Enel X Australia Pty Ltd
Level 18, 535 Bourke Street
Melbourne, Victoria 3000
Australia
T +61-3-8643-5900
www.enelx.com/au/

AER

Submitted by email: AERringfencing@aer.gov.au

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Dear AER

RE: Draft electricity distribution ring-fencing guideline

Thank you for the opportunity to provide feedback on the draft electricity distribution ring-fencing guideline.

Enel X operates Australia's largest virtual power plant.[1] We work with commercial and industrial energy users to develop demand-side flexibility and offer it into the NEM's energy and ancillary services markets, the RERT mechanism, and to network businesses. Enel X is a global market leader in the development and operation of on-site battery storage systems for C&I customers.

This submission sets out our responses to sections 3 and 4 of the explanatory statement – specifically, the sections regarding contestable services from batteries and minor amendments. The key points are:

- DNSPs have not provided strong reasons to justify an ability to offer contestable services with batteries.
- The competitiveness of the battery market is threatened when regulated businesses are allowed to leverage their monopoly role to crowd out other providers.
- Thus we support the AER's draft position to prohibit DNSPs from offering contestable services with batteries.
- However, we are concerned that the waiver process is not robust enough and may rely on "commitments" from DNSPs that have no real weight and are not easily enforced.
- Similarly, compliance with the guideline relies on DNSPs self-reporting breaches after the wrongdoing has occurred.
- An alternative approach, and one that would provide more confidence to the market, would be to require DNSPs to proactively show evidence that they are complying with the obligations of the guideline and any conditions imposed on granted waivers.

If you have any questions or would like to discuss this submission further, please do not hesitate to contact me.

Regards

Claire Richards
Manager, Industry Engagement and Regulatory Affairs
claire.richards@enel.com

[1] Bloomberg NEF, December 2019.

Section 3: Contestable services from batteries

We support the AER's objective to develop a ring-fencing framework that "promotes the competitive provision of contestable services using batteries" and one that has "robust safeguards in place to mitigate the risks from DNSP discrimination and cross-subsidisation in order to encourage competition."

The draft guideline largely achieves this objective in restricting the ability for DNSPs to offer contestable services with batteries. However, any assessment of waivers to these restrictions must be robust and enforceable. In general, compliance with the guideline relies on DNSPs self-reporting breaches after the wrongdoing has occurred. An alternative approach, and one that would provide more confidence to the market, would be to require DNSPs to proactively show evidence that they are complying with the obligations of the guideline and any waiver conditions. Leniency here could have serious consequences for the long-term competitiveness of the battery market.

The energy transition necessitates a discussion about whether the roles and responsibilities of the providers in the traditional electricity supply chain need to change. This includes consideration of what services will be needed in future, how they should be procured, and who should be able to offer them. The ESB is considering these matters through its Post-2025 review and the proposed DER maturity plan. A decision on the role and responsibilities of DNSPs through that process will provide a clearer direction on the broader question of whether there is a role for DNSPs to play in contestable markets. In the meantime, the AER's position on DNSPs providing contestable services is appropriate.

3.2.1 Potential harms from DNSPs providing contestable services using batteries

We agree with the AER that there is value in "using a single battery to provide regulated network services (or inputs to regulated network services) and contestable services". Battery investments stack up when the owner/operator can access all available value streams. The question is which party should be stacking that value – competitive providers or regulated DNSPs?

DNSPs have not provided strong reasons to justify an ability to own batteries or offer contestable services with batteries. While nascent, there is no evidence to suggest that DNSP involvement is required to make the battery market (or the markets it supplies, e.g. energy and FCAS) competitive. Rather, the competitiveness of the battery market is threatened when regulated businesses are allowed to leverage their monopoly role to crowd out other providers.

We concur with the list of potential harms from DNSPs providing contestable services in section 3.2.1 of the paper, and have some specific comments below.

3.2.1.1 Access agreements

DNSPs set their own network access requirements, and therefore have an incentive to allow preferential access by a battery that it, or its RESP, owns. This could include waiving certain charges or choosing to prioritise the connection of their own assets over others.

The AER's response to this concern points to DNSPs' connection policies and the charges that apply under them, but provides no comfort that DNSPs will follow them when connecting batteries that they (or their RESP) own. DNSPs should be required to provide evidence to the AER that they will apply the same connection policy, process and charges to a battery that it (or its RESP) owns as it would any other battery.

3.2.1.2 Tariffs and charges

DNSPs set their own system charges, and therefore have an incentive to provide preferential network tariffs and charges to a battery that it, or its RESP, owns.

The paper acknowledges this concern and notes the AER's Victorian TSS decision, which determined that battery ownership should not be the basis for differential tariff treatment. However, as far as we are aware, this decision only applies to the Victorian DNSPs, so again provides no comfort about the behaviour of DNSPs in other jurisdictions. As above, DNSPs should be required to provide evidence to the AER that it will apply the same tariffs and charges to a battery that it (or its RESP) owns as it would any other battery.

We also note that the AEMC recently made a draft rule to give DNSPs the ability to charge for exports. A network-owned or affiliated battery should not be exempt from such charges, where they apply, and the DNSP should be required to provide evidence of that.

Our specific comments on each of the three models of ownership/operation are set out below.

Model 1: DNSPs providing network services using batteries

We agree with the AER that achieving the greatest net benefit does not require DNSP ownership of the battery. Shifting commercial risks to the customers of their regulated businesses gives DNSPs a competitive advantage, which can crowd out other providers in the battery market.

