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17 November 2020

Mr Arek Gulbenkoglou  
A/General Manager, Consumers and Markets Branch  
Australian Energy Regulator  
GPO Box 520  
Melbourne VIC 3001

Submitted via email to [AERringfencing@aer.gov.au](mailto:AERringfencing@ aer.gov.au)

Dear Mr Gulbenkoglou,

**Re: United Energy Ring Fencing Waiver Application**

Red Energy and Lumo Energy (Red and Lumo) welcome the opportunity to provide a submission to the Australian Energy Regulator (the AER) regarding United Energy's application to seek a waiver for the legal separation obligation under section 3.1(b) of the Ring Fencing Guideline (Guideline).

United Energy intends to purchase 40 pole mounted Battery Energy Storage System (BESS) units in a trial that would be used to provide regulated services during system peaks and competitive energy storage services to its retail partner. This trial would also see the BESS rolled into the United Energy's regulated asset base (RAB). Red and Lumo do not support the application for a ring fencing waiver.

United Energy operates their network in a highly competitive retail market in Victoria, and we retail electricity to customers within their network. Competitive markets deliver benefits to consumers and are uniquely positioned to deliver those benefits. This application has implications for both the retail and competitive services markets.

United Energy, and other distribution network service providers (DNSPs), are regulated monopolies who are required to deliver reliable and efficient electricity networks for consumers. Network support services fall outside the RAB and should be provided for by the competitive market. United Energy's proposal to include BESS units in the RAB is contrary to the view that battery storage assets would generally be regarded as competitive energy services under the Guideline. Obtaining these services, contractually from the competitive market provides flexibility to both the network and the competitive asset owner, while also shielding consumers from potentially poor investment decisions particularly when network services are rolled into the RAB.

It is unclear from the application whether there has been a tender process undertaken by United Energy to obtain the 40 BESS from the competitive market or other solutions to deliver the network

support required. A more preferable and flexible solution for United Energy is to lease the batteries from an independent third party paying them an opex charge. Such an arrangement would help to preserve the competitive nature of the battery storage market, and protect consumers from any unintended investment risk by rolling them into the RAB.

United Energy requires a waiver from legal separation under the Guideline because it has chosen to purchase the batteries and offer competitive services in addition to their regulated services, instead of purchasing these from the market. We consider there to be a large risk should the AER approve the application. This would allow for all DNSPs to undertake an equivalent project and for these scenarios to be common across the NEM. These less than efficient outcomes will increase costs for consumers in the long run.

Red and Lumo consider that the application for a legal waiver fails to satisfy the required criteria for a legal separation application in the Guideline. Particularly, as the BESS proposal in its current form would incentivise and allow United Energy to cross subsidise its retail partner. The main reason for this is that the deferred capital value arising from the BESS units would not cover the costs of the BESS units in today's prices, without the revenue from the retail partner.<sup>1</sup>

Further, we consider that relying on the Cost Allocation Manuals (CAM) to prevent cross subsidies would not be sufficient. The net effect of this application would have consequential impacts on retail competition. The application of United Energy's CAM to allocate direct and shared costs between the categories of electricity services to mitigate any potential for cross subsidy of a retailer partner would be a poor substitute in comparison to legal separation.

The cost allocation principles included in a DNSPs CAM are high level and provide DNSPs flexibility to allocate both direct and shared costs in the manner they see fit. To mitigate this risk, we believe that the original intention of the Guideline for legal separation of both regulated and competitive business should be applied.

It is not evident how United Energy's CAM would deal with a change in the allocation of shared and direct costs from a change in the services the BESS units provide, namely to change from standard control services to leasing storage services. This could have implications on the capability of United Energy to cross subsidise its retail partner in the future.

United Energy would have a strong incentive to cross subsidise its retail partner under the proposal, in particular if this model is rolled out on scale as planned. While we acknowledge that in a trial scenario there would be less incentives to cross subsidise its retail partner, United Energy could ensure the project's financial viability. The AER must ensure that competition and consumer benefits are not eroded, which it can do by rejecting the application.

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<sup>1</sup> United Energy Ring Fencing Application, p.5 Accessible:  
<https://www.aer.gov.au/system/files/Application%20for%20waiver%2012-Oct-2020%20-%20redacted%20%28002%29.pdf>

## **Criteria for legal separation**

Aside from the impacts on competition and consumers, United Energy's waiver application fails to satisfy the criteria outlined in the Guideline. In November 2016, the AER published an explanatory statement that would assist stakeholder understanding of the Guideline when it was first published.

In the explanatory statement, the AER stated there were only two circumstances in which they would grant a waiver from legal separation in the Guideline. The first circumstance is 'services' provided by a DNSP which are also regulated services. The second is for 'other services' that DNSPs were required by law to provide.<sup>2</sup>

It is unclear whether, if at all, leasing the BESS units to United Energy's retailer partner to provide energy storage qualifies for either of these cases. On this basis, we question whether the AER will be able to approve the application as it clearly does not fit within either of the circumstances outlined in the explanatory statement.

This application provides an opportunity for the AER to signal to the market and networks that it will retain the integrity of the ring-fencing guideline and the separation of monopoly and competitive services.

## **About Red and Lumo**

Red and Lumo are 100% Australian owned subsidiaries of Snowy Hydro Limited. Collectively, we retail gas and electricity in New South Wales, Victoria, South Australia, Queensland, and the ACT to over 1 million customers.

Should the AER wish to discuss or have any enquiries regarding this submission, please contact Con Noutso, Regulatory Manager on 0481 013 988.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Ramy Soussou". The signature is stylized with loops and a horizontal line at the end.

**Ramy Soussou**

General Manager Regulatory Affairs & Stakeholder Relations

**Red Energy Pty Ltd**

**Lumo Energy (Australia) Pty Ltd**

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<sup>2</sup> AER, Electricity Distribution Ring-Fencing Guideline Explanatory statement November 2016 p. 55 Accessible: <https://www.aer.gov.au/system/files/AER%20Ring-fencing%20Guideline%20-%20Explanatory%20statement%20-%20030%20November%202016.pdf>