Informal feedback post ENA/AER meeting

AER Electricity Distribution Ring-fencing Guideline Review

Please note that this represents informal ENA feedback post the ENA/AER discussion on energy storage discussions in September 2021.

1 Overview

- ENA welcomes and strongly supports the AER Chair's recognition in the recently released 2021-22 AER Corporate Plan that the AER must support, via updated Ring-fencing Guidelines, the uptake of Stand Alone Power Systems and Community Batteries.[1]
- Enabling value-stacking of energy storage devices (**ESDs**) reduces the cost to all consumers of distribution network service providers (**DNSPs**) providing distribution services and would foster the energy storage market, provide incentives for third parties to enter, and support retail competition.
- Ring-fencing waivers add time, cost and uncertainty to energy storage projects. A streamlined waiver process will not address the investment uncertainty that is inherent in the waiver process and is not a practical nor innovative solution to enabling technologies such as community batteries.
- We recommend that further consideration be given to what the waiver process is seeking to achieve and the potential harms that it is seeking to address. Feedback from stakeholders about potential harms arising from DNSPs value stacking ESDs is largely focused on potential discriminatory behaviour, and cross subsidisation concerns.

  ENA supports the development of direct and transparent safeguards built into the *Electricity Distribution Ringfencing Guideline* that directly target these concerns rather than a continuation of the waiver process in all cases, irrespective of whether it is streamlined.
- To meet strong consumer and community support and demand for network-led roll-out of technologies such as community batteries, ENA recommends the following amendments, all designed to work collectively in practice:
  - Introduction of additional safeguards to provide the AER and stakeholders with further transparency and confidence in the ring-fencing framework,
  - Introduction of a size-based exemption approach with strong oversight and transparency measures, and
  - Introduction of a streamlined waiver process that would apply in circumstances that don't meet the proposed size-based exemption criteria.
- Implementation of a size-based exemption approach for ESDs does not automatically provide the DNSP with exclusivity over service provision. ENA's approach does not mandate a particular approach or propose that DNSPs will be the most efficient service delivery option in all cases, but rather it enables more options for consumers to benefit from the adoption of technologies with the support of targeted, proportionate, and effective regulation.

  DNSPs will continue to 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.

[1] ACCC and AER, ACCC and AER Corporate Plan: 2021-22, Message from AER Chair, Clare Savage, August 2021.

2 Energy storage devices

2.1 Background

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.

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 ESDs can and should be addressed directly in a proportionate and targeted manner, rather than applying inflexible asset-based regulation.

2.2 Concerns with the AER draft approach

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 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 appropriate safeguards, is required.

2.2.1 Stakeholder submissions

Stakeholder submissions to the AER's draft decision also highlighted concerns with the proposed approach to rely on ring-fencing waivers:

*"We **question whether requiring distribution networks to obtain a waiver for each community battery represents prudent and necessary regulation when the effect is to discourage investment** in the kind of sustainable and innovative services that we, as their customers, desire. We advise that the rule proposed by the AER runs contrary to our expectation that innovations in energy technologies including shared storage devices and electric vehicle fast charging become more readily accessible to our community, not less so." –* Blacktown City Council submission.

*"To achieve the most cost competitive outcome, we think that the regulatory framework should be designed to encourage a wide range of competitive market players. We **think that effectively preventing DNSP participation (by imposing tough ringfencing requirements) is needlessly removing a potentially competitive market participant**." And "**Regulating one of the best potential market participants out of a market, before the market has even been established, based on no actual evidence, does not seem to be in the interests of consumers**." –* Ecojoule Energy submission.

"I well understand that the regulation of the ownership, location and operation of community batteries will be complex, but surely this can be managed given the long term benefits for the community. ***The ring-fencing rules must not be allowed to delay the rollout of a large number of community batteries****"* – Peter Youll (private citizen) submission.

"For that reason, ***we do not support the draft Guideline's proposal to specifically require a ring-fencing waiver for the leasing of distributor-owned batteries to provide contestable services****. The* ***need to obtain a ring-fencing waiver would delay investments in community battery projects*** *and significantly increase the regulatory uncertainty and costs for potential participants that would lease the excess battery capacity."* – Ausgrid/Simply Energy/PIAC combined submission.

2.3 Waiver process

Ring-fencing waivers add time, cost and uncertainty to energy storage projects. For example, United Energy's recent ring-fencing waiver (pole-mounted battery trial) cost close to $100,000 to acquire.[2] It also took around 12-months to organise and get approved, which led to an equal delay in the implementation of the project.

