwise be allocated to the RAB. If Government wishes to use the program funding to support the delivery of other retail products to customers, it may wish to see funding used to offset the unregulated costs of the battery.

Nexa Advisory proposed the waiver should ensure that DNSPs would not use funds, such as Demand Management Innovation Allowance (DMIA), funded through revenue from regulated network services, to

<sup>25</sup> AER, *Ring-fencing Electricity Distribution Guideline (Version 3)*, November 2021, cl. 5.3.2(a)(iii).

<sup>26</sup> Australian Energy Council, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 12 January 2023, p.2

<sup>27</sup> Energy Consumers Australia, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 10 January 2023, p.4

subsidise battery costs and associated services under the program<sup>28</sup>. This is because this funding is already paid for by consumers. Treatment of DMIA funding is outlined below.

ENA commented there were complexities with forecasting unregulated revenues<sup>29</sup>, which have a high degree of uncertainty particularly given the lack of experience of the battery market, and that DNSPs would need to provide customers with the forecast benefit upfront (which may mean customers are provided with more or less returns than actual benefits). For this reason, submissions from ENA and DNSPs proposed that a revenue sharing mechanism was preferable to a strict cost allocation methodology which exposed DNSPs to forecasting risk in relation to leasing revenue, which could see networks customers paying less than their fair share for the regulated services provided by the battery. This is discussed further below.

### **Alternate cost allocation approach**

ENA, in its submission, proposed an alternative to 'class (b)' set out in our initiation notice. The ENA's 'revenue sharing' approach would allow the DNSP to allocate the full costs of the battery, minus Government funding, to the RAB without forecasting unregulated revenue, so long as the cost paid for by regulated customers did not exceed the benefit to those customers. Non-network benefits (leasing revenue) would then be shared with customers if it that revenue exceeded the costs the DNSP has incurred<sup>30</sup>.

ENA's approach attempts to provide a dynamic mechanism that would give flexibility to DNSPs in relation to cost allocation. However, we consider significant further analysis would be required to understand different scenarios for benefit sharing with customers and the risks that customers of regulated assets will over-pay for these battery assets. Both the AER's cost allocation approach, and ENA's revenue sharing approach, attempt to allocate uncertainty between DNSPs and customers of regulated network services and manage forecasting risks. Under the AER's approach, a 'point in time' assessment is made as to the apportionment of costs and revenues, with the aim of delivering cost reflective pricing, to minimise cross-subsidisation risk and consequent impacts on the development of competitive markets. Under this approach risks accrue to both the DNPS and/or customers of the regulated network where actual benefits vary materially from forecast benefits. That is, there is a risk that regulated network customers may overpay for network services if leasing revenues are higher than forecast or underpay if leasing revenues are lower than forecast. The quality of DNSP forecasting of both regulated network benefits and unregulated benefits will be key to this approach.

However, under a revenue sharing methodology of the type proposed by the ENA, there is a greater risk that regulated network customers are likely to overpay for network services in the short to medium term, as they do not benefit from forecast leasing revenue reducing their upfront costs. The aim of this approach would be to address that imbalance over time as the DNSP passes a share of its revenues (after costs) back to customers, through a mechanism that would need to be specified. However, should those revenues not materialise, network customers would not benefit at all.

A revenue sharing approach would also require greater specificity as to the mechanism for sharing revenue back with networks customers, along with clearer guidance on how to calculate leasing revenue after costs, and how these costs would be verified.

Detailed analysis of the costs and benefits of both approaches is made more difficult by a lack of data on battery service revenue which would allow us to assess the potential variability between forecast and actual revenue from battery services. However, our initial view is that network customers will be better off under the AER's proposed approach, as it is more likely to produce a reasonable sharing of the risks and benefits associated with investments in batteries for the purpose of providing both regulated network services and battery services in competitive markets.

The AER will continue to study, in consultation with stakeholders, the implications and benefits of these approaches, including whether cost allocation or revenue sharing mechanisms, or a mixture of both, provide the optimal approach to battery assets. We will do this through reviewing data received from annual reporting under this waiver, including leasing contracts and actual leasing revenue, as well as ongoing stakeholder engagement, to inform our decisions on future battery waivers.

