Updating the Electricity Distribution Ring-fencing Guideline

Response to AER Draft Electricity Distribution Ring-fencing Guideline – Version 3

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Energy Networks Australia

Contents

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Key messages

- The **ring-fencing framework needs to adapt to ensure that consumers can benefit from the adoption and use of emerging technologies**. ENA supports a final policy decision that is evidence based, focused on end-customer outcomes and is technology neutral rather than the proposed inflexible asset-based regulation included in the draft.
- ENA **does not support the draft position to continue with the lengthy and costly waiver process for all battery applications**.

  Instead, we propose **a pragmatic size-based exemption approach with strong oversight and transparency measures.** This will enable **distributors to provide efficient innovative customer-focused outcomes, such as community-scale batteries, that also support retail competition**.
- ENA **supports the draft position to introduce a broad-based SAPS exemption**, which will improve customer outcomes, kickstart market development, and incentivise more entry by third parties over time. However, **amendments to the proposed generation revenue cap thresholds are required** to accommodate the timely and efficient deployment of SAPS by DNSPs.

1 Overview

Energy Networks Australia appreciates the opportunity to provide a response to the Australian Energy Regulator's (**AER**) Draft Electricity Distribution Ring-fencing Guideline (Version 3), which proposes changes to the Electricity Distribution Ring-fencing Guideline Version 2[1] (the **Distribution Guideline**) to address emerging technologies such as stand-alone power systems (**SAPS**) and energy storage devices.

Energy Networks Australia (**ENA**) is the national industry body representing Australia's electricity transmission and distribution and gas distribution networks. Our members provide more than 16 million electricity and gas connections to almost every home and business across Australia.

Distributors have an important role to play in facilitating the customer-driven transition to distributed energy, which is supporting Australia's move to a low carbon future. The regulatory framework should facilitate network businesses providing innovative solutions that are in the long-term interests of customers.

To ensure that consumers can benefit from the adoption and use of emerging technologies, further amendments to the Distribution Guideline are required – in particular, the enabling of value-stacking of energy storage devices by distributors without introducing unnecessary time, cost and uncertainty to these projects via a waiver process.

ENA supports a final policy decision that is evidence based, focused on end-customer outcomes and technology neutral rather than the proposed inflexible asset-based regulation included in the draft.

Our feedback on the AER's draft decision reflects our key positions for the ring-fencing framework for the electricity *distribution* network only.

[1] Australian Energy Regulator, *Electricity Distribution Ring-fencing Guideline – Version 2*, October 2017.

2 Energy storage devices

Key messages

- **Enabling value-stacking of energy storage devices reduces the cost to all consumers of DNSPs providing distribution services** and would foster the energy storage market, provide incentives for third parties to enter, and support retail competition.
- ENA **does not support the draft position to continue with the lengthy and costly waiver process for all energy storage applications**.

  Instead, we propose **a pragmatic size-based exemption approach with strong oversight and transparency measures.** This will enable **distributors to provide efficient innovative customer focused outcomes that also support retail competition**.
- The possibility of any harms arising from DNSPs investing in energy storage devices can and should be **addressed directly in a proportionate and targeted manner**, rather than applying inflexible asset-based regulation. We **support an enhancement to the ring-fencing non-discrimination provisions, and the introduction of public shared ESD registers**.
- The focus needs to be the delivery of positive customer outcomes. Ring-fencing obligations should represent a targeted, proportionate, and effective regulatory response to the potential harm faced by consumers – **it should not extend to creating technology-specific obligations that inhibit the development and use of those technologies** for the provision of distribution services.
- **Need to avoid the risks of repeating the consequences of the metering competition reform**, which resulted in poor customer outcomes.

2.1 ESDs – provision of distribution services

Australia's energy system is undergoing a significant transition, moving away from large, centralised coal and gas generation to smaller scale dispersed generation that is increasingly renewable generation.

Distributors have an important role to play in facilitating the customer-driven transition to distributed energy, which is supporting Australia's move to a low carbon future.

Energy storage devices (**ESDs**), sometimes more commonly referred to as batteries, represent an increasingly efficient option to address local network issues such as peak/minimum demand, and voltage regulation to enable additional hosting of distributed generation – DNSPs can currently use ESDs to provide distribution services under the regulatory framework either with their own ESD or by seeking services from third party providers.

As noted by the AER, the scope of the ring-fencing review is DNSPs' use of ESDs to provide services other than distribution services. However, to provide context on the competitive battery market for the provision of distribution services and to address unevidenced claims stated at AER public forums, we have included examples below on DNSP interactions with non-network solution providers.

