21 December 2020

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

Sent via email: AERringfencing@aer.gov.au

Dear Mr Gulbenkoglu

Submission to AER Issues Paper on updates to the Distribution Ring-Fencing Guidelines.

SA Power Networks welcomes the opportunity to comment on the AER Issues Paper – Updating the Ring-Fencing Guidelines for Stand-Alone Power Systems and Energy Storage Devices (Issues Paper).

We are pleased that the Issues Paper appears to reflect a genuine desire to examine where regulatory flexibility can enable Distribution Network Service Providers (distributors) to provide services using emerging technologies, where this best promotes efficient outcomes in customers' long-term interests.

Our submission, contained in the attachment to this letter, provides further comment in support of the submission from Energy Networks Australia. Our key recommendations are that:

- broad-based Guideline exemptions allowing distributor involvement in the provision of Stand-Alone Power System (SAPS) supply will best recognise that SAPS supply in the near term is unlikely to always be efficiently and prudently provided by a third party;
- distributor investment in, and use of, energy storage devices either in partnership with third parties or individually, should not be discouraged where this can drive efficiency in National Electricity Market services – safeguards to potential anti-competitive conduct already exist and can be further enhanced by means other than blanket restrictions;
- the utility of staff sharing registers could be enhanced but any further required information should be targeted to avoid unnecessary cost;
- the 'materiality' threshold be maintained for breaches that need to be immediately reported, but that further clarity be provided in relation to its application and interpretation;
- constraints on distributor and related electricity service provider co-branding be reduced; and
- moving to calendar year annual compliance reporting will help with resourcing issues.

If you have any queries or require further information in relation to our submission, please contact Bruno Coelho on 0419 666 389 or bruno.coelho@sapowernetworks.com.au.

Yours sincerely

Mark Vincent
General Manager Strategy and Transformation

1. Stand-alone Power Systems (SAPS)[1]

1.1 Current state of SAPS in South Australia

Distributor involvement in SAPS services over the next decade will likely provide the best outcome for customers with respect to the efficiency and performance of these services. Over this period of time, there is unlikely to be effective competition for providing SAPS services in South Australia noting that:

- while we are still working with our customer representatives to identify potential candidate sites for SAPS supply, we expect these to be limited to small numbers over the decade;
- SAPS supply will likely be most efficient and prudent in remote and rural areas where we may have individual customers, or few customers connected to the end of long powerlines on the edges of our State-wide distribution network - these candidate sites are likely to be geographically dispersed throughout our network;
- under the framework proposed by the Australian Energy Market Commission (AEMC), energy supply via a SAPS will need to conform to distribution network service standards so that customers experience no deterioration in their current service levels. Service providers will also need to put in place quite complex commercial constructs involving multiple parties. The willingness of third parties to establish such arrangements and comply with stringent technical requirements is unlikely to occur until the market is of sufficient size and scale; and
- with these factors combined, we expect it will be unlikely that a third party can install and provide ongoing maintenance / support for SAPS as efficiently as ourselves, given that we could draw on our existing regional field crews and economies of scale and scope.

1.2 Exemptions generally

Given the limited near-term prospects for effective competition, we strongly favour inserting automatic exemptions into the Guidelines, rather than requiring waivers to permit distributor involvement in SAPS. Exemptions will:

- avoid unnecessary administrative cost, where it is clearly preferable for a distributor to be involved in SAPS supply;
- ensure energy supply to customers is restored as quickly as possible, in cases where SAPS may be provided following an emergency event such as a bushfire;
- provide greater regulatory certainty for distributors to invest, train staff and purchase inventory for SAPS supply, also avoiding delays in SAPS deployment; and
- represent a practical way of recognising that cases below the exemption threshold cannot be presumed to always be efficiently and prudently provided by a third party.

Will exemptions allowing distributor involvement in SAPS hurt long-term prospects for competition?

Harm to emerging competition will be avoided:

- Exemptions will not provide distributors with exclusivity in SAPS services over third parties.
- The largest market for SAPS is likely to remain the unregulated market for greenfield applications (third party led).
- Distributors will be guided by incentive regulation to use third parties if efficient.
- Minimising barriers to distributor deployment of SAPS will increase the size of the market.
- Distributor deployment of SAPS can be publicly reported, audited, and reviewed by the AER.
- The AER could review exemption thresholds over time and /or for each jurisdiction so that they reflect the expected state of competition.