<sup>28</sup> Nexa Advisory, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 9 January 2023, p.3

<sup>29</sup> Energy Networks Australia, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 18 January 2023, p.5

<sup>30</sup> Energy Networks Australia, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 18 January 2023, p.8

## **AER position on approach to allocating costs**

### **Introduction**

Having considered stakeholder submissions and concerns, we have refined the specific classes and criteria from our initiation notice to ensure the costs allocated to regulated network customers do not exceed the prudent and efficient cost of providing network services, and that cost reductions from forecast battery service revenue are reflected at the outset.

We have designed the waiver so that the eligible 'classes' include projects wholly excluded from the RAB; or included in the RAB but with requirements to mitigate cross-subsidisation risks. The risk of cross-subsidisation is significantly less pronounced where the battery is wholly excluded from the DNSP's RAB.

Our approach was developed after consideration of alternate approaches, put forward by DNSPs and ENA as outlined above.

Our approach to calculating the amount allocated to a DNSP's RAB is consistent with existing ring-fencing requirements to minimise cross-subsidisation. Under clause 3.2.2 of the Guideline, a DNSP must allocate or attribute costs in a manner that is consistent with the Cost Allocation Principles. It is also consistent with our standard approach and assessment of forecast capex, which is concerned with determining the prudent and efficient costs of providing network services.

Under the apportionment calculation for this class waiver, a DNSP must demonstrate that the proportion of the asset cost to be allocated to the DNSP's RAB (and therefore recovered from customers through regulated network revenue) will not exceed the proportion of the benefit to network customers (relative to the total benefit).

The RAB allocation is an estimation made at a point in time. The AER does not wish to create uncertainty in investment decisions for DNSPs, which could occur if DNSPs were required to modify their RAB inclusions based on actual benefits. We note that the point where the DNSP makes its investment decision may differ from the point in time where it applies for and receives program funding. The cost allocation methodology outlined in this waiver relies on forecast network and non-network benefits at the time of the investment decision is made by the DNSP.

### **Inclusions and exclusions**

#### ***Demand Management Innovation Allowance Mechanism allowances***

The Demand Management Innovation Allowance Mechanism (DMIAM) is established under clause 6.6.3A of the NER with the aim to encourage distribution businesses to find lower cost alternatives to investing in network solutions. DMIAM allowances are treated as revenue adjustments, and do not increase the RAB. Provided that the expenditure is within the DNSP's DMIAM allowance and the proposed project meets the "eligible project" criteria, then incurred costs that relate to direct control services could be allocated to regulated revenue (but not the RAB) based on the apportionment method.

#### ***Treatment of Government funding***

In our draft initiation notice, we had Government funding being netted off as the first step, before the calculation of the portion attributable to network benefits. However, we also noted that the AER's approach was for the Government to be able to determine whether its grant funding would reduce costs for regulated network customers or be directed towards the unregulated stream of a DNSP's asset base.

Our intention was to allow Government to decide, based on its policy aims for the Community Batteries for Household Solar Program, where its funding would be directed.

To fulfil this intention (which was outlined in our footnote in the initiation notice), we now clarify that Government grant funding is netted off after the apportionment calculation, not before.

### **Controls:**

To further reduce the risk of cross-subsidisation, we have developed two controls:

1. The Government contribution may be used to offset costs (regulated or unregulated) either partially or fully but may not exceed the total cost allocation to a particular stack (regulated or unregulated). For example, assume that 80% of the battery's total cost of \$1m is attributed as a network cost allocation (i.e., \$0.8m). Then the unregulated network costs to the business is \$0.2m. If the Government's funding (total funding of \$0.5m) is used to offset unregulated costs, they can only do this up to the amount of those costs (i.e., \$0.2m). Any remaining Government

funding above this amount must be applied to the other cost stack. This means that unregulated costs are reduced from \$0.2m to \$0, and regulated costs are reduced from \$0.8m to \$0.5m.

2. Notwithstanding the apportionment percentage derived, the cost of the battery allocated to the RAB cannot exceed the forecast network benefit (e.g., if the total network benefits were \$0.25m, and the total unregulated benefits were \$0.25m, resulting in a benefit allocation of 50%, this would not allow 50% of the cost of a \$1m battery (\$0.5m) to be allocated to the RAB. In this case, this control would cap the total RAB allocation at \$0.25m).

