



1 December 2021

Mr Mark Feather  
General Manager  
Australian Energy Regulator  
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Melbourne, VIC, 3001

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Dear Mr Feather,

**RE: SUBMISSION TO AER RING-FENCING GUIDELINE – FINAL DECISION**

Origin Energy (Origin) appreciates the opportunity to provide a submission to the Australian Energy Regulator (AER) in relation to the proposed streamlined waiver process associated with battery deployment by distribution network service providers (DNSPs).

Third-party provision of battery services obtained through a competitive process should be preferred above DNSP involvement in the market. We consider that the market will be able to efficiently provide battery services in all but the most exceptional of circumstances. Allowing DNSPs to participate in the provision of contestable services from batteries has the potential to impact current and future competitive provision.

DNSPs have expressed a strong desire to be involved in the provision of contestable battery services and we are concerned that DNSPs will skew the case for battery provision in their favour by virtue of their network ownership and associated information asymmetry. Further, DNSPs are able to use their economies of scale to potentially offer cost-effective provision options. This may provide cost benefits in the short-term but has the potential to displace genuine competitive provision to the long-term detriment of customers. It is important that the AER remain focused on long-term benefits associated with robust competitive provision, rather than potential short-term gains.

We are concerned that even with the best of intentions, it will be difficult for the AER to guarantee that the proposed streamlined waiver process provides a truly level playing field for all participants. In our view this presents a significant risk to competitive provision and the associated long-term customer benefits.

The streamlined waiver process provides for DNSP deployment of batteries where the DNSP demonstrates that the risk of cross-subsidisation has been addressed and the DNSP has tested the market for the provision of the required network support service. The AER suggests that cross-subsidisation risk can be addressed by ensuring that only that portion of the battery that is required for network support is included in the regulatory asset base (RAB). Presumably, the remaining portion of the battery is then available to the DNSP for the provision of competitive services. The AER provides the example of 20 per cent of a battery being utilised for network support and therefore attributed to the RAB.

The AER states that if a DNSP battery waiver application for supplying excess capacity for use by third parties meets its streamlined waiver criteria, then this battery deployment may be lower risk i.e. cross-subsidisation risk is addressed, which reduces competitive harm.

While we appreciate that the competitive market for batteries is still developing, we consider that the long-term interests of consumers are best served through fostering the development of the competitive market. DNSP involvement in the market has the potential to stifle that development, even if inadvertently. We consider that, to the extent DNSPs seek to participate in the competitive market, they should do so on a level playing field i.e. via an appropriately ring-fenced entity (Option 3). Alternatively, as suggested in Option 1, DNSPs may procure the benefits of storage options through commercial arrangements with other service providers.

Our expectation is that the provision of network support services can be more than adequately serviced by third-party providers in all but the most exceptional of circumstances. Further, these third-party provision options do not require elaborate allocation processes and do not introduce the uncertainty and risk potentially associated with DNSP provision both through the initial tender process and DNSP involvement in the competitive market.

We are particularly concerned that the streamlined waiver process provides a foray for DNSPs to the competitive market in the guise of network support. For example, under the AER's example, only 20 per cent of the battery is used for network support, leaving 80 per cent for competitive services. To the extent that this occurs on a widespread scale, DNSPs have the potential to be significant players in the competitive market – a market in which DNSPs are restricted from retailing energy. Rather, the DNSPs will simply contract out energy with no associated wholesaling or retailing costs. We question whether this is the intent of the streamlined waiver process and whether it represents a “low risk” to the competitive provision of contestable services using batteries.

We consider that the AER needs to clarify the concept of “low risk”. The initial premise is that DNSPs should be prohibited from providing excess capacity to others without an approved waiver. The AER set out a number of risks associated with DNSP involvement in the competitive market. While we appreciate that the streamlined waiver process is intended to level the playing field so that DNSPs and non-DNSPs participate in the competitive market on an equal footing, DNSPs retain significant advantages in terms of network control and information. Further, DNSPs are in the unique position of seeking third-party provision for a service they themselves are seeking to provide and have a significant financial incentive to do so. This has the potential to add significant bias to the market testing process.

We are concerned that the streamlined waiver process has the potential to facilitate significant entry to the competitive market by DNSPs even if inadvertently particularly in the initial stages as the process is developed and refined. Once the DNSP is provided entry to the competitive market, the involvement continues for the life of the battery and any advantage provided to the DNSP by virtue of the streamlined waiver process is similarly locked in. We consider this represents an unacceptable risk to the development of the competitive market and associated consumer benefits. In our view, the only way to avoid the potential issues associated with a streamlined waiver process is to only allow DNSP participation in the market through a separate legal entity or contractually through a third-party provider.

