Ref: 20210704 AS:CB

12 July 2021

General Manager, Consumers and Markets
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Submitted electronically via AERringfencing@aer.gov.au

Australian Energy Regulator – Draft electricity distribution ring-fencing guideline

Essential Energy welcomes the opportunity to provide a submission in response to the Australian Energy Regulator's (AER) *Draft electricity distribution ring-fencing guideline (version 3) and explanatory statement* (the Draft Guideline). Essential Energy would also like to commend the engaging approach undertaken by the AER demonstrated through multiple rounds of consultation.

Distribution network service providers (DNSPs) have a vital role to play in the transition of customers to off-grid supply and the adoption of stand-alone power systems (SAPS) represents a significant opportunity to reduce network costs for all energy consumers. As such, Essential Energy welcomes the AER's draft determination to allow generation services for DNSP-led SAPS under a revenue cap.

The adoption of a broad-based revenue generation cap exemption framework is a pragmatic assessment which balances efficiency and administrative simplicity. We also support the proposed categorisation of different tiers, allowing for divergences between regional and metropolitan DNSPs. Essential Energy believes it is important that there is transparency about the extent to which DNSPs are providing SAPS generation services under the guideline and for this reason, we support the AER's proposed reporting register.

In relation to Energy Storage Devices (ESDs), Essential Energy does not support the draft guideline's prohibition on DNSPs from entering into joint ventures with third parties to access network owned ESDs. Whilst we understand the need for constraints being placed on regulated distribution businesses when engaging in certain activities, these constraints must always be balanced and aligned with the long-term interests of consumers. DNSP facilitated ESDs have a key role in assisting the transition to a more distributed energy market and lower emissions economy.

In this regard, we are of the view that an alternative regulatory approach could be explored which better balances the AER's concerns with the substantial community benefits which can be delivered through ESD joint ventures. To that end, we are supportive of a targeted framework which provides for a streamlined exemption process for community scaled ESDs of a size up to 5MW.

These issues are explored in further detail below. If you have any questions in relation to this submission, please contact me directly or Mr Anders Sangkuhl, Regulatory Strategy Manager via anders.sangkuhl@essentialenergy.com.au or via phone on 0409 968 326.

Yours sincerely,

Chantelle Bramley

Chantelle Bramley
General Manager, Strategy, Regulation and Corporate Affairs

Essential Energy submission to the draft electricity distribution ring-fencing guideline

Standalone Power Systems

Essential Energy is committed to improving customer experience, creating operating efficiencies, building a resilient network and lowering prices for all network customers. Deploying SAPS when it is efficient to do so is a mechanism for delivering these benefits.

When the poles and wires of the traditional electricity infrastructure in remote areas are removed, and customers are supplied electricity via a SAPS, there may be a significant reduction in DNSP expenditure which in turn has the potential to deliver savings to all network users. These savings are driven by reduced operational costs and the ability to remove sections of the network that traverse through difficult terrain and serve very few customers.

Initial modelling by Essential Energy has shown that SAPS could serve between 800 and 1400 customers (dependent on the cost-based assumptions used) with potential savings of $120 million over 20 years of avoided network refurbishment and vegetation management. We estimate that there are potential benefits from reduced bushfire risk of $1 million per annum, as well as expected reliability improvements for customers. In addition, SAPS have the potential to embed resilience in the network, enabling a customer or community to isolate itself and remain energised in an emergency.

For these reasons, the further development of SAPS across our distribution footprint is a strategic priority for Essential Energy, and the AER's draft guideline determination is timely given the rapid technological developments in this area and benefits flowing to consumers.

We support the AER's determination allowing generation services for DNSP-led SAPS under a generation revenue cap

Essential Energy welcomes the amendment to the distribution ring-fencing guideline to allow DNSPs to provide generation services for DNSP led SAPS under a revenue generation cap exemption framework. Allowing DNSPs to provide generation services for SAPS will promote competition and efficiency in the long run by promoting market development for these services, whilst also ensuring that SAPS customers experience the same service standards and protections afforded to other customers.

The adoption of a broad-based revenue generation cap exemption framework is a pragmatic assessment which balances efficiency and administrative simplicity. In practise, this will allow Essential Energy appropriate discretion to maximise flexibility in preferencing sites on the network which would benefit from transitioning to a SAPS and deliver cost savings to all network users. However, we would ask the AER to consider specifically removing streetlighting from the revenue cap exemption as these assets consume minute electricity and are insignificant to the competitive market.