### **Evidence:**

We expect a DNSP to provide rigorous evidence to support the allocation of costs to the RAB. This would cover the expected asset costs, and estimation of benefits from both regulated and unregulated revenue streams. Our guidance note provides further information. Examples:

- For costs:
  - The present value of forecast expenditure for the project (an input to the cost-benefit analysis that informed the investment case).
- For non-network benefits:
  - Within 20 business days of execution, relevant details of the contract (see our guidance note) that a DNSP holds with their leasing partner.
    - We would expect to see that this contract, including the leasing rates, has been market tested (further detailed in section 3.4 'potential for discrimination').
- For network benefits: the present value of quantified benefits, which may include wholesale market, network services and environmental benefits. Our DER integration expenditure guidance note outlines methodologies for quantifying these types of benefits.<sup>31</sup>

The AER understands that in forecasting non-network benefits (leasing revenue), there may be forecasting errors (i.e., when the forecast benefit does not align with the actual benefit) affecting either the DNSP or regulated consumers. The ongoing reporting requirements regarding actual leasing revenue will assist us in understanding the materiality of these variations and refine forecasting for future processes.

### **Ongoing reporting requirements**

We have developed criteria (detailed in section 4 of this decision) to provide the AER with transparency over the use of the battery and ensure that the risk of cross-subsidisation impacting consumers is minimised. The criteria are designed to provide for additional protection against the risk of cross-subsidisation through the revenue determination process which will give scrutiny to any costs that are to be recovered through the RAB.

One of the objectives of the program is ensuring that consumers are better off, and the AER expects DNSPs who own batteries to be able to demonstrate and provide supporting evidence that this is the case throughout the economic life of any battery projects funded.

Under our criteria, DNSPs are required to include in their annual ring-fencing compliance reports, information on the benefit streams both individually and as a whole, as well as a comparison of the uses of the battery. As per ring-fencing compliance reporting requirements stipulated under the Guideline, this must be independently audited.

We note that projects funded through the program will have additional reporting obligations to the program. For example, under both the ARENA and Business Grants Hub programs, final project reports would occur no later than two years after the completion date for the project. The AER's ongoing reporting requirements are in place to ensure that DNSP-led projects continue to comply with this ring-fencing waiver and broader ring-fencing obligations.

<sup>31</sup> AER, [DER integration expenditure guidance note](#), June 2022.

### 3.4 AER analysis - Potential for discrimination

The ring-fencing Guideline prohibits a DNSP from:

- discriminating between itself (or an affiliated entity of the DNSP) and a competitor (or potential competitor); or
- discriminating between any two legal entities in connection with the supply of contestable electricity services by those legal entities, on the basis of the use by one or both of those legal entities of assets owned, operated or otherwise controlled (in whole or in part) by the DNSP.

This overarching obligation is enshrined in clause 4.1 of the Guideline, the obligation not to discriminate, which cannot be waived.

However, the Guideline provides for waiving of clauses 4.2.1, 4.2.2 and 4.2.3, which are the functional separation of offices, staff and co-branding. To allow the operation of a battery that has been leased, and will be used for multiple purposes, we consider it is necessary to waive clauses 4.2.1 (physical separation / co-location) and 4.2.2 (staff sharing).

This is to enable a more practical approach to arrangements for batteries under the program. For example, for batteries installed under this class waiver, negotiation of contracts for the purpose of leasing may be undertaken by the DNSP. The DNSP staff member negotiating the contract would have electricity information which is required to negotiate the contract.

We propose clarifying the streamlined individual waiver process in due course to include clause 4.2.1 and 4.2.2.

The risk associated with waiving functional separation requirements to allow battery leasing, is that DNSPs may have the opportunity to deal directly with affiliated parties on uncommercial terms and/or without conducting a competitive tender process to deal with that entity.

Stakeholder submissions raised some concerns about the risk of discrimination under the proposed class waiver. Acacia Energy and Village Zero Sandringham noted that “discrimination is notoriously difficult to demonstrate”<sup>32</sup> and Origin Energy noted it is difficult for the AER to practically assess if DNSPs discriminate against other battery providers.<sup>33</sup> Origin suggested the AER should provide detail on the information it will require to review discriminatory behaviour and how it will be assessed.