The waiver process has an immediate cooling effect on investor appetite. Without the certainty the project will go ahead, or when it will go ahead, all processes related to the implementation of the project are effectively stalled. For example, the AER requires a waiver for leasing of the battery, however the waiver process itself can be a cause of the delay in the negotiation of the value and timing of the lease.

The transaction costs of the lease of the battery are increased through the waiver process, and customers can then miss out both through wholesale market value and lower network costs by the delays and the uncertainty caused by the waiver process.

The trade-off between the cost of the waiver and the transaction costs caused by the waiver delays, and the value of the lease, would be a key determinant in the decision on whether to lease the battery and unlocking its full value. The ratio of transaction costs to the size of the battery is also a significant factor – the cost and time of the wavier is the same for a very large battery and a community battery, however the ratio of the cost to the value of the battery is much higher (and arguably restricting) for smaller community batteries.

Community batteries are a flexible and cost-efficient alternative to low voltage network upgrades, which are typically low-cost network investments. However, the transaction costs of a waiver compound to outweigh the benefits of the low-cost upgrade (for example to address peak demand constraints), potentially making a low-cost option uneconomic.

A streamlined waiver process will not address the investment uncertainty that is inherent in the waiver process. For example, suitable delivery partners may not have the risk appetite or capital to accommodate the risk that a waiver may not be approved or delayed. This is compounded by the risk that a waiver can be revoked before the full value of the asset is realised or is only approved for a limited duration of the asset's life. To date, potential trial partners frequently raise concerns with the waiver process as a reason to not proceed with an otherwise mutually beneficial trial. Ultimately, a streamlined waiver process is not a practical nor innovative solution to enabling technologies such as community batteries.

[2] CitiPower, Powercor and United Energy, Draft electricity distribution ring-fencing guideline: Submission to the Australian Energy Regulator, July 2021.

We recommend that further consideration be given to what the waiver process is seeking to achieve and the potential harms that it is seeking to address – and whether this can instead be addressed by targeted, proportionate, and effective amendments to the *Electricity Distribution Ring-fencing Guideline*.

Feedback from stakeholders about potential harms arising from DNSPs value stacking ESDs is largely focused on potential discriminatory behaviour, and cross subsidisation concerns. ENA supports the development of direct and transparent safeguards built into the *Electricity Distribution Ring-fencing Guideline* that address these concerns rather than a continuation of the waiver process in all cases, irrespective of whether it is streamlined.

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

If potential discriminatory behaviour and cross-subsidisation concerns are addressed directly through additional ring-fencing obligations, we seek further clarity from the AER as to what the waiver process is seeking to achieve and the potential harms that it seeking to address.

2.3.1 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 *Electricity Distribution 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 AER's Issues Paper as a proportionate and targeted way to strengthen the existing ring-fencing obligations, and we continue to support its introduction.

Distributors must also abide by access arrangements that are determined by the AER at the time of the regulatory reset, and are also subject to various duties and obligations currently within the regulatory framework that effectively prevent DNSPs from engaging in discriminatory behaviour, including:

- **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 (**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 and associated connection timeframes.

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

We seek further clarity from the AER as to what the waiver process is seeking to achieve that will not already be addressed by the current and proposed ring-fencing obligations.

2.3.2 Cross subsidisation

The regulatory framework currently recognises the benefits of shared assets – as noted in the AER's Better Regulation fact sheet:

"Electricity network businesses may use assets to provide both electricity services we regulate and other services we do not regulate. These assets are called 'shared assets'… Our shared asset guideline outlines how consumers will benefit from the other services electricity network businesses may provide using the assets consumers pay for."[3]

The AER's *Better Regulation - Shared Asset Guideline* sets out how the AER will reduce consumer costs for shared assets, with respect to materiality, method and information reporting, and provisions included in the *Electricity Distribution Ring-fencing Guideline* facilitate this.

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. We do not support the AER's proposed amendment of clause 3.1(d)(i) of the *Electricity Distribution Ring-fencing Guideline* to expressly prevent the sharing of ESDs. Instead, we recommend consideration of how cost allocation concerns can be addressed by the introduction of targeted and proportionate measures within the *Electricity Distribution Ring-fencing Guideline*.

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 Regulatory Information Notices to the AER on an annual basis that include detailed externally audited expenditure information.

In prior submissions to the AER[4] ENA recommended further collaboration with the AER and stakeholders to determine appropriate principles and/or methodologies for ESD cost allocation.

