Informal feedback in response to AER discussion slides

AER Electricity Distribution Ring-fencing Guideline Review

ENA feedback to AER on SAPS & ESD preliminary positions

Please note that this represents initial informal ENA feedback in response to AER workshop discussion slides[1], and aligns with points raised by ENA in the workshops. It should not be considered as a formal submission.

1 Stand-alone power systems

1.1 Exemption design

SAPS can provide a cost-efficient alternative to traditional poles and wires investment, increasing reliability and safety for stand-alone power systems (SAPS) connected customers, and lowering costs for *all customers* over time. However, the AEMC's proposed framework[2] restricts DNSPs rolling out integrated SAPS without first applying for a ring-fencing waiver. This imposes costs, and delays delivering SAPS' benefits to customers.

ENA therefore strongly supports the AER's preliminary position to introduce a broad-based exemption in the Electricity Distribution Ring-fencing Guideline (Distribution Guideline) to enable a DNSP-led SAPS roll-out. This approach will improve customer outcomes, kickstart market development, and incentivise more entry by third-parties over time.

ENA supports the introduction of a broad-based exemption designed to allow a DNSP to earn revenue (on a per annum basis) from stand-alone power systems (SAPS) generating systems (i.e., the administered SAPS settlement price) up to a given percentage of a DNSP's annual standard control service (SCS) revenue cap. We welcome further discussion with the AER on the proposed operation of the per annum revenue cap.

A broad-based approach is strongly preferable to designing a list of specific exemption categories – in which case, a definition may be inadequately defined, a threshold may not be set appropriately, or this approach, given the infancy of the SAPS roll-out, may fail to identify all circumstances in which an exemption ought to apply.

1.2 Exemption thresholds

ENA broadly supports different per annum revenue cap thresholds being developed for urban and rural DNSPs. However, we think further consideration needs to be given to the classification of DNSPs, particularly for those that have both urban and rural networks (for example, 44% of Ausgrid's network is classified as rural[3]). In addition, we welcome further discussion with the AER on the proposed per annum percentage thresholds.

ENA is **strongly supportive of the AER's preliminary position to provide DNSPs with the option to apply for a waiver that increases the revenue cap specific to that DNSP**, thereby allowing the AER and stakeholders to publicly consider jurisdictional specific SAPS roll-out plans. This is a more cost and time

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[1] AER, *Distribution Ring-fencing Guideline Review – Targeted stakeholder discussion (26 February 2021 & 3 March 2021)*, slide pack circulated to registered attendees on 23 February 2021.
[2] AEMC, *Updating the regulatory frameworks for distributor-led stand-alone power systems*, Final report, 28 May 2020.
[3] Ausgrid 2019-20 - Economic Benchmarking - RIN Response - Consolidated - 30 October 2020 – PUBLIC [Table 3.7.2 Terrain Factors].

effective approach than requiring waivers for individual SAPS over the per annum revenue cap threshold and recognises that a NEM-wide threshold may not be suitable in all cases.

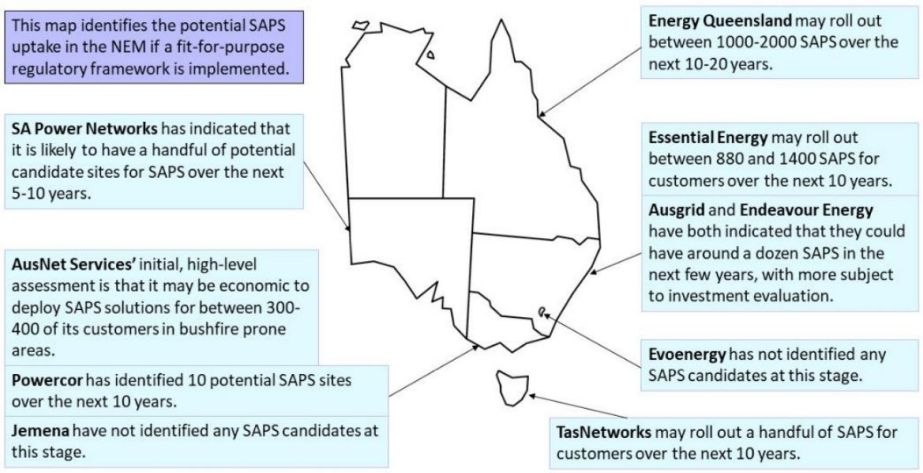
1.2.1 SAPS roll-out plans

ENA provided a figure in its submission to the AER's Issues Paper[4] (reproduced below) indicating the potential uptake of DNSP-led SAPS, which is dependent on the implementation of a fit-for-purpose regulatory framework and individual DNSP internal business processes.