The examples clearly demonstrate a willingness on the part of DNSPs to support third party owned energy storage solutions contrary to anecdotal suggestions of uncooperative and/or discriminatory network behaviour.

2.1.1 Case Study 1: Endeavour Energy – South Penrith network deferral

Endeavour Energy's FY19 Distribution Annual Planning Report (**DAPR**) included information on an emerging constraint in the South Penrith area. Based on demand forecasts, it was expected that a new zone substation would be required by FY23 to address the need, subject to a RIT-D assessment.

During the 'options analysis and case for investment' stage of Endeavour Energy's investment governance framework, which aligns to the AER's Regulatory Investment Test for Distribution (**RIT-D**), Endeavour Energy typically identifies short-term measures to defer the network investment. Following the exhaustion of these options, the network option becomes credible, and a RIT-D process is triggered to solicit longer term non-network solutions.

During this phase Endeavour Energy received an unsolicited offer from a third party based on the information contained in its DAPR in April 2020. The third party proposed a grid connected battery to curtail peak demand and defer a traditional network solution.

To Endeavour Energy's knowledge this would be the first large-scale independently owned grid-connected battery in Australia. The battery forms part of the Emerging Energy Program, a NSW Government Clean Energy initiative that provides funding to assist in the development of innovative, large-scale electricity and storage projects in NSW. The third party has made a connection application to connect a 20MVA/40MWh unit to the 11kV busbar at Penrith Zone Substation. As an independently owned battery the third party would unlock the full value stack of the battery.

Endeavour Energy's understanding is that the main sources of income would be energy arbitrage against the NEM spot market and frequency support to the Australian Energy Market Operator through the frequency control ancillary support market. A relatively small portion of the value would be provided by Endeavour Energy in the form of network support payments.

Whilst the network support payments would form a relatively smaller component of the value stack, Endeavour Energy committed to supporting the third party in its efforts to secure a grant from ARENA for financial assistance and liaising with the AER on RIT-D compliance.

In addition, Endeavour Energy committed to providing:

- Engineering resources to assist with issues affecting control, protection, and operation of the Endeavour network at the grid battery location.
- Provision of data from its Penrith Zone Substation, for example power quality data, to assist in understanding any impacts of the battery operation on the network and vice versa.
- Coordinating the deployment of thousands of customer smart meters to enable removal of the AFIC system for hot water control and enable split bus operation at Penrith.
- Sharing of the smart meter data with the third party to assist in evaluation of the battery system operation.

Endeavour Energy held discussions with the AER in September 2020 and wrote to the AER in February 2021 to confirm that its intention to enter into a Network Support Agreement (**NSA**) with the third party was compliant with the RIT-D (and potentially Demand Management Incentive Scheme) requirements. This included providing assurance that this NSA represented the lowest cost/highest value solution and that a RIT-D process would be unlikely to uncover better options at the expense of precluding this third party from offering support given its financial and technical timeline requirements.

It should be noted that the value of the network deferral has reduced (via the discount rates applied) in line with the application of the 2018 Rate of Return Instrument (**RORI**) to Endeavour Energy from FY20 in accordance with declining interest rates.

The third party has been appreciative of Endeavour Energy's information sharing and proactive support in obtaining its ARENA application, overcoming regulatory constraints and supporting the development of a competitive, third party, non-network energy storage service provider market. Overall, Endeavour Energy invested significant time and resources in supporting this third-party proposal.

Whilst there will be difficulties associated with incorporating new technologies and solutions in the regulatory framework, these difficulties are not reflective of a lack of effort or support from Endeavour Energy. Instead, Endeavour Energy's efforts serve as compelling evidence that Endeavour Energy has been going above and beyond regulatory requirements to support third party owned energy storage solutions contrary to suggestions of uncooperative and/or discriminatory network behaviour.

2.1.2 Case Study 2: CitiPower, Powercor and United Energy

In the past four years CitiPower and Powercor have conducted four RIT-Ds. As part of these processes, they:

- received no formal proposals from third party providers for energy storage.
- received a number of informal queries, however, when further information was provided with regard to the nature of the constraint and size of the solution required, this did not lead to any formal submissions. Informal queries were received from councils and community groups, and large-scale generator suppliers.

United Energy have undertaken three RIT-Ds. United Energy received six formal submissions, including a mix of large customer or large site curtailment, virtual power plant (**VPP**) solutions and diesel generators. A number of proposals were inadequate with regard to size of the solution, i.e., insufficient demand deferral. United Energy progressed with the remaining proposals, seeking to refine the detail and agree the terms and conditions.