ENA suggested that DNSPs, to mitigate the risk of discrimination, undertake a range of third-party engagement processes<sup>34</sup> including: competitive tender, request for proposals, and partnership models with community groups and local councils. ENA suggested DNSPs should not be restricted to only undertaking competitive tenders<sup>35</sup>.

#### Information asymmetry

We are mindful of the challenges noted by stakeholders in relation to information asymmetry and the lack of a level playing field for non-DNSP entities in obtaining information to enable them to connect to the network. Stakeholder submissions suggest this may be a material issue with the potential to hinder competition in the market for battery services.

Stakeholders proposed solutions to this issue, such as requiring DNSPs to publish, in a timely manner, accurate information on capacity constraints, or network opportunities for community batteries<sup>36</sup>. Based on

<sup>32</sup> Acacia Energy, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 10 January 2023, p.2; Village Zero Sandringham, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 12 January 2023, p.2

<sup>33</sup> Origin Energy, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 12 January 2023, p.2

<sup>34</sup> Energy Networks Australia, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 18 January 2023, p.9

<sup>35</sup> Energy Networks Australia, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 18 January 2023, p.9

<sup>36</sup> AGL *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 12 January 2023, p.2; CEC, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission* 11 January 2023, p.2; Merri-Bek City Council, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 9 January 2023 p.2; Nexa Advisory, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission*, 9 January 2023, p.3; Village Zero Sandringham, *Australian Government's Community Batteries for Household Solar Program – proposed ring-fencing class waiver submission* 12 January 2023, p.3

stakeholder feedback on this point, this appears to be a material issue requiring further analysis and consideration. Developing an information sharing framework would require a greater understanding of the potential harms resulting from any information asymmetry, as well as the form any framework might take, and the costs and benefits of a framework of this nature. We anticipate that the reporting required under this waiver will provide valuable information which will assist in considering these issues further, either through amendments to this waiver in the future, or in consideration of future battery waivers.

To mitigate the risk of discrimination and address feedback from stakeholders, in addition to the obligation not to discriminate already present in the Guideline, the following criteria will apply to any DNSP seeking to operate under this class waiver:

- A DNSP must provide the AER with information as to the terms and conditions of the contracts entered into with third parties for the leasing of battery capacity. This information should include:
  - a. the name of the contracting party or parties;
  - b. the volume of capacity (in kW and kWh) leased to that party or parties;
  - c. the price the capacity is leased for; and
  - d. which party controls the operation of the battery and on what terms.

DNSPs must provide this information to the AER within 20 business days of the contract being entered into.

Contractual information provided will remain confidential between the DNSP and AER.

The AER also expects DNSPs will undertake an open, competitive process to select a third party and provide evidence of this. Our expectations are detailed further in our guidance note.

## 3.5 AER analysis – Other issues

### Alignment with the Guideline

As outlined above, in assessing whether to grant a ring-fencing waiver, including a class waiver the AER must have regard to:

- the National Electricity Objective (NEO);
- the potential for cross-subsidisation and discrimination if the class waiver is granted or refused; and
- whether the benefit, or likely benefit, to electricity consumers of the DNSP complying with the obligations (including any benefit or likely benefit from increased competition) would be outweighed by the cost to the DNSP of complying with that obligation<sup>37</sup>.

In assessing the merits of a class waiver, we have considered each factor listed above, as well as stakeholder feedback provided through our consultation process. We have addressed our assessment of the waiver against the NEO above, and our assessment against cross-subsidisation and discrimination issues, as well as consumer considerations.

We have assessed that a class waiver is an appropriate mechanism for dealing with projects funded under the program, as the program will entail numerous projects of a similar nature, with similar risks to be mitigated, and affected by ring-fencing regulation in a like manner. We have determined that a class waiver is appropriate for batteries funded under the program to give stakeholders reasonable regulatory and investment certainty concerning the uses and revenue streams of their proposed batteries and to ensure these batteries deliver intended outcomes for consumers. This also avoids layering additional cost and time onto the program through assessing numerous individual applications given these projects are alike in nature and outcomes and consumer impacts are likely to be similar.