Third-party provision avoids the complexities associated with the proposed streamlined waiver process and ensures the integrity of the competitive market is maintained. On this basis we consider that third-party provision of battery services should be preferred above DNSP involvement in the market. Accordingly, market testing should be both robust and exhaustive. We consider that the market will be able to efficiently provide battery services in all but the most exceptional of circumstances. We believe that market provision represents a true “low risk” approach. To the extent that DNSP-led battery provision is identified as a preferred supply option, we considered this should be heavily weighted to network support with minimal excess battery capacity. Further, the identification of the network support

component to be incorporated in the RAB must be rigorously scrutinised to ensure there is no scope for cross-subsidy.

#### *Determination of network support usage*

As part of the proposed streamlined waiver process, the AER indicates that only the cost of the portion of battery that provides standard control network services should be included in the RAB. The AER identifies a number of options available to DNSPs to demonstrate the accuracy of the proposed portion to be allocated to the RAB including, modelling the capacity; the present value percentage to be attributed; and the third-party price for service provision.

We consider the identification and specification of the required network support component – to be critical. In the first instance the DNSP must be required to demonstrate the required need for network support and the business case of a battery solution as opposed to traditional network augmentation. Having established the case, the service requirement can then be specified. We consider it important that the process from identification to specification be reviewed by the AER to ensure the validity and accuracy of the network support service to be provided.

Similarly, the process for determining the appropriate proportion to be attributed to the RAB needs to be closely reviewed to ensure there is no scope for cross-subsidisation. Any initial cross-subsidisation has the potential to be entrenched for the life of the service with potential significant implications for competitive services in the battery sector. We consider that any allocation process adopted should be both rigorous and transparent. The AER should validate the proposed allocation process and attest to the accuracy of the outcomes before any consideration for inclusion in the RAB.

The AER also indicates that cost allocation of the battery will be audited annually. We consider that any cost allocation applied by DNSPs should be rigorously reviewed. Given their broad nature, we consider compliance with approved Cost Allocation Methodologies (CAMs) to be inadequate – a lower-level detailed assessment of cost allocation is required to ensure that there is no cross subsidy between regulated and unregulated businesses. We consider that the typical materiality conditions applied in the CAMs are not appropriate when assessing cross subsidisation toward the DNSPs' competitive services. Any advantage to the DNSPs' competitive service provider, no matter how small, has the potential to disadvantage competing third-party providers and result in sub-optimal consumer outcomes in the long-run. Accordingly, we consider that no materiality threshold should be applied when assessing costs allocated between DNSPs and their competitive service providers.

#### *Market testing*

We consider there is a natural tension in the market testing process that necessitates considerable and ongoing assessment of the process by the AER. Namely, the party requesting the network service (the DNSP) has expressed a strong interest in self-provision of battery assets and associated contestable services. DNSP provision allows for inclusion of the network support component of the battery to be incorporated in the DNSPs' RAB and the provision of competitive services offers the potential for significant additional revenue. Under these circumstances, we consider that DNSPs have a significant incentive to bias the tender process in favour of self-provision and compromise third-party provision. This could occur through various avenues, including project specification/information, project timing etc. We consider that the DNSPs' information asymmetry together with the incentive for self-provision presents a significant risk to the tender process.

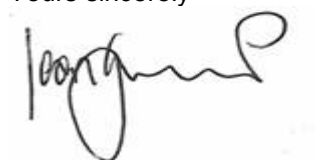
Given these circumstances, we believe the AER ought to be heavily involved in the tender process. In particular, the AER need to ensure complete transparency, provision of all relevant information and address any third-party concerns regarding the application of the tender process to ensure the process is completely unbiased.

Further, we consider that any assessment of competing network support service options must be closely scrutinised to ensure the options are considered on a strictly like-for-like basis. For example, in

considering the financial implications of DNSP self-provision of a battery versus the provision of network support via commercial arrangements with a third-party battery provider, the assessment must be limited to the network support component only. That is, the net present value (NPV) of the network support component of the DNSP battery (e.g. the 80 per cent to be included in the RAB) must be compared against the NPV of the third-party network support fee over the proposed life of the service. We consider that the AER must be responsible for developing the financial assessment framework and for assessing the competing business cases under this framework.

If you have any questions regarding this submission, please contact Gary Davies in the first instance at [gary.davies@originenergy.com.au](mailto:gary.davies@originenergy.com.au).

Yours sincerely

A handwritten signature in black ink, appearing to read 'Sean Greenup', written over a light grey rectangular background.

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