However, after negotiations United Energy was unable to agree on terms such as:

- low network support payments based on the record low AER allowed cost of capital, and
- uncertainty of future payments due to uncertainty around the ongoing requirement for the solution.

CitiPower, Powercor and United Energy's learnings and feedback from third parties has been that for those proposals that include customer curtailment or participation, they needed more time to review/analyse network requirements, and survey and engage customers to develop demand management capability.

In response to this feedback, CitiPower, Powercor and United Energy started running annual DAPR forums to foreshadow upcoming constraints. They also share information (such as area map/feeder map/details on constraints including load duration curves etc.) with interested parties so that they put forward credible solutions when responding to a RIT-D.

CitiPower, Powercor and United Energy's experience with the deferrals in the LV network is that if the supply area has larger customers, economic solutions are likely. However, if the supply areas are residential, procurement of demand management solutions is challenging due to the cost of recruitment and insecurity of delivery.

2.2 ESDs – value-stacking

ENA does not support the AER's draft position to continue with the lengthy and costly waiver process for all energy storage applications. The possibility of any harms arising from DNSPs investing in energy storage devices can and should be addressed directly in a proportionate and targeted manner, rather than applying inflexible asset-based regulation.

Without going through the proposed 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 to a third-party who might, for example, provide services in other markets or offer access to the battery as a shared storage service (i.e., currently non-distribution services).

Introducing unnecessary time, cost, and uncertainty to DNSPs' energy storage projects via the proposed waiver process will constrain networks' ability to enter into partnerships and will reduce the commercial viability and competitiveness of using ESDs to provide distribution services. It is critical that multiple revenue streams are accessed via value-stacking given the cost of ESDs relative to traditional 'poles and wires' network solutions.

Value-stacking is key to ensuring efficient deployment of batteries, but it is difficult and unwise to presume how value stacking might best occur in every circumstance, and therefore flexibility coupled with strong safeguards, is required.

Enabling value-stacking of ESDs reduces the cost to all consumers of DNSPs providing distribution services and would foster the energy storage market, provide incentives for third parties to enter, and support retail competition. This view is supported by consumer advocates, as demonstrated by the feedback highlighted in **Figure 1**.

Figure 1: Feedback to the AER's Electricity Distribution Ring-fencing Review Issues Paper

Public Interest Advocacy Centre (PIAC)

*"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 submission

Simply Energy/PIAC/Ausgrid

*"Distribution level batteries can play an important role in this transition and help lower the overall costs of the supply chain. This can be achieved by **allowing network businesses to provide other services from storage devices and share the value** across a range of stakeholders"*

- Simply Energy, PIAC & Ausgrid submission

Energy Consumers Australia

*"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"*

- ECA (Strategen) submission

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, such as the Public Interest Advocacy Centre which states, '*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.*'[2]

The AER's Demand Management Incentive Scheme (**DMIS**) recognises that a distributor might provide the demand management component of an eligible project inhouse subject to certain criteria. The DMIS recognises that customer outcomes may sometimes be maximised by inhouse DNSP options and this

[2] Public Interest Advocacy Centre, *Submission to AER ring-fencing issues paper*, 22 December 2020 [emphasis added].

requires competitive testing and a CEO declaration. Whereas, to maximise customer benefits by value-stacking energy storage projects, under the draft, distributors will require external AER Board approval via a lengthy and costly waiver approval process.

2.3 Potential harms and responses

Ring-fencing is the identification and separation of these regulated activities, costs and revenues from those associated with the network providing services in a competitive market and aims to prevent the harm that could result from cross-subsidising and discriminatory behaviour.

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.

With 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 DAPR and network opportunity maps, which requires the publication of extensive information to all parties on emerging network issues and constraints.
- **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.

The AER also assesses, and reviews costs that DNSPs propose via the regulatory reset process and has the discretion to undertake an ex-post assessment if required. The Australian Competition and Consumer Competition also monitors anti-competitive conduct in Australia.

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.

Importantly, the benefit, or likely benefit, to consumers of a network business complying with ring-fencing obligations must outweigh the cost to the network provider of complying with that obligation.

Ring-fencing obligations should represent a targeted, proportionate and effective regulatory response to the potential harm faced by consumers. They should not extend to creating technology-specific obligations that impede the development and use of those technologies for the provision of distribution services.

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 irrespective of which party provides the service or owns the underlying storage asset.

