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General Manager, Strategic Policy and Energy Systems Innovation
Australian Energy Regulator
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Submitted online: AERringfencing@aer.gov.au

12 January 2023

Dear Mr Feather,

Waiver Assessment - Distribution Network Service Providers leasing battery capacity to third parties for batteries funded under the Commonwealth Government's Community Batteries for Household Solar Program

The Australian Energy Council (AEC) welcomes the opportunity to respond to the waiver assessment by the Australian Energy Regulator (AER).

The Australian Energy Council (AEC) is the peak industry body for electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. Our members collectively generate the overwhelming majority of electricity in Australia, sell gas and electricity to millions of homes and businesses, and are major investors in renewable energy generation. The AEC supports reaching net-zero by 2050 as well as a 55 percent emissions reduction target by 2035 and is part of the Australian Climate Roundtable promoting climate ambition.

Protecting competition in developing markets

The expansion of energy storage infrastructure is inevitable and indeed desirable if we are to achieve energy reliability with greater distributed generation and as the reliability support historically provided by grid scale fossil fuel generators closes out. Encouraging private capital to continue to invest rationally in grid side storage means that the regulatory framework must support investor confidence in investing in long lived assets. The AER should therefore apply a high threshold within its waiver framework to protect and encourage competition in the developing competitive energy markets.

Beyond convenience, it is not apparent that there is a need for a class waiver. The current Ring-Fencing Guideline (the Guideline) provides for a case-by-case assessment of any Distribution Network Service Providers (DNSP) proposal. The Guideline was itself the subject of extensive consultation to establish a rigorous framework to give effect to preventing regulated businesses from discriminating in favour of their related parties to disadvantage competitors also operating in those markets, and to prevent use of revenue earned from regulated services to cross-subsidise contestable service. In this case the expedited process class waiver could give practical effect to exactly the outcomes that the Guideline seeks to avoid.

It is incumbent on the AER to administer the Guideline in a manner that provides confidence in an enduring and stable framework, and that will not likely see a chilling effect on investment by non-regulated providers of these assets. Because the markets for contestable energy services within which DNSPs operate are still in their early stages of development, any incorrect decision by the AER may have serious consequences on long term competition.

The waiver

Whilst an expedited process or a class waiver is permissible under the Guideline, the issue that is the subject of this waiver is too important and too complex to be considered for an expedited process or a class waiver. It is not just some minor administrative hassle. The AER must have regard to the National Electricity Objective (NEO), as well as the potential for cross-subsidisation and discrimination if a waiver is granted or not granted, and whether the benefit, or likely benefit, to electricity consumers of the DNSP complying with the Guideline are outweighed. In this case there is probable detriment to the NEO, and confidence about both cross subsidy and competitive neutrality is low. To grant a class waiver in preference to a vigorous case by case assessment in these circumstances would be irresponsible.

Nonetheless the AER is considering granting a class waiver under section 5.3A of the guideline. This waiver will allow DNSPs to lease out any excess capacity from batteries that are funded under the Government's Community Batteries for Household Solar Program. Under the current guideline, DNSPs with batteries that provide regulated services are not permitted to lease excess capacity without meeting legal separation and functional separation requirements.

The specific terms of the waiver would include a request for clauses 3.1, (legal separation) and (functional separation) 4.2.1 and 4.2.2 of the guideline for projects that are developed under the program be waived. The waivers would be applied to projects where a battery was funded under the program where:

- a. an asset was not allocated to the Regulatory Asset Base (RAB), or;
- b. DNSPs allocate the part of the battery that is used to provide direct control services to the RAB.

For any projects that fell within class (b) above, DNSPs would be required to

- comply with the Cost Allocation Principles in the National Electricity Rules (NER) to ensure the correct allocation and attribution of costs for the relevant asset between direct control services and contestable energy services
- provide an independent audit report that confirms the usage by the DNSP and the usage by the third party that leases the battery including the initial proposed allocation as a baseline against which actual usage of the assets can be compared. Any non-compliance would be subject to the civil penalty provisions for breaches of the guideline.

AEC position

The AEC does not support the proposed class waiver that applies to these assets that fall within class (b) above. The waiver conditions do not prevent the DNSPs from providing cross subsidised services from these battery assets because:

- battery storage facilities are able to provide regulated and non-regulated services almost simultaneously and to switch between these services within milliseconds in real time making it impossible for any regulator to accurately determine how costs between the regulated and non-regulated services have been allocated, and;
- a robust methodology for deciding on the manner in which the split between supplying regulated and contestable services of a battery storage facility would be allocated has yet to be developed.

The civil penalty provisions that apply to a breach of the guideline may provide an incentive for DNSPs to comply with the conditions of the waiver. But they will unfortunately do nothing to address the real problem of being able to determine whether the asset is providing regulated or non-regulated services in real time.

This waiver was lodged under the expedited waiver process to support DNSPs to access multiple revenue streams for their batteries. While the intentions are predictable, the risk to the NEO is that these arrangements could allow DNSPs to cross subsidise their non-regulated activities and ultimately to ensure that they end up dominating these markets. As a general principle, it should be of a greater concern and priority to the AER that the increasing availability of alternatives to

'traditional' (DNSP-initiated, capex-based) approaches is encouraged in delivering regulated network services¹. In the AEC's view a robust and full waiver process is essential to this.

In its considerations, the AER needs to balance the benefits; consumer detriment for the long-term by narrowing providers of these services against the short-term cost of distributors simply complying with the current guideline. The current Guideline requires DNSPs supply any contestable battery services to third parties through an independent ring-fenced affiliate. In the long run, this latter approach will ensure that DNSPs compete in a fair and reasonable manner on a competitively neutral basis, and that a flourishing market in these services can develop, to the greater benefit of consumers.

Please contact the undersigned at David.Markham@energycouncil.com.au should you wish to discuss.

Yours sincerely,

David Markham
Australian Energy Council

¹ Greater competition in network services would also assist in disentangling whether there is a DNSP capex bias or not.