Ausgrid Submission

AER distribution ring-fencing guideline review

December 2020

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Attn: Arek Gulbenkoglu
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Australian Energy Regulator
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Lodged by email: ringfencing@aer.gov.au

Dear Mr Gulbenkoglu,

Ausgrid is pleased to provide this submission to the Australian Energy Regulator's (**AER**) review of the Ring-fencing Guideline for Electricity Distribution (Version 2) (the **Guideline**). We welcome the AER's review of the Guideline to ensure that it remains fit-for-purpose.

The electricity system is going through a once in a century transformation. As an integral part of the supply chain, it is important that electricity networks can innovate and trial the provision of new services in order to help facilitate this transformation. Although ring-fencing arrangements are an important part of the regulatory framework, recent policy reviews have questioned whether current arrangements are acting as a barrier to innovation and positive customer outcomes. We therefore support the AER in its review of the Guideline to ensure that it supports innovation and reflects the changing nature of services offered by distributors.

Attachment A to our submission provides high level comments on the AER's November 2020 Ring-fencing Issues Paper (**Issues Paper**) while Attachment B provides detailed answers to the AER's targeted questions.

We appreciate the AER's engagement on these issues to date and would welcome a further discussion prior to publication of a draft Guideline. Should the AER have any questions in relation to this submission, please contact John Skinner, Regulatory Policy Manager on 02 9269 4357 or john.skinner@ausgrid.com.au.

Yours sincerely

Alex McPherson
Head of Regulation

Attachment A: Overview

Ausgrid operates a shared electricity network that powers the homes and businesses of more than 4 million Australians living and working in an area that covers over 22,000 square kilometres from the Sydney CBD to the Upper Hunter.

This shared network is playing a key role in the transition to a more distributed energy system and a lower carbon economy and must be harnessed to ensure it continues to deliver benefits for customers. We also believe that many of these benefits will be unlocked by the development of new markets, new technology and greater competition in the energy sector. Like the telecommunications network, electricity distribution networks will be a platform that new technologies leverage to deliver the next generation of energy services to customers.

Electricity distribution networks need to evolve and become smarter if they are going to facilitate this transition and become the energy platforms of the future. However, there is increasing evidence that ring-fencing is a barrier to this evolution. We therefore support the AER's review of the Guideline to ensure that it is fit-for-purpose and reflects the changing nature of services offered by distribution businesses.

We also recognise that many of the new services being offered by distribution businesses operate at the boundary between regulated and unregulated electricity markets. We therefore support changes to the Guideline which encourage the adoption of new technologies by distributors while at the same time providing transparency to the market about the new services we are offering.

This overview section provides high level views on the matters raised in the Issues Paper, while Attachment B provides detailed answers to the AER's questions.

Ring-fencing and evolving distribution networks

The electricity industry is undergoing a significant transformation. For over a hundred years energy flows have been predominantly one directional, with energy moving from large thermal generators to households and businesses along high voltage transmission lines and lower voltage distribution lines. This paradigm is changing rapidly. Households, communities and businesses now want to generate, consume and store their own electricity and sell any excess back into the grid. Distribution networks and the regulatory framework under which they operate were not designed with these 'two way' energy flows in mind.

The AEMC's 2020 *Electricity Networks Economic Regulatory Framework review* recognised that the electricity system needs to adapt to support multi-directional flows and 'become a platform to support different services that future electricity system users may value'. We support this view. We also

support the AEMC proposing changes to the regulatory framework to support the integration of DER, including community batteries, in its work program for 2021.[1]

The Energy Security Board (ESB) has similarly recognised that electricity networks need to evolve and has also suggested that ring-fencing may be constraining that evolution. In its *Health of the National Electricity Market,* the ESB commented that:[2]

> *On the distribution network there is work underway considering the constraints that ring-fencing places on the network companies and the extent to which this leads to optimal outcomes in a transitioning system. At present the ownership of batteries within the network is constrained and this may not be optimal nor fit with the role of the network if it is to be a platform to provide services.*

We recognise the important role of ring-fencing in promoting competition. Ring-fencing achieves this by putting in place measures to prevent cross-subsidies and discriminatory behaviour. That said, ring-fencing is only as agile as the classification of services established in a distributor's five yearly revenue determination. Until a new service is classified by the AER, the Guideline prevents a distributor from offering this service without a waiver, even for trial purposes.[3] We therefore support changes to the Guideline that allow distributors to trial and offer the services that our customers increasingly expect.