[1] Our comments concern the component of SAPS services that the AEMC framework deems to be 'Generation Services' as they are provided via a 'Generation System' (ie some combination of solar PV, storage devices, back-up generation). The AEMC framework prohibits distributors from providing this service component, unless approved via the Guidelines.

Exemptions do not provide distributors with exclusivity in SAPS service provision at the expense of third parties and potential competition. For any SAPS candidate site, distributors will be driven by current regulatory incentives to consider where it may be more efficient, in their circumstances, to use third parties for some component of SAPS supply rather than using in-house resources.

1.3 Broad-based exemption criteria

A single broad-based exemption will be the most practical and administratively simple option to enact and monitor. Further, the simplest means of setting a threshold for this exemption would be as a percentage of a distributor's revenue, calculated on the basis of the Distribution Use of System (DUoS) revenue earned from SAPS customers over a defined period of time.

However, other options could involve defining a broad-based exemption on the basis of:

- the total number of customers supplied via SAPS cumulatively over a defined time period; or
- the total number of customers supplied by a single SAPS.

The exemption threshold could be reviewed by the AER over time or between jurisdictions to ensure that it remains commensurate with the AER's view on the expected level of competition for SAPS services. This could potentially occur via the AER Framework and Approach process.

Further, for transparency and AER oversight, distributors could be required to maintain a public SAPS register detailing relevant information. Exemptions applied by a distributor could also be reviewed by an independent auditor via the annual Ring-fencing audit and reported in the annual Ring-fencing compliance report (as per the existing Guideline's compliance requirements).

1.4 Specific exemption criteria

In Table 1 we comment on the specific exemptions that the Issues Paper has explored. However, we do not support specific exemptions, as these risk being defined too narrowly and becoming obsolete over time. We expect that no single specific exemption is likely to be appropriate, and that either a large number of exemptions would need to be defined, these would need to apply in addition to a broad-based exemption discussed earlier.

Table 1: SA Power Networks views on potential specific exemptions

Options that might be considered	Options likely to be problematic
Exemption based on a SAPS' energy capacity The Essential Services Commission of South Australia uses this approach (threshold of greater than 100kVA) to determine if licensing is required.	**Exemption based on expenditure on SAPS** This would be problematic due to the potential variation in expenditure that may be required over the SAPS assets' life cycle.
Exemption where no public tenders are received. This exemption would be limited to situations where *no* third-party tenders are received.	**Exemption based on efficiency** Efficiency and prudency are drivers for distributor involvement in SAPS. However, such exemptions are impractical and costly, as they require cumbersome and detailed reporting of likely immaterial cases.

Options that might be considered	Options likely to be problematic
	If such an exemption is used, this must consider price (ie the costs of a third party's tender versus the distributor's costs), and non-price factors that determine the prudency of outsourcing. This includes any factor that may affect the quality, safety and security of customers' energy supply.
Exemptions for faults, emergency response and natural disasters It is impractical to rely on waiver applications for these cases, risking delay in supply to customers.	**Exemptions based on the type of SAPS** This would require an extensive list and is impractical.
Exemptions for distributors to take over SAPS activities in the event of principal default This exemption would cover cases where a distributor needs to take over from a third party where they are no longer able/willing to provide SAPS services (eg ongoing maintenance) or cease operating (eg provider of last resort situations).[2]	**Exemption for sites with restricted access** Access issues do not appear relevant to determining situations where competition is unlikely to be effective. Further, without a detailed list of all relevant criteria, the test for use of this exemption would be highly subjective.
	Exemptions based on remoteness or population density These are inflexible, do not necessarily help capture where competition is ineffective, and are complicated by the difficulty of defining regional boundaries.

1.5 Waiver process

An effective broad-based exemption should cover most situations where it cannot be presumed that third party supplied SAPS services will be most efficient and prudent. However, we also recommend reforms to the waiver application and approval process to enable AER consideration of rare cases that may exceed the exemption thresholds. These reforms include:

- ensuring that the waiver assessment criteria in the Guideline allow the AER to consider not only whether there is a third party tendering to provide a service, but also the competitiveness of that tender, relative to what a distributor can provide. Assessments must extend to price and non-price factors (following standard procurement practice) that may determine what will likely promote the best service outcome for customers;[3] and
- allowing waivers to last for the life of the SAPS generation assets. It is unclear why distributors would not be provided with investment confidence in cases where a waiver is granted.

[2] These circumstances could be written into contracts between a distributor and the third party, where relevant.

[3] Non price factors could include: previous project performance; safety record; contractual terms such as warranties and indemnities; scheduling and completion dates, safety quality and post completion obligations.