Essential Energy also supports the AER's proposed categorisation of individual DNSPs into different tiers, allowing for unique divergences between DNSPs, such as metropolitan or regional. Regional DNSPs will almost always require a higher cap than urban distributors who do not face the same quota or cost imperatives to roll out SAPS for efficiency and reliability purposes due to the inherent differences in the network areas that they serve. Nonetheless, it is worth noting that tier three (0.001%) does appear set prohibitively low, even for city based DNSPs. In practise, some SAPS customers may be located in a heavily vegetated and hilly districts with high vegetation management costs, yet only be 10-20 kms from a major population centre. We would encourage further consideration on this point.

In relation to ring-fencing waivers, Essential Energy supports the AER decision to not progress with ring-fencing waivers at this time. Ring-fencing waivers would not have been fit for purpose given the costs and time associated with applying for individual applications would be disproportionate and inefficient, both for DNSPs in submitting applications and AER staff. As such the decision to adopt exemptions is well measured, providing DNSPs with the confidence to invest in infrastructure, train staff and enter into supply contracts with third parties for the provision of SAPS services.

Existing SAPS market depth

It is Essential Energy's expectation that the competitive market will almost always be able to deliver a SAPS installation. However, there may be instances where a third-party is not available or willing to undertake the operating & maintenance (O&M) activities and unlikely to be able to deliver fault & emergency (F&E) services for DNSPs to meet licence conditions or reliability obligations.

Where the competitive market cannot deliver all three of these services to the level required, in order to unlock consumer benefit, it is appropriate that DNSPs act as the SAPS resource provider.

In response to any apprehension that DNSPs may crowd out competition in the SAPS market, it should be noted that DNSPs continue to operate under a regulated revenue cap whereby any earnings arising through SAPS generation will not be in addition to revenues derived from network services. Thus, DNSPs are only incentivised to transition customers to SAPS solutions where it is efficient to do so, driving improved customer outcomes for all network users. The incentives which drive behaviour and compliance in this area are robust.

It is also worth mentioning that Essential Energy has recently completed an expression of interest (EOI) process for the purpose of establishing a panel of contractors who will be invited to tender for SAPS in the future. This EOI process has provided Essential Energy with a holistic view of the competitive depth of the market for SAPS services and gives insights into some of the business models and O&M and F&E capabilities available today. For privacy reasons, the results from the SAPS EOI process cannot be produced in this public submission, however, to assist the AER's considerations, as to the level of competition in the market, Essential Energy has provided a briefing at the AER staff level on the aggregated results of that EOI process.

Compliance and reporting obligations

For reasons of reputational integrity as well as effective corporate governance, Essential Energy believes it is important that there is transparency about the extent to which DNSPs are providing SAPS generation services under the guideline, and the locations in which those SAPS are being deployed. For that reason, we support the AER's proposed reporting register which must contain the following information:

- The local government area in which the SAPS was deployed.
- The number of premises served by the SAPS.
- The estimated maximum demand in kW served by the SAPS.
- The aggregated annual average energy consumption in kWh.
- The revenue earned by the DNSP for providing other services by means of the SAPS.
- A statement of whether the DNSP has requested the supply of other services by one or more unaffiliated third parties.

We believe that the above information is appropriately targeted to the select matters that will assist the AER in performing its functions and is sufficiently aggregated to ensure privacy is preserved. However, in relation to streetlighting SAPS, we would ask the AER to specifically not include streetlighting assets in the compliance and reporting obligations as they insignificant to the competitive market.

Future review of the SAPS exemption framework

We note that at the AER's issues paper stage, a specific requirement was proposed to review the SAPS exemption guideline after a period of three years to assess overall performance. In our view, specifically reviewing the SAPS guideline within three years would have allowed insufficient time for the SAPS market to develop and become adequately established. A premature three-year review would have introduced regulatory uncertainty, undermining DNSPs ability to make investment decisions in a stable framework. For these reasons, we support the AER removing this mandated review of the guideline, noting that the AER continues to retain their existing right to initiate review of the guideline at any time.

Energy Storage Devices (ESDs)

An increase in DNSP facilitated ESDs installed across the network has the potential to play a key role in the energy transition to a more distributed energy market and lower emissions economy.