2.3.2.1 *Cost allocation approaches*

ENA supports the development of ESD cost allocation arrangements that outline a methodology and/or principles for allocating ESD costs between distribution and non-distribution services. DNSPs' compliance with these obligations will be subject to an annual external audit under the ring-fencing framework.

ENA supports the further consideration of the following cost allocation approaches:

- **Residual value:** the DNSP will only allocate the residual costs of the ESD to its RAB i.e., the value received from a competitive tender, grants etc. will be deducted from the cost of the ESD and not allocated to distribution services. This approach was approved by the AER in the United Energy Pole-mounted Battery Trial ring-fencing waiver.
- **Cap at an amount for the network value:** the DNSP will only allocate the value of distribution services provided by the ESD to its RAB. This network value could be determined based on:
  - the alternate network augmentation value,

[3] AER, Better Regulation factsheet: Shared asset guideline, November 2013.
[4] ENA's submission to the AER's Issues Paper (December 2020), ENA's feedback to the AER post the AER's Issues Paper Public Forum (March 2021), and ENA's submission to AER's Draft Decision (July 2021).

- the percentage of the battery that will be held for distribution services (e.g., 70% distribution services = 70% of ESD cost allocated to the RAB), or
- the value offered to third parties to provide the distribution services.

It may be appropriate to allow for flexibility in which approach is applied to determine the network value. ENA would also support consideration of the appropriateness of further safeguards such an ex-post adjustment to the recovery of capital costs should there be a material deviation from ex-ante forecasts.

The existing regulatory framework, with the addition of ESD cost allocation arrangements, therefore, will appropriately address potential cross-subsidisation harms raised by stakeholders.

We seek further clarity from the AER as to what the waiver process is seeking to achieve that will not already be addressed by the current and proposed ring-fencing obligations.

3 ENA recommendations

To ensure that consumers can fully benefit from networks' adoption and use of ESDs, ENA recommends the introduction of the following amendments, all designed to work collectively in practice:

- **Recommendation 1 - Introduce additional safeguards** to provide the AER and stakeholders with further transparency and confidence in the ring-fencing framework:
  - An enhancement to the ring-fencing non-discrimination provisions to ensure that a distributor cannot discriminate between itself and other third-party providers of ESDs.
  - The development of ESD cost allocation arrangements that outline a methodology and/or principles for allocating ESD costs.

  These measures are in addition to the ring-fencing obligations that are already applied under the current framework.
- **Recommendation 2 - Introduce a size-based exemption approach with strong oversight and transparency measures**:
  - **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.
- **Recommendation 3 - Introduce a streamlined waiver process that would apply in circumstances that don't meet the proposed size-based exemption criteria**. We propose the following improvements to the waiver process to simplify the process:
  - the issuing of waivers that last for the life of the asset rather than having to reapply each regulatory control period,
  - the implementation of clear timeframes on the waiver approval process, and

- an update of current clause 5.4 (The AER may publish its reasons for granting or refusing to grant a waiver or interim waiver) to require the AER to develop a register that includes all applications for waivers under review with the AER including the stage of review and the reasons for granting or refusing a waiver. This will improve transparency of the waiver process and create a precedent list for when and why a waiver is refused versus approved to mitigate the risk of duplicate applications across DNSPs.

We would also recommend the AER giving consideration to developing a waiver process whereby the AER, in the initial waiver application, pre-approves for additional projects of similar scope to be rolled out without the need for additional waiver applications. There will, however, need consideration given to what 'similar in scope' entails in practical terms.

3.1 Consumer benefits

Implementation of these targeted recommendations 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.

Under the proposed approach, a distributor may directly provide energy storage services to customers, or partner with a third-party retailer (determined under a competitive process) to lease out the spare capacity for the retailer to provide energy storage services to its customers. Both indirect and direct use of ESDs by DNSPs to provide energy storage services support retail competition – direct provision allows customers to access community energy storage services without being locked into a particular retailer. Indirect provision allows retailers, particularly smaller retailers that may not have the customer base, resources or investment capital to rollout ESDs directly, to partner with a DNSP to provide energy storage services to its customers.

Allowing DNSPs to value-stack ESDs, under strict criteria and with implementation of the additional obligations proposed, 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.

Importantly, implementation of a size-based exemption approach for ESDs does not automatically provide the DNSP with exclusivity over service provision. ENA's approach does not mandate a particular approach or propose that DNSPs will be the most efficient service delivery option in all cases, but rather it enables more options with the support of targeted, proportionate, and effective regulation.

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.