2. Storage Devices

Large scale storage devices can potentially provide support for distribution networks during times of constraint, and services valued by customers directly[4] or by the wholesale market. [5] As technology and markets evolve, so too must regulation.

In this respect, we note that the storage market has evolved rapidly since the initial establishment of Guidelines. There is now more than 200MW of distributed storage active in the South Australian market – an amount that dwarfs the resources likely to be deployed by a distributor. The likelihood of a distributor materially influencing that market is therefore negligible.

This being the case, rather than the blanket Ring-fencing boundaries that have historically been used, regulation should be flexible to achieve long-term least cost outcomes for customers.

Are there safeguards to competition if distributors are allowed indirect or direct use of storage devices?

Existing safeguards include:

- The AER can assess regulated expenditure proposed by distributors to invest in storage, to determine if the anticipated use for regulated purposes is reasonable to justify the expenditure.
- Distributors must report future network constraints in the Distribution Annual Planning Reports – this is intended to be used by third parties wanting to provide network support.
- The Australian Competition and Consumer Commission monitors competitive conduct.

Other potential safeguards could include:

- new principles to guide allocation of storage costs between regulated and unregulated services; and
- provisions requiring distributors to not discriminate against competitor storage service providers, providing a threat of AER investigation.

With any asset such as storage that can provide regulated and unregulated services, it is unwise for regulation to pre-determine how such assets might most efficiently be used and shared by market participants. There may be cases where distributors may seek to:

- invest in and own a storage device solely for network support;
- invest in storage for network support but share the investment costs with a third party who uses the device to provide unregulated services (the AER terms this as 'indirect use'); or
- invest in storage for network support but find that is more efficient to use the storage device directly for unregulated services (the AER terms this as 'direct use').

As the AER examines its approach, we agree that it is useful to distinguish between 'indirect' and 'direct' use of energy storage by distributors, as the approach may vary between the two.

2.1 Indirect use of storage devices

There may be cases where it is efficient for a distributor and a third party to co-invest and share in the use of a storage device for regulated and unregulated services respectively. This is already occurring in the National Electricity Market.[6] We expect many storage projects may involve such partnerships.

To enable this to occur, we support amending clause 3.1(d) of the Guideline to make it clearer that, in addition to 'shared assets', for the purposes of the shared asset rules, this clause also applies to other circumstances in which third parties might use a distributor's assets to provide distribution services, transmission services or other services.

[4] For example: community storage services, where customers store and retrieve energy from a communal asset service.

[5] For example: Frequency Control Ancillary Services (FCAS) or Reliability and Emergency Reserve Trader (RERT) services.

[6] This includes the example of Electranet partnering with AGL for a transmission network scale storage project.

2.2 Direct use of storage devices

In other cases, it may be efficient for a distributor to be the sole investor in, and owner of, a storage device and directly use this device for regulated and unregulated services, and we welcome the AER having recognised these cases. These cases may arise where:

- there are prohibitive transaction costs in entering into and monitoring contracts with a third party. A key issue will likely be that the distributor's use of a storage device for network support must always take precedence to avoid network constraints; or
- there are material inefficiencies in providing unregulated services via a ring-fenced affiliate.

Where direct use by distributors can deliver efficient NEM outcomes for customers while presenting no harm to competition, as there are other safeguards to address the root-cause of such potential harm, then regulation should be flexible to enabling such outcomes.

2.3 Compliance and monitoring

If there are concerns with potential harm to competition from a distributor's indirect or direct use of storage devices, we encourage the AER to address the root-cause of such concerns rather than imposing blanket restrictions that risks inefficiency for customers. For example:

- if the concern pertains to cost allocation, we would be pleased to work with the AER and stakeholders to define appropriate principles for devices such as storage, which could be informed by approaches the AER has approved, such as Electranet's ESCRI-SA Project; or
- if the concern pertains to a distributor having the potential to discriminate in favour of itself over a third-party storage service provider, the AER could strengthen the non-discrimination provisions in the Guideline to refer to interactions between the distributor and competitors. Such provisions would provide a threat of AER undertaking compliance investigations particularly if a complaint is raised by a third party.

3. Other General Improvements to the Guidelines

3.1 Staff sharing and information access and disclosure

We support enhancing the publicly available staff-sharing registers, as an effective way of strengthening the transparency of staff sharing arrangements between a distributor and its affiliates. To ensure that there are benefits in any additional information that may be required, we recommend that the AER:

- outline what it considers to represent best-practice among distributors, so that we can precisely determine what additional information is sought and how this assists the AER's role; and
- not require a level of detail that may need frequent updates to the registers when staff position titles or organisational restructures occur over time.