The AER's draft explanatory statement[3] outlines four potential harms arising from DNSPs value-stacking ESDs, which appear to be stemming from an unevidenced perception that that DNSPs may leverage their monopoly role and access to information to dominate batteries.

We outline in the following sections how the existing framework addresses these potential harms but nonetheless our support for the introduction of additional strengthened obligations to provide the AER and stakeholders with further transparency and confidence in the ring-fencing framework.

2.3.1 Access arrangements

Stakeholders have stated that potential conflicts could arise where a DNSP provides itself with preferential access to its network through the setting of access arrangements, giving the DNSP's battery a competitive advantage.

As rightly stated in the AER's draft, access arrangements are determined by the regulator at the time of the regulatory reset and any concerns with a distributor's connection arrangements can and should be addressed through the AER's approval process or subsequent complaints process.

The existing regulatory framework therefore already addresses this perceived harm raised by stakeholders.

2.3.2 Tariffs and charges

Stakeholders have stated that potential conflicts could arise where a DNSP provides itself with preferential distribution use of system charges for use of its network, reducing trading costs and, in turn, possibly giving its battery a competitive advantage.

In the AER's recent Victorian Tariff Structure Statement (**TSS**) final decision, it was determined that ownership of batteries should not be the basis for differential tariff treatment. Under the National Electricity Rules, DNSPs are required to comply with their AER approved TSS.

The existing regulatory framework therefore already addresses this perceived harm raised by stakeholders.

2.3.3 Preferential network use

Stakeholders have stated that, with the use of 'dynamic operating envelopes', a DNSP could have incentives to improve access to its own battery, thereby adding value to its battery, and/or limiting access to third party batteries.

Operation and dispatch will be automated and governed by algorithms and control devices that operate in accordance to pre-programmed settings and protocols to meet the needs of the system. It is simply unrealistic to suggest that DNSPs would interfere with complex and dynamic automated processes based on real-time data to discriminate the use of an ESD based on ownership – a suggestion also predicated on the view that distributors would be willing to intentionally breach the ring-fencing guideline.

Nonetheless, ENA supports the AER's proposed enhancement to the ring-fencing non-discrimination provisions to ensure that a distributor cannot discriminate between itself and other third-party providers of ESDs. ENA recommended the introduction of such a provision in our submission to the issues paper as

[3] Australian Energy Regulator, *Draft electricity distribution ring-fencing guideline – Explanatory Statement – Draft Guideline – Version 3*, May 2021, Section 3.2.

a proportionate and targeted way to strengthen the existing ring-fencing obligations, and we continue to support its introduction.

Distributors must also abide by the externally approved access arrangements as outlined in Section 2.3.1.

The existing regulatory framework, with the addition of the proposed strengthened obligation, therefore appropriately addresses this perceived harm raised by stakeholders.

2.3.4 Cost allocation and cross-subsidisation concerns:

Stakeholders have raised the potential for cross-subsidisation of contestable services with revenue from regulated services, distorting competitive markets.

DNSPs prepare and submit annual ring-fencing compliance reports to the AER that include an assessment of compliance undertaken by a qualified independent party. DNSPs also submit RINs to the AER on an annual basis that include detailed externally audited expenditure information.

A clear, reasonable, and transparent process for allocating a proportion of the costs of the battery to the provision of regulated services will be considered for each individual value-stacking opportunity, as proposed by the AER in the draft. This information could be included in an external publicly available shared battery register that is developed and updated by distributors.

The existing regulatory framework, tailored as above for the value-stacking of ESDs, therefore addresses this perceived harm raised by stakeholders.

2.4 ENA proposal

To ensure that consumers can fully benefit from the introduction and integration of these emerging technologies, but also balancing stakeholders' concerns, we propose a pragmatic size-based exemption approach with strong transparency and oversight measures.

The exemption framework will have the following conditions:

- **Size-based:** DNSPs can value-stack ESDs without a waiver but it will be limited to ESDs up to 1MW in size.
- **Oversight:** the AER can vary or revoke the DNSP's exemption to provide non-distribution services using a battery system up to this size with at least 90 business days' notice. Importantly, to ensure investment and regulatory certainty, existing installations would be grand-fathered, and value-stacking opportunities that have commenced the internal investment planning cycle allowed to progress.
- **Transparency:** DNSPs must publish information similar in scope to the AER's draft waiver assessment guidance as appropriate, with publication required as soon as reasonably practicable for each installation.

