

8 July 2021

General Manager, Strategic Policy and Energy Systems Innovation
Australian Energy Regulator
GPO Box 520
Melbourne, VIC, 3001

Submitted electronically at: AERringfencing@aer.gov.au

Dear Sir/Madam,

Electricity distribution Ring-fencing Guideline review – draft.

The Australian Energy Council (AEC) welcomes the consultation opportunity in the Australian Energy Regulator (AER) review of the Electricity distribution Ring-fencing Guideline.

The AEC is the industry body representing 22 electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. These businesses collectively generate the overwhelming majority of electricity in Australia and sell gas and electricity to over 10 million homes and businesses.

The draft guideline further broadens the scope for addressing new energy services. Consumers are increasingly active in the installation of technologies that can augment the network and provide smarter solutions to network constraints than conventional upgrades of poles and wires and the AEMC previous Competition in Energy Services determination consolidated consumers position in this regard.

Many network businesses are keen to explore both the commercial opportunities and grid augmentation benefits of deploying technologies like Stand Alone Power Supplies (SAPS) and storage (batteries). As an adjunct to this they are also keen to grow their businesses outside of the provision of regulated services, establishing ring fenced commercial businesses to operate in the competitive distributed technology market.

The AEC observes that the National Electricity Rules (NER) were not drafted with this kind of market in mind. Ring fencing has an important function and should firstly ensure we get competitively neutral outcomes from this important and evolving market change. This must involve changes that encourage rather than discourage competition and whilst the list of minimum requirements to encourage competition is not onerous and yet continues to fail to be effectively addressed. Networks should be required to:

- Publish all relevant data and forecasts for opportunities for the use of grid augmenting distributed generation technologies,
- Conduct cost benefit analysis to demonstrate the value of the proposed investment,
- Conduct a transparent competitive tender process to procure these services.
- Recover through regulated revenues only the cost of the preferred option as identified by cost-benefit analysis.

Additional safeguards are also required in the waiver process. These should prioritise:

- The procurement of network services from competitive markets; and

- Strict compliance with any waiver process.

Non-discrimination.

The proposed new non-discrimination clause reflects that confidence in distributor compliance with ring fencing requirements is low, as illustrated by both Firm Power and NECA concerns¹. These concerns are widely shared by our members, and they tell us they are already having a chilling effect on the development of a flourishing competitive market in both SAPS and storage services. The AER has a role in energy network regulation, and whilst compliance monitoring and enforcement is a key function mentioned on the AER website on coverage of both wholesale and retail regulation, neither compliance nor enforcement is mentioned in the AER's primary network regulation roles.²

Mitigating the risks from DNSP discrimination and cross-subsidisation has rated mention in most of the AER ring fencing guideline reviews and yet little has in practice been observed by industry in this regard. First remedies would require that all competitors of network-owned commercial businesses should be granted the same access to data and access arrangements, and these requirements that should be enforced by annual audit and where required compliance penalties. Positive assurances for compliance, such as "*a demonstrated commitment to deal with the battery in an arms-length, transparent and non-discriminatory manner*"³ do not in the AEC's view provide a plausible nor demonstrable enforceable compliance regime. The regulator and broader stakeholders need to be satisfied that no violations have occurred if we are to rebuild any confidence in the effectiveness of ring fencing arrangements.

Non-discrimination is essential to ensure that all relevant competitive service providers can compete for the provision of these services on the same terms, and that the competitive tendering will ensure the discovery of the best price. Success will reveal itself through healthy competition between all service providers, leading to innovation and greater efficiency. Failure will reveal itself (as now) through lackluster competition, the absence of depth in the market and a consolidation of the uneasily close commercial relationships between regulated network providers and their ring fenced affiliates.

Failure will also result in long term consumer costs above what they could have been, and efficiency lower than it could have been.

Deployment of SAPS by DNSPs in situations where there is likely to be limited third party providers of SAPS generation services.

The AER assessment is that this test for likelihood might be:

1. A third party provider is not available or willing to offer services,
2. The SAPS may be too small to make outsourcing the generation services economical,
3. A third party may not be able to offer the ongoing operating and maintenance required to meet NER technical and performance standards.

The AER does not examine the root cause of such likelihood. The crude fact in each of these cases is that the third party provider is signalling that they do not find the SAPS economical: they cannot get a sufficient return. Why would this be the case? This question has not been tested at all. Competitive markets are dynamic and ready and waiting to serve opportunities. Why couldn't the market provide the solution.

Conversely ring fencing is concerned with preventing network businesses from taking advantage of their knowledge and insight in contestable commercial opportunities associated with their regulated activities. Therefore, if only the network or its ring fenced affiliate can find the necessary returns in

¹ P.48

² <https://www.aer.gov.au/about-us/our-role>

³ P.31

all or the majority of cases, doesn't that provide a prima facie case that there is something about ring fencing arrangements that is facilitating a discriminatory outcome?