SAPS will be rolled out when it is cost efficient to do so, and this is primarily driven by high cost to serve customers and a DNSP's retirement strategy (either once assets reach retirement age or experience significant damage that requires material network remediation and investment, for example, as a result of bushfires, or have a high-risk of network failure).

The majority of SAPS that DNSPs are considering are small to medium.

Figure 1: Potential uptake of DNSP SAPS



As mentioned above, we welcome further discussion with the AER on the proposed operation of the per annum revenue cap, the proposed per annum percentage thresholds, and the proposed classification (urban/rural) of DNSPs to then be able compare against the proposed roll-out plans.

1.3 Review period

A mandated SAPS review in 3 years' time will create regulatory and investment uncertainty, which will negatively impact the roll-out of DNSP-led SAPS:

- If the SAPS exemptions framework does not provide investment certainty, financial investment decisions may be curtailed. In addition, to implement SAPS, DNSPs must invest in uplifting the capability of staff and systems, including training and development over a 12-to-18-month period to upskill staff in renewable energy design and site evaluation. DNSPs need certainty to be able to ensure staff are properly trained, have stock ordered / available, undertake the engineering assessment, planning, execution, and all the detailed customer consultation. In some cases, such as

[4] ENA, *Updating the Electricity Distribution Ring-fencing Guideline: Response to the AER Issues Paper – Updating the Ring-fencing Guidelines for Stand-Alone Power Systems and Energy Storage Devices*, 18 December 2020.

in South Australia, DNSPs need to also seek approvals from jurisdictional regulators to decommission rural lines.

The 3-year timeframe is extremely short when considering the cost and effort to address the capability of DNSP to implement SAPS, which will contribute to investments in SAPS not being made. The 3-year review timeframe may therefore disincentive the most long-term efficient investment (due to the lack of certainty) and therefore, "traditional" poles and wires solutions may be deployed, which will not be in the long-term interests of customers.

- Given jurisdictions must opt-in to the AEMC framework and this may occur at different times, the imposition of a 3-year timeframe to undertake a review will be extremely premature for jurisdictions that opt-in late and will serve only to further stifle SAPS rollouts in these areas.
- The timing of the review would also be problematic for DNSPs who expect to be able to build in some degree of SAPS roll-out into their next regulatory proposals. Given engagement on regulatory proposals begins more than two years ahead of the start of the regulatory period, it is unclear how such DNSPs could prepare robust business cases that would withstand the scrutiny of stakeholders, customers and the AER given the uncertainty surrounding such expenditures. In any case, meaningful customer and stakeholder engagement takes time and the 3-year timeframe would likely result in a reduction in the size and scope of any Priority 1 SAPS roll-out.

Competition will open up gradually, under jurisdictional specific timeframes as each jurisdiction opt-ins to the AEMC's framework, and at different paces within each jurisdiction depending on population size, population dispersity, supporting industries etc – this is not compatible with a short, fixed review timeframe applying to all DNSPs equally.

The Rules currently provide the AER with the flexibility to amend the Distribution Guideline in consultation with stakeholders. **We do not consider a mandated SAPS review in 3 years' time is necessary**. DNSPs are generally considering SAPS rollouts over a 5 to 10-year period, therefore, if a mandated review period is deemed necessary, we would suggest that this timeframe is more appropriate.

1.4 Service provision

These proposed changes are focused on enabling DNSPs to roll out DNSP-led SAPS. **The implementation of SAPS exemption categories, however, does not automatically provide the DNSP with exclusivity over service provision. DNSPs will still respond to the incentive regime in practice**, and if over time it emerges that some component of the SAPS service may be efficiently provided through a third-party, DNSPs will pursue this (as they do currently).