To ensure consistency of reported information, the AER could publish a template register and provide additional guidance on the level of required detail (for example, in a sample register).

With respect to information access and disclosure, we support amending the term 'confidential information' to be 'Ring-fenced information' to avoid misconceptions regarding 'confidential information'. We note, however, that there is no intent to amend the original definition ie 'Ring-fenced information' would be defined as per the current Guideline's definition of 'confidential information'.

3.2 Materiality of breaches

We support extending the time required for immediate reporting of breaches to the AER. However, we oppose introducing a requirement to disclose *all* breaches on an immediate basis. In our view:

- the increased administrative burden is disproportionate to the intended outcome and would lead to distributors being required to report 'trivial' breaches;
- it would be preferable to change the term 'material breach' to 'notifiable breach' to reduce the confusion surrounding the term. It is important to note that *all* breaches are still required to be reported through the annual Ring-fencing compliance regime. This provision is only concerned with the *time* in which the breach needs to be reported;
- a workable definition for a 'notifiable breach' could be developed with reference to:
    - the *nature* of the breach (ie a more objective approach). This could be achieved by referencing specific provisions of the Guidelines and stating whether the provision is applicable. For example: "Notifiable Breach means a breach of the Guidelines, other than a breach of sections X, Y, Z;" and
    - the *severity* of the breach (ie a more subjective approach). For example: "Notifiable Breach means a breach of the Guidelines that caused or was likely to cause significant harm". This definition could also go further, and incorporate factors listed at part 2.1 of the AER's Ring-fencing Guidelines Compliance Reporting best practice manual; and
- the AER could consider an approach where an initial conversation is had with AER staff to determine if a breach does need formal reporting within the set timeframe.

3.3 Branding

The issues paper queried whether the current branding provisions are proportionate. In our view, the provision at 4.2.3(a)(i) of the Guidelines is ambiguous. Distributors have applied broad interpretations of the provision and have adopted very conservative policies and procedures for the use of branding that are disproportionate to the potential harm caused.

'Branding' should be more clearly defined, including examples of material and uses that are and are not 'branding'. For example, 4.2.3(a)(i) can be interpreted to mean that the regulated and non-regulated branding can never appear together in the broad context of Direct Control Services. On the basis that provisions 4.2.3(a)(ii) and (iii) of the Guidelines regulate 'advertising' and 'promoting', the use of the term 'branding' in 4.2.3(a)(i) suggests an intention to capture situations beyond marketing (ie an application beyond external uses).

While we acknowledge the potential harm that co-branding may cause to competitors, there are multiple situations when either there is no, or negligible, harm in allowing regulated and non-regulated branding to appear 'side by side'. For example:

- dealing with industry stakeholders and suppliers who engage regularly with distributors, related electricity service providers or both. Such persons are aware of the relationship between the entities and the fact that certain services are shared. While the primary purpose of such material is not to promote one or both entities, the material is being divulged outside of the organisation;

- safety and information bulletins or circulars. Again, this material is being divulged outside of the organisation but for a benevolent and functional purpose. Such information is predominantly produced and disseminated by Safety and Procurement departments, which are an acknowledged shared service. It is inefficient and disproportionate to the aim of the material to restrict co-branding and have the same material released under separate branding; and
- personnel and vehicles being present simultaneously on project sites. The fact that regulated and non-regulated personnel and vehicles are both present does not divulge the relationship between the two and is no different to third party contractors being present. To the extent that this does create issues, it is not discriminatory as the work has already been awarded and the work can only be awarded via a process that accords with the Guideline.

To require separation in the examples outlined above, creates unreasonable and disproportionate cost impacts on DNSPs. This includes not only the cost in 'double handling' in separating out material, but also the administrative cost of determining whether or not the relevant material can be co-branded.

If the AER's intention of provision 4.2.3 is to prevent discriminatory behaviour, then provisions 4.2.3(a)(ii) and (iii) adequately prevent distributors from giving an unfair competitive advantage to the related service provider in a public perception or marketing sense. Our concern is the non-marketing uses of 'brands' where the current restrictions outweigh the potential harm.

3.4 Timing of compliance reports.

We support moving to calendar year annual compliance reporting which will assist networks' resourcing requirements by helping to spread the workload of compliance teams who are already busy with Regulatory Information Notice audits.