Accommodating a growing volume of distributed energy resources (DER) on our network is one area where customers' expectations are changing. Distributors are now expected to:

- connect DER to the network easily and flexibly, with minimal limitations ('first come first served' is not considered acceptable);
- take proactive steps to ensure customers can maximise value from DER they connect; and
- continue to operate the network safely and securely (as do Governments and regulators).

Distributors will seek to meet these expectations by trialing and offering new services, many of which haven't been defined yet. However, what is clear is that distributors need to become smarter and mature as their role changes into the future.

Collaboration with customers on a community battery trial

As part of our 2019-24 distribution determination process, stakeholders told us that they want a role in driving the direction of innovation and there is strong interest in unlocking the potential of community

1 AEMC, *Electricity Networks Economic Regulatory Framework* 2020, p4.
2 ESB, *Health of the National Electricity Market,* Volume 1, 2019, p39.
3 AER, *Electricity Distribution Ring-fencing Guideline Version 2,* subclause 3.1(b)

solar and storage solutions. Customers recognise that the efficient use and integration of these technologies has the potential to allow distribution networks to reduce capital expenditure on traditional poles and wires solutions, thereby placing downward pressure on whole of system costs for customers.

Our innovation program is focused on the progressive implementation of new grid technologies that will lay the foundations for the broader scale adoption of these technologies in the future. Our customer advocates support our innovation program, recognising that network innovation is essential as we move towards a zero-carbon future.

Central to our innovation program is our Network Innovation Advisory Committee (NIAC). Its members include customer advocates, research bodies, and environmental organisations. The purpose of the NIAC is to place our customers at the centre of our investment decisions as we transform our network. The NIAC is doing this by working collaboratively with us to review business cases for planned innovation projects to help ensure they are appropriately targeted in terms of scope and cost.

A community battery trial is one of the first projects we are undertaking under our innovation program. However, without going through a formal waiver process, the Guideline significantly constrains the scope of what we can test as part of the trial. Other distributors across the National Electricity Market are encountering similar constraints.[4] As the pace of innovation continues to increase, the need for regulatory waivers to conduct trials and provide innovative new services is not likely to be in customers' long-term interests.

Length of exemptions and waivers

Under clause 5.3.4 of the Guideline, the AER can only grant a ring-fencing waiver up until the end of a distributor's next regulatory control period. This approach may require distributors to reapply for a waiver, and leaves open the possibility that the regulator will 'change its mind'. In our view, waivers should last for the life of the asset such as a SAPS or a battery storage system.

As noted by United Energy in its October 2020 waiver application, batteries are currently expected to have a life of approximately 10 years.[5] Provisions in the Guideline which allow for the AER to grant a waiver of this duration will provide distributors and their investors, with greater investment certainty and avoid the need to reapply for a ring-fencing waiver..

4 United Energy, *Ring-fencing waiver application,* 12 October 2020

5 United Energy, *Ring-fencing waiver application,* 12 October 2020, p10

A seamless customer experience must be a priority

As recent experience in NSW has shown, restricting the activities that can be undertaken by distributors can have unintended and adverse consequences and does not always lead to the best customer outcomes.

Following the introduction of the Guideline in 2017, NSW distributors were no longer permitted to undertake simple repairs behind the customer meter. For example, the replacement of a service fuse or circuit breaker were often undertaken when Ausgrid staff were first on site following a customer report of 'no supply'. The AER subsequently recognised that its new ring-fencing guideline was resulting in poor outcomes due to the extra time and cost associated with fixing simple faults.[6] There was considerable customer frustration when an Ausgrid staff member had to advise the customer that he or she had to call an electrician to fix a simple fault that had already been diagnosed by the on-site Ausgrid staff member.

In its November 2018 draft decision the AER relaxed the ring-fencing prohibition introduced in the 2017 guideline to ensure better customer outcomes.[7] Several aspects of the proposed SAPS arrangements currently being considered by the Energy National Cabinet Reform Committee raise concerns like those experienced in 2017. Care must be taken to ensure that customers do not receive sub-optimal outcomes through the operation of the Guideline. It is the responsibility of the energy industry and regulators to collaboratively work together to reduce the complexity and increase the efficiency of customer-facing services.