If DNSPs are indeed the primary beneficiaries of batteries, as some submissions suggested, then they have an incentive to work with third party battery providers to access that benefit on behalf of their customers. As noted above, a battery provider will seek to maximise revenue by accessing all available value streams. This includes network value, which can be accessed by locating the battery in a particular area and striking an agreement with the DNSP for the provision of network services.

DNSPs are the only entities that can assess network needs and thus determine the value of network services. They have an incentive to deploy batteries themselves (whether in front or behind the meter) and monopolise network service value early. It is important that DNSPs provide equitable visibility of, and access to, this value.

If a DNSP makes an investment in a battery it should be because a transparent assessment of all options to address the identified network need showed it to be the option that would bring the greatest net benefits to its customers. We agree that DNSPs should be required to provide evidence of the benefits that cannot be realised if they don't own the battery, and their attempts to procure network services via other means, before proceeding with a battery investment themselves.

Model 2: DNSPs providing contestable services using batteries

We support the AER's proposed prohibition on DNSPs providing contestable services with a battery.

In its submission SAPN indicated that DNSPs might want to provide contestable services with batteries if there were prohibitive transaction costs involved in entering into and monitoring contracts with a third party, or if there were material inefficiencies in providing non-distribution services via a ring-fenced affiliate. It is difficult to imagine that either of these costs would be so great as to justify the provision of contestable services by a DNSP. If there are costs or inefficiencies involved in contracting with third parties, the DNSP should focus on addressing these issues, not circumventing them.

The draft decision is not clear on whether DNSPs can seek a waiver from this prohibition. The summary of the draft position in section 3.1 suggests that DNSPs cannot, but section 3.3.2 suggests they can. Clarification on this would be helpful.

Any waiver from this prohibition should only be granted in unique circumstances where the DNSP can clearly demonstrate that:

1. the benefits of waiving the prohibition will outweigh the potential harm to competition in the battery market
2. the revenues received from providing contestable services will be shared back with those who paid for the battery, i.e. the DNSP's customers
3. the DNSP will not award itself preferential treatment regarding the connection or ongoing operation of the battery, or any tariffs and charges.

Model 3: DNSPs supplying excess capacity to third parties for contestable services

We agree with the AER that the benefits of a DNSP supplying excess capacity to a third party could equally be achieved where a DNSP procures network support services from third party-owned batteries who then offer the remaining capacity to contestable markets.

However, where a DNSP-owned battery exists and has excess capacity, we agree that it is preferable for the DNSP to outsource its use to a third party rather than using it to offer contestable services itself. For this reason, we support the AER's proposed approach to this model – that is, to prohibit DNSPs supplying excess capacity to a third party but allowing DNSPs to apply for a waiver of this prohibition. We support the use of the waiver process to provide an independent check on the costs and benefits of supplying excess capacity, and to make sure that DNSPs are not overinvesting in battery capacity at customers' expense.

Where a waiver is granted, the DNSP should be subject to remaining obligations in the ring-fencing guideline, for example regarding the preferential treatment of RESPs in awarding that capacity. Alternatively, a simple ban on DNSPs granting access to spare capacity to its RESP would provide confidence to the market and clarity to DNSPs.

There should also be clear separation between the market revenues received by the third party and the lease revenues paid to the DNSP for use of the asset. That is, the DNSP should not receive a share of market revenues. And, as above, the DNSP must show that the lease revenue it receives from the third party will be shared back with those who paid for the battery, i.e. the DNSP's customers.

Waivers

The paper sets out the factors that the AER proposes to consider when assessing waiver applications in relation to batteries. In general, we agree with these factors, although they are not reflected in the actual guideline and should perhaps be formalised somewhere.

However, we are concerned that "a demonstrated commitment to deal with the battery in an arms-length, transparent and non-discriminatory manner" has no real weight and is not easily enforced. Statements like this do not provide private battery providers with confidence that DNSPs will honour this commitment. As noted in previous sections, a more appropriate approach may be to require the DNSP to provide ongoing evidence to the AER of its compliance with these matters after a waiver has been granted, rather than relying on commitments or self-reports of any breaches.

The wording in clause 5.3.2(a)(iii) in the draft ring-fencing guideline suggests that the AER will only have regard to the costs that the DNSP might incur in complying with the obligations of the ring-fencing guideline if those obligations are not waived. The AER must also explicitly consider the costs to consumers and potential market harm in granting the waiver.

Where waivers are granted, the DNSP must be clear about how the benefits of providing unregulated services with a DNSP-owned battery will be shared with customers, i.e. those who paid for the battery.

Section 4: Improving the guideline – minor amendments

Section 4.2 – Information access and disclosure

The guideline allows a DNSP to share certain information with its RESP provided it gives other entities access to that information on an equitable basis. The challenge is that third parties might not be aware of what information has been provided by a DNSP to its RESP, and therefore what is available to them. We agree with the comments made by the CEC that the AER should define what information third parties should expect to receive from DNSPs and the process for obtaining it.

Section 4.3 – Breaches

Several DNSP submissions argued that requiring DNSPs to report all breaches would create unnecessary burden on DNSPs and impose costs on consumers. If that is true, it means that there is a concerning number of breaches occurring.

We support the AER's proposed approach to require DNSPs to report all breaches, as the interpretation of "materiality" is subjective. Where possible, the guideline should be free of ambiguity, to provide confidence to the market and clarity to DNSPs.