Implementation of this targeted proposal will enable distributors to provide efficient innovative customer-focused outcomes (such as community-scale battery services) that also support retail competition by ensuring that all retailers, irrespective of size, have the opportunity to offer their customers community-scale battery solutions. Allowing DNSPs to value-stack ESDs, under strict criteria and with implementation of the additional strengthened obligations proposed in Section 2.3, will foster the energy storage market and provide incentives for third parties to enter.

This approach also seeks to mitigate the risks of the same sub-optimal customer outcomes from the competition in metering competition rule change occurring because of this review. The competitive

metering market has not delivered the innovation needed to realise the full value to consumers and there is a risk of this occurring again if distributors are blocked from the energy storage market.

2.5 Key recommendations

Key recommendations – Energy storage devices

ENA recommends the following key amendments to the draft position, which will ensure that consumers can fully benefit from networks' adoption and use of energy storage technologies:

- Introduce a size-based exemption approach with the oversight and transparency measures as proposed in Section 2.4.
- Confirm that the assignment of incidental revenue from metered batteries does not constitute the granting of a right to use the DNSP battery (installed solely for network purposes) to other legal entities.[4] ENA does not consider that it is the AER's intent for this to require a waiver and would appreciate explicit confirmation of this in the final decision.

ENA also strongly recommends that the AER undertakes further engagement with councils, small retailers, and end-use customers to ensure that the final decision integrates their feedback. We support an extension to the AER's final decision to enable this if necessary.

[4] Although we do not consider it to be the AER's intent, the draft's proposed prohibition on granting other legal entities the right to use DNSP batteries may also have the unintended consequence of preventing DNSPs from installing market metering on new and existing network batteries or require waivers. In most circumstances, network batteries will be charging when wholesale market prices are low and discharging when wholesale market prices are high – this will result in wholesale market revenue for the assigned Financial Responsible Market Participant (FRMP). This is because the assignment of the net revenue from the battery to a FRMP may constitute a right of use.

Recent rule changes to establish Global Settlements require every connection point to have metering. Prior to the introduction of Global Settlements, the NER allowed the entirety of generation to be purchased by, and consumption from franchise loads allocated to, the Local Retailer. After the Global Settlement rule changes come into effect on 1 October 2021, all generation must be metered due to changes to clause 2.2.5.

Consequently, DNSPs may need to apply for a waiver for every existing network and every new battery installed solely for network purposes. Existing batteries already funded by a DNSPs' demand management incentive scheme and innovation allowance may also need waivers. This represents an unnecessary regulatory burden and is not considered to be the intent of the AER's draft position on ESDs.

3 Stand-alone power systems

Key messages

- **SAPS can provide a cost-efficient alternative** to traditional poles and wires investment, increasing reliability and safety for SAPS connected customers, and lowering costs for all customers over time.
- ENA **supports the draft position to introduce a broad-based SAPS exemption** designed to allow a DNSP to earn revenue from SAPS generating systems up to a given percentage of a DNSP's annual revenue requirement (SAPS generation revenue cap) → a broad-based exemption **will improve customer outcomes, kickstart market development, and incentivise more entry by third parties over time**.
- A **broad-based approach is strongly preferable to designing a list of specific exemption categories,** which might result in inadequately defined definitions, categories that may not be fit for purpose over time and may fail to identify all circumstances in which an exemption ought to apply given the infancy of the market.
- However, **amendments to the DNSP categorisation & thresholds for the SAPS revenue cap are required** to accommodate the timely and efficient deployment of SAPS by DNSPs.
- 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.

3.1 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 Australian Energy Market Commission's (**AEMC**) SAPS framework restricts distribution network service providers (**DNSPs**) from 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 introduction of a broad-based SAPS exemption in the Distribution Guideline designed to allow a DNSP to earn revenue from SAPS generating systems up to a given percentage of a DNSP's annual revenue requirement (SAPS generation revenue cap). This approach will enable a DNSP-led SAPS roll-out, which will improve customer outcomes, kickstart market development, and incentivise more entry by third parties over time.

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.

ENA understands from discussions with AER staff leading the review that currently installed SAPS will not be taken into account in a DNSPs' SAPS generation revenue cap – we support this position and request specific confirmation of this in the AER's final decision.

ENA also supports:

- the AER's draft position that temporary SAPS – that is, SAPS that are used to provide assistance to the extent necessary to respond to an event that is 'beyond a DNSPs reasonable control' – should not be included in the DNSP's SAPS revenue cap, and

» the AER's proposed approach to provide certainty for SAPS assets that have been deployed under the exemption approach, even if the annual generation revenue cap subsequently changes.