### Impacts on competition

As discussed above, the Guideline seeks to protect consumers through ensuring competition by requiring that DNSPs do not discriminate in favour of any related entities. The requirements imposed by the class waiver are intended to mitigate the risk of discrimination through DNSPs reporting to us on their contractual arrangements with third parties. Further, the class waiver does not waive any standing obligations that a DNSP may have under other legal and regulatory frameworks. For example, DNSPs are bound by the

<sup>37</sup> AER, *Ring-fencing Electricity Distribution Guideline (Version 3)*, November 2021, cl. 5.3.2.



*Competition and Consumer Act 2010 (CCA)*, including Part IV, which prohibits restrictive trade practices, and the Australian Consumer Law (ACL).

### **Duration of waiver**

The program allows for batteries to be installed in 2025-26. Our initiation notice stated that the AER was considering granting the class waiver for a period that reflected the anticipated life of the asset (usually 15 years). We agree with submissions that proposed the waiver should cover the operational life of batteries that are installed in the final year (2025-26) of the Government's program and as such, the waiver will run until 30 June 2041.

### **Review of waiver**

Some stakeholders suggested a 12-month review process for this waiver. However, rather than determining a precise time for any review of the class waiver, it is more appropriate for the AER to monitor and assess the information provided by DNSPs, starting from the first projects funded under the program, in order to inform any decision about a formal review. This is in-line with our existing approach to reporting and monitoring of compliance with the Guideline.

One of the objectives of the program is ensuring that consumers are better off, and the AER expects DNSPs who own batteries to be able to demonstrate this is the case throughout the economic life of any battery projects funded. Annual reporting by DNSPs, including on this point, will inform our ongoing consideration as to whether the waiver remains appropriate.

### **Prudent and efficient investment**

Our existing framework requires network businesses to submit a regulatory proposal, usually every five years. These regulatory proposals include forecast capital expenditure (capex) for the forthcoming five-year period (note: actual capex is what is ultimately included in the RAB). Forecast capex is subject to an assessment against the capex objectives and capex criteria in the NER<sup>38</sup>. The AER considers whether an investment is prudent and efficient, as well as whether the total benefits of a project exceed the total cost of the project.

The way a DNSP should allocate its costs to satisfy the capex principles under this waiver is detailed in section 3.3 and the Guidance note which accompanies this decision.

### **Cost Allocation and Shared Asset Guidelines**

The issue of assets which receive both regulated revenue and other, unregulated revenue, is not new. The AER uses two mechanisms to deal with this issue: cost allocation and revenue sharing.

Where regulated businesses recover the cost of regulated assets through regulated revenue, and then also charge for unregulated services provided by these assets, network service providers may recover the costs of the asset more than once. This can result in electricity consumers paying more than their fair share for these assets.

The Shared Asset Guideline sets out our approach to revenue sharing: sharing the benefits with consumers when a network business is paid for providing unregulated services by using assets funded through regulated revenue. The Shared Asset Guideline is used where cost allocation has not been applied at the outset.

Our general cost allocation requirements are set out in the Cost Allocation Guideline, designed to apportion costs incurred by a service provider to the different services it provides. By allocating costs to services correctly the service provider recovers them from the consumers who benefit from those services (cost reflective pricing). It is important to note that cost allocation usually only occurs when the assets are first invested in. Where an asset was not subject to a cost allocation, but was funded through regulated revenue, to provide regulated services, but later realises additional unregulated revenue, the shared asset Guideline operates to reduce costs to electricity consumers. This is achieved through adjustments to regulated revenue.

<sup>38</sup> Under the capex criteria, the total forecast capex should reasonably reflect (i) the efficient costs of achieving the capex objectives; (ii) the costs that a prudent operator would require to achieve the capex objectives; and (iii) a realistic expectation of the demand forecast and cost inputs required to achieve the capex objectives.

In the case of batteries funded under the program, cost allocation should be applied rather than revenue sharing as it is clear at the outset that these assets will provide both regulated and unregulated services. As a result, this waiver does not apply the Shared Asset Guideline. The AER will consider undertaking a review of the Shared Asset Guideline as part of its 2023/24 work program.

### **Other issues**

Stakeholders noted other issues such as oversight of achievement of the program's aims, however these are outside of the AER's ring-fencing remit and as have not been considered in this final decision.

## **3.6 Benefits and costs of DNSPs complying with ring-fencing obligations**

We acknowledge the concerns raised by stakeholders in relation to risks of discrimination and cross subsidisation, including:

- information asymmetry, where DNSPs holds critical information relating to the network, including data that identifies optimal locations for batteries; and
- increasing barriers to entry for new entrants into emerging markets.