Drawing from the AEMC's analysis and final decision on SAPS, points 1 & 2 above appears to be based on hypothesis and not market experience. Point 3, provided by SAPN, again represents a fear rather than fact. The AEC does not support assigning the greater part of SAPS for the next decade directly to DNSP's in the manner effected by the draft guideline (the exemption framework) on these three basis.

Enabling consumers to realise the benefits of lower cost and higher reliability supply, while also providing information and the scope for third party providers to enter the market.

The AER contemplates an obligation on regulated network businesses to provide network performance data and load data to competitors to its related business that will enable decisions to invest in generation or storage as an alternative to distribution capacity is required. This has been a problem over time and the AEMC is still wrestling with this in the current review of DER integration.

The AEC acknowledges that the information is somewhat available, but our members advise it's incomplete, it is very hard to decipher is one of the main reasons there is less appetite from competitive players.

AGL in its submission to this review called for a published statement of opportunities that should set out specific and detailed information to maximise the potential for the most cost competitive solutions. Our view in the opening paragraphs of this submission sets out what we believe are the minimum requirements.

Promoting efficient deployment of SAPS in the early stages of market development, reviewing the exemption framework to consider if it remains appropriate.

The problem with this approach is the advantage it consolidates in the market in the early stages of market development. We have raised these issues in our remarks on non-discrimination. In the circumstances of accounting separation, the regulated networks ring fenced affiliate could in theory provide the service at a discounted price by using part of the benefit available to them to do so. This has the potential to crowd out potentially more efficient service providers from the SAPS market in the short-term, which diminishes productive efficiency, and would have a chilling effect on competition and technological development in the SAPS market in the long-term, which diminishes dynamic efficiency. This outcome is not in the long term interests of consumers.

In our view it is imperative that the regulatory framework requires network businesses to effectively test the market for cost competitive solutions before any waiver is granted. We also encourage the AER to monitor their own expectation that rural NSW and Queensland will likely be the SAPS deployment locations.

The use of batteries to provide contestable services.

The AER proposes that DNSPs are prohibited from providing contestable services with a battery (whether the service consists of the supply of excess capacity to third parties, or the provision of other contestable services themselves with the battery).

Our understanding is this is consistent with the emergent AEMC and ESB view. Our concerns remain with regard to where a ring fenced affiliate (or the NSP, as a result of their ring fenced affiliate's actions) can monetise a benefit that another competitor cannot simply as a result of the regulatory framework. This would then skew the market in favour of the ring fenced affiliate in that they may be able to capture more market share than they otherwise would have.

Information asymmetry and “free kick” deals with ring fenced affiliates could be mitigated if networks were required to publish network service opportunities, tender outcomes and the situations and an accompanying statement of reasons where distribution network owned batteries have secured an AER waiver. Our view is that all network service opportunities also be subject to a minimum 12-week market consultation.

Finally, recent analysis undertaken by Oakley Greenwood (OGW) for the AEC⁴ examined changes to the Network Access Code in Western Australia (WA) is worthy of the AER’s attention. The proposal allows Western Power to own grid-side connected batteries and bundle these costs into the RAB. OGW assessed impacts to potential market competition as a result, and their analysis highlights risks that are common to any regulatory framework.

The WA approach allows the distribution network to justify a grid-side battery investment over other network solutions based on its earnings from *both* regulated and unregulated services and its ability to recover this investment under the RAB, even if this is not the most efficient investment. Giving practical effect to this approach through the loose ring fencing and waiver requirements currently proposed by the AER for the NEM will create a comparable barrier to WA for those competitors providing these services in the market who face investment exposure and risk with unregulated rates of return. We commend the OGW report to the AER.

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.

We note the proposal to design a waiver process that is robust and provides additional guidance on the factors the AER may consider when assessing a waiver application in relation to batteries. In our submission the AEC contend that the waiver process could also suffice for SAPS and given the harms are similar we are confused by the difference.

The waiver process requires an emphasis that addresses the perverse incentives for network batteries. For example, if they are paid for under the RAB, then who should be receiving the profit from any generation? Could it be the third party with the agreement, the network, or could it translate to a direct reduction in network costs for consumers? The waiver test therefore should not rely upon network assessments that the benefits outweigh the harm, but rather a proof of no harm test that examines and provides a hurdle for the distribution of compensations.

It is imperative that the regulatory framework requires network businesses to effectively test the market for cost competitive solutions before any waiver is granted. Like SAPS, the market for energy storage is in its early stages of development and an incorrect decision by the AER could have serious consequences on long term competition.

Any questions about this submission should be addressed to David Markham by email to david.markham@energycouncil.com.au or by telephone on (03) 9205 3107.

Yours sincerely,

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⁴ Oakley Greenwood, Implications of network ownership of grid-side battery assets on competition in the Wholesale Electricity Market (May 2021), Available at [ogw-report_wa-competitive-effects-of-network-provision-of-grid-scale-batteries_may2021.pdf](https://www.energycouncil.com.au/ogw-report-wa-competitive-effects-of-network-provision-of-grid-scale-batteries-may2021.pdf) (energycouncil.com.au).