3.2 Exemption thresholds

ENA presented a map in our Issues Paper submission[5] showing the potential likelihood of the SAPS rollouts to provide some contextual information about the possible scale, and the importance of getting the right flexible outcomes in place. This was largely based on rough estimates at a point in time, mainly sourced from high-level figures provided as part of the AEMC's SAPS review, which commenced in 2018 when there was a high-level of uncertainty about the legal and regulatory framework for SAPS. For most DNSPs these figures were not the result of an in-depth analysis of opportunities but rather a high-level verbal indication of possible opportunities.

This map was never intended to be used in a deterministic way and we strongly caution against the use of these figures to develop hard coded thresholds in the Distribution Guideline. As demonstrated in **Table 1**, this results in unsuitably low thresholds being applied. For example, the majority of DNSPs would only be able to roll out between 0.8 and 8.6 20kW SAPS in total before having to apply for a waiver, which will not accommodate the timely and efficient rollout of DNSP-led SAPS.

Table 1: AER draft decision – SAPS generation revenue cap categorisation and thresholds

Category	DNSP	Proposed AER SAPS gen. revenue cap (%)	Number of indicative 20kW SAPS under cap[6]
Category 1	Ergon Energy	0.20% of annual revenue requirement (ARR)	1,492.4
	Essential Energy		961.2
Category 2	AusNet Services	0.07% of ARR	271.8
Category 3	Ausgrid	0.001% of ARR	7.9
	Endeavour Energy		4.9
	Powercor		3.7
	SA Power Networks		4.8
	TasNetworks		2.2
	CitiPower		1.8
	Evoenergy		0.8
	Jemena		1.6
	Power and Water Corporation		1.1
	United Energy		2.5
	Energex		8.6

[5] Energy Networks Australia, *Updating the Electricity Distribution Ring-fencing Guideline – Response to AER Issues Paper*, 18 December 2020, Figure 1.

[6] Calculated based on information sourced from Appendix C (SAPS Generation revenue cap calculation) of the AER's Draft electricity distribution ring-fencing guideline – Explanatory Statement – Draft Guideline – Version 3, May 2021.

Formal implementation of the DNSP-led (i.e., Priority 1) SAPS framework is still yet to occur. It is therefore very difficult to provide accurate estimates for every DNSP as most have not formally developed a SAPS strategy given the lack of clarity on how the framework will apply in practice.

Section 3.2.1 instead outlines ENA's alternate proposal to accommodate the timely and efficient rollout of DNSP-led SAPS.

3.2.1 Alternate proposal

DNSPs submit annual Regulatory Information Notices (**RINs**) to the AER that contain externally audited operational and financial network specific information. The annual Economic Benchmarking RIN includes operating environment information including the DNSP's 'rural proportion', which is calculated as the short and long rural route line length divided by total route line length – with the latest available data shown in **Table 2**.

Table 2: Rural proportion of distribution network service providers

DNSP	Rural Proportion
Ergon Energy	95.5%
AusNet Services	92.6%
Power and Water Corporation	92.2%
Powercor	91.6%
Essential Energy	88.5%
SA Power Networks	79.9%
TasNetworks	55.5%
Evoenergy	49.0%
Endeavour Energy	48.6%
Ausgrid	44.4%
Energex	37.3%
Jemena	26.2%
United Energy	26.0%
CitiPower	0.0%

**Source: 2019-20 and 2020 Economic Benchmarking RINs - Table 3.7.2*

ENA supports different per annum revenue cap thresholds being developed for urban and rural DNSPs. ENA therefore proposes that the DNSPs are categorised for the purpose of SAPS generation revenue cap thresholds based on the proportion of their route line that is classified as rural. **Table 3** outlines the proposed three categories, which are more evenly dispersed than those proposed in the draft decision, and the basis for their categorisation.

Table 3: ENA proposed – categorisation of DNSPs

Category	DNSP	Basis of Categorisation
Category 1	Ergon Energy	80-100% rural proportion
	AusNet Services	
	Power and Water Corporation	
	Powercor	
	Essential Energy	
Category 2	SA Power Networks	50-80% rural proportion
	TasNetworks	
Category 3	Evoenergy	0-50% rural proportion
	Endeavour Energy	
	Ausgrid	
	Energex	
	Jemena	
	United Energy	
	CitiPower	

Table 4 on the following page outlines the proposed generation revenue cap thresholds for each of the three proposed categories, and the estimated number of indicative 20kW SAPS under the cap.