1.4.1 Market examples

26 Compliant submissions were received in response to Essential Energy's recent EOI for SAPS services. Of these submissions:

- Companies viewed small SAPS as uneconomical for Power Purchase Agreements (PPA), based on the minimal generation and revenues and variable consumption habits of customers in this category.
- SAPS leasing options contained full capital recovery mechanisms early in the life of the SAPS to reduce risk and ensure an adequate return on investment. This approach simply adds costs to the SAPS which reduces their economic viability and the potential savings that can be passed onto customers.

Of the 26 submissions received, 19 companies provided information on capabilities to complete the full suite of install, servicing, and fault repairs. All proposed business models relied on engaging

subcontractors to complete fault & emergency (F&E) works on the units and requested individual contractual service level agreements be established to detail the service requirements and monthly costs associated with providing this standby service given their existing locations would not meet the F&E and O&M service level requirements that Essential Energy currently operates under.

In addition:

» Most submissions did not provide information on response times. Where information was provided, response times varied from 2-24 hours to receive phone calls, and 2 days to 4 weeks to respond to issues on site, depending on the availability of parts and the conditions agreed to within the service level agreement.

This research validated the expectation that enabling the private sector to complete F&E and O&M activities will introduce substantial ongoing payments to achieve the required reliability and performance standards expected under existing licence conditions, thereby reducing the viability of installing SAPS using the AEMC model.

1.5 Public reporting

To provide transparency and foster the competitive market, ENA **supports the introduction of a publicly available SAPS exemption register that is maintained by each DNSP**.

We are interested in further understanding the information that would be considered valuable to the AER and industry and how we can refine the reporting to make it more relevant and valuable.

1.6 Next steps

We would welcome a meeting between AER, ENA and DNSPs to discuss the proposed operation of the SAPS revenue cap, the proposed percentage thresholds, and the proposed urban/rural classification in further detail.

2 Energy storage devices

Energy storage devices (ESDs) represent an increasingly efficient option to address local network issues such as peak/minimum demand and voltage regulation – DNSPs can currently use ESDs to provide distribution services under the regulatory framework.

The scope of this review is DNSPs' use of ESDs for services not currently classified as distribution services. Distributors can value stack energy storage devices, and provide non-distribution services either:

- indirectly (i.e., through a third party) → an example of this is the United Energy trial, which is installing 40 new pole-mounted battery energy storage system units in the low voltage network as part of a trial to provide network peak demand support (a distribution service). In order to deliver the greatest benefits to consumers and a lower cost outcome for consumers from the installation of the storage units, United Energy is partnering with a retailer selected under a competitive process. The retailer partner will use the storage units to provide non-distribution services.
- directly → an example of this is Ausgrid's virtual trial of a community battery, which provides a community storage solution for solar customers (which is not currently classified as a distribution service) and a more cost-efficient alternative to traditional poles and wires investment to address peak demand (a distribution service).

2.1 Benefits

Without going through a lengthy and costly waiver process, DNSPs are currently unable to increase the viability of ESDs by value-stacking i.e., using the same ESD for multiple purposes – for example, primarily to provide network support (i.e., distribution service) but also, for example, leasing out spare capacity or offering customers access to a shared storage service (i.e., currently non-distribution services).

Enabling value-stacking of ESDs reduces the cost to all consumers of DNSPs providing distribution services and would foster the energy storage market and provide incentives for third parties to enter. This view is supported by consumer advocates who state that:

- Storage systems will play an important role in the future of the NEM, and regulated networks can help enable and accelerate this transition. In additional to the benefits noted in the Issues Paper, allowing network businesses to provide other services from storage devices can help accelerate roll-out and share benefits across more consumers (PIAC, page 3).
- In the face of the unprecedented transformation impacting energy consumers and distribution network businesses, regulatory transformation will be critical in providing downward pressure on SAPS and ESD costs while increasing system efficiencies that benefit all consumers (Strategen for ECA, page 16).

2.2 Framework changes

ENA **supports the AER's position that the ring-fencing framework needs to be able to accommodate energy storage devices, including value stacking, when it results in consumer benefits**. This view is shared by consumer advocates, who state '*Restricting or preventing regulated networks from owning grid-connected storage systems would be overzealous, and risk missing out on opportunities to accelerate prudent investment in storage systems*' (PIAC, page 3).