Essential Energy strongly believes there are benefits and efficiencies which can be delivered to customers as well as the broader network through targeted amendments to the ring-fencing guideline. Namely these benefits relate to DNSPs being able to:

Table 1

Benefit derived from DNSP facilitated ESDs	Description
Efficiently orchestrated and supporting competition	To maximise locational value to the network from ESDs, DNSPs can utilise their detailed understanding of current and future network needs and efficiently locate ESDs across the network in areas of greatest need, leveraging synergies with existing (and planned) distribution assets to derive more value for customers. DNSP are then in a strong position to provide access to efficiently located storage assets for third-party providers on a neutral basis, and in doing so support competition.
Overcoming cost barriers to reduce network pressure	The DNSP value proposition of lowering overall costs to consumers is more likely to overcome the high-cost barrier for consumers purchasing ESDs than if they were offered by purely by third parties. This would likely result in quicker uptake, which would assist the more efficient utilisation of local renewable generation. This would reduce pressure on existing network assets and, at scale, may help defer or avoid network costs.
DNSPs can best manage network issues	DNSPs are best placed to use ESDs to support the network by managing voltage issues and absorbing excess intermittent energy at a community level. This would most effectively be done as owner-operator of ESDs or through joint venture activities.
DNSPs can offer other market services to optimise usage	DNSPs are well placed to use storage to provide ‘other services’ such as ancillary services when the ESD is available. This provides an opportunity to optimally use the available energy storage capacity.
Access to economies of scale	DNSPs have access to economies of scale that could allow for greater investment in more intelligent storage technology and programming if able to be offered to consumers.
Solve coordination problems	The AER accepts that the use of ESDs in the NEM is likely to increase significantly over time. If DNSPs are only able to use storage to provide distribution services, there will likely be more ESDs in the grid than would otherwise be efficient. Each third party owned ESD will likely provide different services to different stakeholders at different times, in order to maximise their value stack. This may increase grid instability and cause coordination issues at a local and network level. Allowing greater DNSP involvement through joint venture activities would enable many of these services to be centrally controlled and coordinated.

We would encourage the AER to further consider the strategic approach put forth in the draft guideline in relation to ESDs

Whilst Essential Energy understands the need for appropriately designed constraints being placed on regulated distribution businesses when engaging in certain activities, these constraints must always be balanced and aligned with the long-term interests of consumers.

It is crucial that in the development of the ring-fencing guideline that the AER maintains a strong and pragmatic focus on positive customer outcomes that ESDs can deliver, particularly in relation to the shared assets rule.

Essential Energy does not support the interpretation of clause 3.1(d)I

Whilst we understand the general prohibition on DNSPs from directly providing contestable services within a ESD themselves, we do not support the direction and interpretation of clause 3.1(d)I, otherwise known as the "shared assets rule".

Allowing DNSPs to progress select efficient ESD projects, based on a business model that may include the outsourcing of some excess capacity to a third party (e.g., for the provision of frequency control ancillary service) is an efficient outcome (to the extent that the doing so does not materially prejudice the battery's provision of network support). Such a scenario enhances productive efficiency because it allows for a third party to co-contribute to costs that in some instances may be required to lower the costs of the project overall. This "value stacking" is what may contribute to the commercial feasibility of projects relative to a more traditional network solution.

In addition, community ESDs with open access arrangements provide customers with the opportunity to benefit from ESD services they may not have had the ability to either afford (due to the high costs of private ownership) or install on their own property (due to physical spatial constraints, e.g. apartments). In this way, we believe the shared assets rule would promote competition in an area of the market still in its infancy leading to increased growth and scale of ESD capabilities. This promotes customer choice and contestability for ESD services, generating the greatest net community benefit and ultimately lowering network charges for all consumers.

Finally, it is worth noting that DNSPs are highly skilled electrical asset specialists who are charged with planning and managing electrical equipment cohesively within the communities we serve. DNSPs perform this role to the high safety and reliability standards which are befitting of a modern 21st century electrical network. We believe that DNSP facilitation of ESDs within the existing electrical grid is something firmly within our remit and technical capacity.

Essential Energy would encourage the AER further consider clause 3.1(d)I with the intention that it is not confined to shared assets, but rather has a broader application for storage devices in circumstances in which third parties might use a DNSP's assets.