Overall, we consider that the benefit of granting the class waiver, on the conditions specified in section 4 below, outweighs the cost to DNSPs of complying with the obligations of legal and functional separation.

The waiver has been crafted to provide the AER with oversight and the ability to monitor and address the risks of DNSP owned or operated batteries over the life of the assets.

## **3.7 Conclusion**

On balance, we consider that our design of the class and criteria that a DNSP must meet to be eligible for this class waiver are sufficiently rigorous to mitigate the potential risk of cross-subsidisation and discrimination that may arise from DNSPs leasing community batteries. We consider this should mitigate potential impacts on the developing competitive market for batteries and battery services. Having regard to the NEO, the AER considers that the benefits to consumers of requiring DNSPs to comply with each of the requirements of the Guideline are outweighed by the costs of compliance with these obligations.

## 4 Decision

Our decision is to grant a ring-fencing class waiver from clauses 3.1 and 4.2.1 and 4.2.2 of the Guideline, effective from 3 February 2023 to 30 June 2041, for DNSP-led projects that meet the classes and criteria of this waiver.

### Classes this waiver applies to

The scope of this class waiver is limited to DNSP-led projects where the battery asset is funded under the Australian Government's Community Batteries for Household Solar Program (administered by the Business Grants Hub or ARENA), where:

- a) the asset is wholly excluded from the DNSP's RAB; or
- b) what is allocated to the DNSP's RAB is only the part of the total cost of the asset that reflects the proportionate share (that relates to *direct control services*) of the total quantified benefit that is forecast at the time the investment decision is made, where:
  - i. prior to the RAB allocation at the DNSP's next regulatory proposal, the DNSP includes in its regulatory proposal evidence, and a report from an independent auditor, that confirms compliance with this provision b);
  - ii. the **DNSP** may use the Government contribution to offset costs (regulated or unregulated) either partially or fully but may not exceed the total cost allocation to a particular stack (regulated or unregulated);<sup>39</sup>
  - iii. the total cost of the battery allocated to the RAB must be an amount equal to or less than the forecast network benefit; and
  - iv. definitions:
    - the **total quantified benefit** is the sum of both the forecast network benefit (quantified benefit derived from the deployment of the asset for *direct control services*<sup>40</sup>) and the forecast non-network benefit (quantified benefit accruing to the **DNSP** derived from the deployment of the asset for *other distribution service* and *other services*) over its economic life.

### Criteria

The following criteria apply to projects that fall within class (b):

1. A **DNSP** must comply with the Cost Allocation Principles that require a **DNSP** to appropriately allocate and attribute costs for use of the asset between direct control services, *other distribution services*, and *other services*.
2. A **DNSP** must provide, as part of that DNSP's independently audited annual ring-fencing compliance report that is required under clause 6.2 of the Guideline.
  - a. the total quantified benefit derived from the deployment of the asset or all services over the most recent financial year;
  - b. the total quantified benefit derived from the deployment of the asset from *direct control services* over the most recent financial year;
  - c. the total quantified benefit derived from the deployment of the asset from *other distribution services* and *other services* over the most recent financial year; and
  - d. a comparison of the uses (volume and frequency) of the battery that confirms the usage by the DNSP and usage by its retail partner (or other third party), including the initial proposed allocation as a baseline against which actual usage of the assets can be compared.

<sup>39</sup> This differs from our approach stated in the initiation notice. It is a decision for the Government whether Program funding will be used to offset the regulated or unregulated costs associated with the batteries. Clarification of this change is in section 3.4 ('Treatment of Government Funding') of this document

<sup>40</sup> DNSPs should calculate total quantified benefits from the provision of direct control services with reference to the [AER's DER integration expenditure guidance note](#) and in particular, the benefit streams identified therein.

The following criteria will apply to projects which fall within class (a) or (b):

3. A **DNSP** must provide the AER with information as to the terms and conditions of the contracts entered into with third parties for the leasing of battery capacity. This information should include:
  - a. the name of the contracting party or parties;
  - b. the volume of capacity (in kW or kWh) leased to that party or parties;
  - c. the price the capacity is leased for; and
  - d. which party controls the operation of the battery and on what terms.