2.2.1 Amendment of clause 3.1(d)

ENA **does not support the AER's preliminary position to continue with the waiver process for all ESDs applications and instead considers that an amendment of the Distribution Guideline[5] is required to enable DNSPs' *indirect use* of energy storage devices to provide non-distribution services**. This will ensure that customer benefits are not delayed or eroded by a lengthy and costly waiver process for DNSPs' indirect use of energy storage devices.

We would like to understand further the evidence-based concerns of stakeholders and work collaboratively to address these.

2.2.2 Waiver process

DNSPs' direct use of energy storage devices to provide non-distribution services at this stage can continue to rely on the AER's waiver process. However, ENA **strongly supports amendments to the AER's waiver process that streamline the process and decrease regulatory and investment uncertainty,** including:

- the development of a waiver template,
- the implementation of a time limit on the AER waiver approval process,
- the issuing of waivers that last for the life of the asset rather than having to reapply each regulatory control period, and
- an allowance for a future expansion of a waiver-approved rollout.

2.3 Current measures

The **possibility of any harms arising from DNSPs investing in energy storage devices should be addressed directly rather than simply preventing the realisation of consumer benefits** from DNSPs using energy storage devices to provide both distribution and non-distribution services.

Potential harms that could result from cross-subsidising and discriminatory behaviour are currently addressed through the Distribution Guideline by placing a number of obligations on DNSPs, including the requirement to establish and maintain separate accounts and allocation of costs.

In addition, DNSPs prepare and submit annual ring-fencing compliance reports to the AER that include an assessment of compliance undertaken by a qualified independent party. These reports are available publicly on the AER's website, and the AER also publishes an annual ring-fencing report.

With particular respect to non-discrimination obligations, DNSPs have various duties and obligations that effectively prevent DNSPs from engaging in discriminatory behaviour. Some of these include:

- **Non-discrimination obligations** in the Distribution Guideline and ring-fencing training for staff. These obligations are audited on a yearly basis as part of the ring-fencing compliance process.
- **RIT-D obligations** to consider non-network options, allow third parties to present potential alternative solutions, and publish a final assessment report showing the preferred option.
- **Information disclosure obligations** through the Distribution Annual Planning Report and network opportunity maps.
- **Obligations to connect** customers under the open access framework in the National Energy Retail Law (NERL) and associated connection timeframes.
- **Cost allocation obligations** that prevent cross subsidies.

[5] Specifically, an amendment of clause 3.1(d) of the Distribution Guideline to make it clearer that, in addition to 'shared assets' for the purposes of the shared asset rules, it also applies to other circumstances in which third parties might use a DNSP's assets to provide distribution services, transmission services or other services.

2.4 Potential additional measures

Notwithstanding the breadth of the current measures, there are opportunities to further strengthen these obligations, including but not limited to:

- **Introduction of a shared battery register**, similar to the staff sharing register and proposed SAPS exemption register, which shows where DNSP-owned batteries are being used by third parties to provide non-distribution services, the percentage cost allocation between distribution and non-distribution services, and the network need (for distribution service allocation) being addressed. This register would be subject to yearly audit as part of the ring-fencing compliance process.
- **Enhancement to the ring-fencing non-discrimination provisions** to ensure that a distributor cannot discriminate between itself and other third-party providers of ESDs.
- **Development of ESD cost allocation arrangements** that outline a methodology and/or principles for cost allocation for ESDs.

It is **essential that potential harms are addressed directly in a targeted manner rather than preventing the realisation of consumer benefits from DNSPs using energy storage devices**.

DNSPs are regulated under an incentive-based system that continuously encourages networks to find better ways to efficiently service customers. DNSPs will respond to the incentive regime in practice and seek out the most efficient option.

It is important that ring-fencing is not an impediment to DNSPs adopting innovative technologies, and that consumers are able to benefit fully from DNSPs' adoption of technology.

2.5 Next steps

We would welcome a meeting between AER, ENA and DNSPs to discuss further stakeholders' evidence-based concerns, and, if required, potential measures to address these.

There are safeguards to any potential concerns to the emergence of competition and we would be happy to work with the AER and stakeholders on any potential additional safeguards they consider may be necessary. We want to address any root cause of concerns for competition rather than having blanket restrictions, particularly in a time of significant change – the focus should be on measures that serve to ensure that NEM services are delivered most efficiently as possible.