Waiver Framework

In the context of the benefits outlined in table 1, we consider that the waiver approach put forth in the draft guideline requires further consideration. The requirement for individual ring-fencing waivers to be submitted for situations in which third party access is to be provided through a distribution ESD will have the effect of imposing material application costs and administrative burdens on DNSPs that will reduce the commercial feasibility of projects.

It is again worth noting that at the distribution level the ESD market is still largely in its infancy, characterised mainly by various proof of concept trials focusing on delivering improved customer services and testing new commercial business models.

The time consuming and uncertain nature of waiver applications would undermine the investment certainty that DNSP businesses require to internally invest in activities such as training staff, generating supply contracts with ESD third parties and generally upskilling functions in this area. This will discourage DNSP facilitated ESDs at a time when the market is developing, potentially leading to a fragmented and orchestrated roll out which may slow the market transition.

The draft guideline risks prematurely constraining the development of the market at a time when opportunities for how ESDs can best be integrated within the market are still being explored.

We would encourage consideration of an alternative regulatory approach

Essential Energy believes an alternative regulatory approach could be explored to better balance concerns raised by some stakeholders within the draft guideline and the substantial community benefits which can be delivered through ESD joint venture activities.

To that end, we are supportive of a targeted framework which provides for a streamlined exemption process for **community scaled ESDs of a size up to 5MW** – this would limit the exemption to small scale ESDs, but still be of sufficient size to provide third parties with adequate utility for their contestable service offerings. Such a small size of ESD would also placate any concerns that distribution level ESDs may be overbuilt and thus crowd-out competition in the competitive market. This would also align with the existing 5MW thresholds for generator connection obligations.

This targeted 5MW exemption would be conditional upon the ESD meeting the following compliance and information reporting obligations:

- What other alternatives besides the ESD were investigated to meet the specific distribution network service requirement.
- A detailed cost benefit analysis on the specific ESD which outlines the expected consumer benefits to be derived. The methodology of this cost benefit analysis should be done to an agreed and consistent industry standard.
- Description of the process undertaken to request services by one or more unaffiliated third parties, including documentation outlining the specific network requirements and the value stacking opportunity.
- A statement declaring that the commercial arrangements between the DNSP and the third-party is at arms-length and on commercial terms and conditions available to all other competing parties.
- A statement outlining the correspondence from the DNSP and the unaffiliated third parties explaining the ultimate investment decision.
- A statement which outlines how the ESD will be typically utilised for network purposes, as well as how it will be broadly utilised by the unaffiliated third-party including details of operating procedures.
- A statement as to the cost-allocation arrangements for the ESD project.

Essential Energy considers that this targeted exemption framework would provide the investment certainty required to allow DNSPs to facilitate third party access to community sized ESDs whilst concurrently satisfying compliance and information reporting requirements. This proportionate approach would prevent the premature stymying of the ESD market and deliver benefits in the long-term interest of consumers.

Finally, it is worth noting that under this proposal, the AER would retain their existing oversight and monitoring functions of the distribution guideline under which DNSPs are strongly incentivised to refrain from engaging in anti-competitive activities. If consumer detriment arises under this framework, these existing compliance safeguards and consumer protections are robust as evidenced by the limited contraventions to date.

Other Issues

Timeframe to report breaches

Essential Energy supports the proposal to extend the reporting timeframes within the guidelines from five to fifteen business days. Such a proposal is a sensible compromise which balances both market participants and the AER's administrative workloads whilst still achieving compliance objectives.

However, we would reiterate that further clarification on the definition of materiality would be beneficial within the guideline to provide participants guidance on what constitutes a non-material or trivial breach. Reporting non-material breaches within this timeframe still incurs resourcing costs on DNSPs for limited consumer benefit.

We would appreciate some definitions or examples of materiality within or appended to the guideline. For instance, a simple approach based on factors such as financial gain, systemic non-compliance vs inadvertent non-compliance, or did actual harm occur vs the potential for harm to occur, would all be beneficial in providing further clarity to participants.

Timing of compliance reporting

The draft guideline amends the timing of annual compliance reports so that they are now due within four months of the end of the calendar year to which the compliance report relates. Whilst not our initial preference, we note the AER has explicitly allowed for the Cost Allocation Methodology from the previous regulatory reporting year to be relied upon by the Ring-fencing auditors in this regard and for this reason Essential Energy is supportive of the amendment.