Table 4: ENA proposed – SAPS generation revenue cap categorisation and thresholds

Category	DNSP	Proposed ENA SAPS gen. revenue cap (%)	Number of indicative 20kW SAPS under cap[7]
Category 1	Ergon Energy	0.20% of annual revenue requirement (ARR)	1,492.4
	AusNet Services		776.6
	Power and Water Corporation		211.0
	Powercor		735.9
	Essential Energy		961.2
Category 2	SA Power Networks	0.07% of ARR	339.3
	TasNetworks		151.3
Category 3	Evoenergy	0.02% of ARR	15.3
	Endeavour Energy		97.8
	Ausgrid		157.0
	Energex		172.9
	Jemena		32.5
	United Energy		50.6
	CitiPower		36.2

As noted above, it is very difficult to provide accurate alternate estimates for every DNSP as most have not formally developed a SAPS strategy given the lack of clarity on how the framework will apply in practice. However, ENA's proposed categorisation and thresholds provide an appropriate level of flexibility as the market for SAPS develops, recognising the need to provide investment certainty and to address the early stages of SAPS competitive market development, particularly in remote areas as recognised in the AEMC's final report.[8]

In addition, to implement SAPS effectively, 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. DNSPs need certainty to be able to ensure staff are properly trained, have an adequate number of SAPS, undertake the engineering assessments, planning, execution, and all the detailed customer consultation. In some cases, such as in South Australia, DNSPs need to also seek approvals from jurisdictional regulators to decommission rural lines.

It should be noted that DNSPs are not incentivised to compete for SAPS generation revenue. DNSPs operate under a revenue cap and the AEMC's rules package includes an amendment to clause 6.4.4(c)(3) of the National Electricity Rules that allows the AER to deduct revenue earned by a DNSP from the sale of energy from a SAPS from the DNSP's revenue allowance.[9]

[7] Calculated based on information and sourced from Appendix C (SAPS Generation revenue cap calculation) of the AER's Draft electricity distribution ring-fencing guideline – Explanatory Statement – Draft Guideline – Version 3, May 2021.

[8] Australian Energy Market Commission, *Updating the Regulatory Frameworks for Distributor-led Stand-alone Power Systems*, 28 May 2020, page 52.

[9] Proposed clause 6.6.4(c)(3) of the National Energy Rules – 'Shared assets – under the Energy Ministers Legislative Amendments Consultation on Revised National Electricity Rules and National Energy Retail Rules.

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 asset 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).

High cost to serve customers are generally situated at the geographical fringe of a network, where there are a very small percentage of customers that require a material proportion of the length of the installed network. For example, around 17 per cent of the length of Essential Energy's installed network serves just 0.5 per cent of Essential Energy's customer base. Areas with high maintenance costs, difficult to access sites, and sites with a high bushfire risk are also candidates for SAPS.

3.2.2 Waiver process

ENA is strongly supportive of the AER's draft 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 efficient approach than requiring waivers for individual SAPS over the generation revenue cap threshold.

We also support the AER's proposal to amend the guideline to allow it to grant a SAPS waiver (i.e., to exceed the initial revenue cap) for a term that is not linked to the DNSP's current or next regulatory control period.

This will provide the flexibility for the AER to set longer waiver terms, including:

- for an ongoing increase in the initial revenue cap, a waiver term that extends beyond the end of the next regulatory control period; and
- for each individual SAPS, a waiver term that aligns with the life of the SAPS.

As ENA understands it, the proposed clause 5.3.4(c)[10] is intended to address these matters (allow a waiver for an ongoing increase in the initial generation revenue cap and address the length of the waiver term).

3.3 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 DNSPs 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).

3.3.1 Market testing

Essential Energy recently undertook an expression of interest for SAPS services and received 26 compliant submissions. Of these submissions:

- Companies viewed small SAPS as uneconomical for Power Purchase Agreements, based on the minimal generation and revenues and variable consumption habits of customers in this category.

[10] Proposed clause 5.3.4(c): "in the case of a waiver of clause 3.1 of this Guideline in relation to the use of a stand-alone power system, for a different term or terms; and".

» 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 and 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 operating and maintenance (**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 to 24 hours to receive phone calls, and two days to four 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, at this stage in SAPS market development, requiring 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.

3.4 Public transparency

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.

The AER's draft requires a DNSP to establish, maintain and keep a register for instances where the DNSP provides SAPS generation services. The proposed reporting requirements at draft clause 6.2.3 strike an appropriate balance between the benefits of external transparency and the costs of regulatory reporting, which are borne by end-use customers. ENA therefore does not support a further expansion of the proposed reporting requirements.

