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8 July 2021

Mr Mark Feather
General Manager
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Submitted via email to AERringfencing@aer.gov.au

Dear Mr Feather,

Re: Draft Ring-fencing Guideline Electricity Distribution Version 3

Red Energy and Lumo Energy (Red and Lumo) welcome the opportunity to provide a submission to the Draft Ring-fencing Guideline Electricity Distribution Version 3 (draft Guideline). The Australian Energy Regulator (AER) has proposed some changes to the existing Guideline which we are concerned will lessen competition and lead to poorer consumer outcomes.

The draft Guideline seeks to address the changing nature of services offered by electricity distribution network service providers (DNSPs) through stand alone power systems (SAPS) and contestable services from batteries. We do not consider that DNSPs should be able to provide contestable services from batteries, instead should seek to obtain services from batteries owned by competitive providers. The contestable energy services market is developing and decisions made by the AER, if unchanged from the draft Guideline are likely to have a material impact on competition.

Specifically, this submission opposes the following proposals that have been incorporated into draft Guideline:

1. Exemptions for DNSPs to provide generation services for DNSP-led SAPS up to a cap on the annual revenue earned from these services;
2. Approved waivers that would provide DNSPs with the right to provide the excess capacity of batteries to a third party where the benefits exceed the harm.

Generation services associated with DNSP-led SAPS

The AER has introduced exemptions for DNSP-led SAPS in the draft Guideline, in response to the evidence submitted by DNSPs. This evidence apparently proves there was likely to be no competition in the delivery of generation services to DNSP-led SAPS. However, as the AER has not made the evidence available to the stakeholders as part of the consultation process, it is difficult to refute these claims of no competition detriment.

Competitive markets should, in the first instance, be engaged to supply generation services to DNSP-led SAPS. The DNSPs themselves should be required to provide evidence to the AER to substantiate market failure before being allowed direct ownership of SAPS generation.

We understand that DNSPs may create up to 4000 DNSP-led SAPS over the next 5-10 years, and we are aware that our proposal represents a significant challenge for the DNSPs. However, if the DNSP indicates to the market that it is willing to procure these services, in a variety of locations, then a tender process should inform the market's capability to deliver. An exemption process that gives DNSPs the right to supply up to 75% of the DNSP-led SAPS over the next 5-10 years would crowd out market investment and disincentivise the development of these services. We expect the net outcome of this would substantially lessen competition, to the detriment of consumers.

Contestable services using batteries

The AER's explanatory memorandum outlines that there is "significant potential of batteries and benefits to consumers, [the AERs] aim is to develop a ring-fencing framework for batteries that promotes the competitive provision of contestable services using batteries."[1] In principle, Red and Lumo agree that there is a potential benefit to consumers through the use of batteries in the electricity network and that the right balance must be struck between the competitive market and allowing monopoly providers to sell contestable services from those batteries. However, Red and Lumo do not consider that the AER has struck the balance right in the draft Guideline.

While the AER seeks to allow waivers in situations where a DNSP "wants to supply excess capacity of a battery to a third party in circumstances where it considers the benefits outweigh the harm",[2] it will be near impossible to quantify both harms and benefits. Batteries that are installed for network services will be subject to a cost allocation methodology. This would need to determine the split between supplying regulated and contestable services of a battery, without any understanding or firm knowledge about what split is appropriate. Furthermore, battery use changes over time hence a cost allocation methodology would need to somehow cater for the changes of use to prevent cross subsidisation. It remains unclear how, in a market where these batteries can and would be used to manage wholesale pricing and settlements at 5 minute increments, what the likely benefits or harms may arise.

If the waiver under the draft Guideline was allowed, DNSPs would be therefore required to rely on their existing cost allocation manual to prevent cross subsidies if they were allowed to supply excess capacity from a battery to a third party. However, we consider that there would be a fair risk, and potential harm in relying on DNSPs' existing cost allocation manual to prevent cross subsidies. The cost allocation principles in a DNSPs cost allocation manual are high level and provide flexibility to the DNSP in allocating direct and shared costs in the manner they see fit.This would provide DNSPs considerable flexibility in the manner they could allocate both direct and shared costs in their cost allocation manual.

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[1] Australian Energy Regulator, *Draft electricity distribution Ring-fencing Guideline Explanatory statement Draft Guideline – Version 3*, May 2021, pg 30.

[2] Ibid, pg 30

This is consistent with the concerns Red and Lumo raised to the AER on the United Energy waiver application for their trial for 40 pole mounted battery energy storage systems. In that submission to the AER, we noted that relying on the cost allocation manuals to prevent cross subsidies would be insufficient and would have consequential impacts on competition. Hence why the original intention of ring-fencing and the guideline required legal separation of both regulated and competitive businesses. We maintain that this original approach is superior to the waiver process that has been proposed in the draft Guideline.

In the assessment of the waiver application, including any assessment presented by the DNSP on benefits, costs and harms, it must be noted that the AER's compulsory information gathering powers do not extend beyond standard control services to other services that are offered by DNSPs. Therefore, even if a DNSP used its cost allocation manual for the purposes of allocating costs between regulated and contestable energy services, there would be no way for the AER to verify if the costs of any contestable energy services offered by DNSPs were fair and reasonable.

As the contestable battery and energy services market is developing, a poor decision by the AER would have serious, while unintended, consequences on long term competition. It is important for this market to evolve prior to the AER allowing derogations from the competitive market by DNSPs. We continue to believe that DNSPs should obtain battery services, contractually from the competitive market, which 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 regulated asset base. This arrangement would help to preserve the competitive nature of the battery storage market and given the challenges on cost allocation referred to above, the AER cannot guarantee that the DNSPs will cross subsidise these contestable energy markets.

About Red and Lumo

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

We consider that the AER is undertaking a thorough consultation on this important matter. 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,

Ramy Soussou
General Manager Regulatory Affairs & Stakeholder Relations
Red Energy Pty Ltd
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