In addition to the publicly available SAPS register, a DSNPs' compliance with its SAPS generation revenue cap threshold will be reviewed by an independent auditor as part of the annual ring-fencing audit and reported in the accompanying annual ring-fencing compliance report as per the existing Distribution Guideline's compliance requirements.

The AEMC's SAPS framework also includes customer engagement obligations, which require DNSPs to undertake a comprehensive program of information provision and consumer engagement where the DNSP has identified SAPS supply as being the most efficient means of continuing to supply a customer/s with energy.[11]

[11] Proposed clause 5.13B.2 of the National Energy Rules – 'SAPS customer engagement strategy' – under the Energy Ministers Legislative Amendments Consultation on Revised National Electricity Rules and National Energy Retail Rules.

3.5 Key recommendations

Key recommendations – SAPS

ENA recommends the following key amendments to the draft position, which will ensure that a fit-for-purpose SAPS ring-fencing framework is implemented:

- Update the SAPS generation revenue cap categories and thresholds to that proposed in **Table 4** to accommodate the timely and efficient roll out of DNSP-led SAPS.
- Provide confirmation in the final decision that currently installed SAPS will not be taken into account in a DNSPs' SAPS generation revenue cap.

4 Minor amendments

Key messages

- ENA supports an enhancement of the current publicly available staff-sharing registers and considers that mandated half-yearly updates are appropriate.
- ENA supports the AER's proposal to amend the title of the term 'confidential information' to 'ring-fenced information' to avoid the general misconceptions regarding 'confidential information'.
- ENA welcomes and supports an increase to the breach reporting timeframe. However, the reporting of all breaches, including trivial breaches, within this timeframe will create unnecessary burden on DNSPs and impose costs on consumers. Immaterial breaches should instead be reported to the AER via the comprehensive annual ring-fencing compliance report.
- ENA supports the introduction of calendar year compliance reporting for the Distribution Guideline. ENA welcomes confirmation from the AER of the proposed new transitional arrangement clause 7.2 as soon as practicable given current audit timing requirements.

4.1 Staff sharing and information access and disclosure

ENA supports the proposed enhancement to the current publicly available staff-sharing registers and considers it an effective way to strengthen the transparency of staff sharing arrangements between a DNSP and its affiliates. However, half-yearly updates (rather than quarterly updates) strike the right balance between additional transparency benefits and the administrative burden on DNSPs.

In addition, ENA supports the AER's proposal to amend the title of the term 'confidential information' to 'ring-fenced information to avoid the general misconceptions regarding 'confidential information'. We note, however, that there is no intention to amend the original definition i.e., 'ring-fenced information' would be defined as per the current Distribution Guideline's definition of 'confidential information'.

4.2 Materiality of breaches

ENA welcomes and supports an increase to the breach reporting timeframe to 15 business days.

We do not, however, support the reporting of all breaches within this timeframe, including, by the AER's definition[12], the reporting of all trivial breaches. This will create unnecessary burden on DNSPs and impose costs on consumers, and therefore does not represent a targeted and proportionate ring-fencing obligation. Immaterial breaches should instead continue to be reported to the AER via the comprehensive annual ring-fencing compliance report.

4.3 Timing of annual compliance reports

ENA supports the introduction of calendar year compliance reporting for the Distribution Guideline, which will assist networks' resourcing requirements by helping to spread the workload of many compliance teams who are already busy with RIN audits.

[12] The AER's interpretation of 'material' in the context of a breach is that it means 'something that is more than trivial'.

We also support the AER's position that DNSPs will be able to rely on information obtained from their most recent financial year audit in relation to their cost allocation obligations under the Distribution Guideline. It would be an expensive, unbudgeted cost to consumers if the AER were to instead expect another full audit of cost allocation six-months after the last review.

We also support including a transitional arrangement in the guideline, and ENA welcomes confirmation from the AER of the proposed new transitional arrangement clause 7.2 as soon as practicable given current audit timing requirements.

4.4 Key recommendations

Key recommendations – Minor amendments

ENA recommends the following key amendments to the draft position, which will ensure that the updates strike an appropriate balance with the administrative burden on DNSPs:

- Update proposed clause 4.2.4(b) to require DNSPs to publish updated registers to the website every six months rather than every three months.
- Require immaterial breaches to be reported to the AER via the comprehensive annual ring-fencing compliance report.