Cost allocation for batteries delivering customer storage services

In its issues paper, the AER has indicated that cost allocation may be a problem in circumstances where storage devices are used to provide both network and non-network services. This issue does not arise in circumstances where a battery is originally installed for network purposes and is later used for non-network purposes. In those circumstances, the entire cost of the asset has been allocated to standard control services and the provisions of the shared asset guideline apply. The problem identified by the AER arises if a battery is being installed with the expectation that it will be used for both network and non-network services. In our view, this issue is resolvable.

We agree that distributors should not be able to recover their costs more than once and that network users should not pay for assets that are used for unregulated purposes. That said, we do not think an ex-post adjustment to the recovery of capital costs is appropriate once costs have been allocated. The AER has indicated that such an approach may be inconsistent with the current cost allocation guideline.

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6 AER, *Attachment 12 – Classification of Services, Ausgrid distribution determination 2019-24 Draft Decision,* p12-10

7 AER, *Attachment 12 – Classification of Services, Ausgrid distribution determination 2019-24 Draft Decision,* p12-5

In our view, it is open to the AER to design a method for allocating costs between the different services a battery, at the time of installation, is expected to deliver over its useful life. To allocate these costs efficiently, this method could leverage market mechanisms whereby the amount of costs allocated to non-regulated services (wholesale and FCAS) reflects the present value of all future lease payments. To use a simplified example, if the capital cost of a battery was $1 million and the present value of all future lease payments was $0.5 million, then only 50% of the capital cost of the battery would be rolled into an electricity distributor's Regulatory Asset Base (**RAB**).

If negotiations between a distributor and third party have been conducted at arms' length, the outcome of a commercial negotiation should provide the AER with comfort that the value associated with non-regulated use of a battery is efficient. The value subtracted from the total capital cost of the battery also means that electricity distributors would not recover their costs more than once and that the value going into the RAB only represents the portion of the battery being used for standard control services. This method of allocating costs is consistent with the 'direct attribution' method previously adopted by ElectraNet for its Energy Storage for Commercial Renewable Integration (**ESCRI**) project in South Australia.[8] The AER agreed that this was a practical approach to the cost allocation issue.[9]

In order to provide stakeholders with additional transparency, similar arrangements to the proposed SAPS exemption register could be introduced for battery use. That is, distributors could be required to disclose the extent to which network batteries are being used for non-network purposes.

8 See https://www.aer.gov.au/system/files/ElectraNet%20letter%20to%20AER%20-%20ESCRI-SA%20-%2021%20June%202017.pdf

9 See https://www.aer.gov.au/system/files/AER%20letter%20to%20ElectraNet%20-%20ESCRI-SA%20-%2014%20July%202017.pdf

Attachment B: Answers to consultation questions

#	Question	Proposed response
1	Do stakeholders agree that in some circumstances an exemption would be preferable to requiring DNSPs to apply for a ring-fencing waiver?	Yes, exemptions are preferable to requiring a ring-fencing waiver. Requiring a waiver in order to progress innovative projects increases investor uncertainty and is likely to result in projects that deliver clear customer benefits not going ahead. The fact that the AER may not be able to grant a waiver for the life of the asset increases this uncertainty.
2	Are there other types of exemptions we should consider?	We support an exemption that will allow distributors to rapidly respond in the event of a natural disaster.
3	In regard to the exemptions above, or any others, what is an appropriate threshold?	For simplicity, ideally the Guideline should contain generic exemptions. A size based threshold, for example, below which a distributor could automatically roll out an integrated SAPS solution, would be easy to administer and transparent for stakeholders.
4	Should exemptions for SAPS be defined in specific detail or are generic exemptions, which would apply more broadly, preferable?	We agree that generic exemption are generally preferable, however specific exemptions may be required to deal with situations not adequately dealt with by generic exemptions (e.g. natural disaster relief).

#	Question	Proposed response
5	How can we be sure that DNSPs using exemptions are complying with the Distribution Guideline?	To ensure compliance with the Guideline, distributors must submit an annual ring-fencing compliance report describing how the distributor complies with its obligations. The annual compliance report is accompanied by an assessment of compliance from an independent auditor. The independent auditor assesses distributor compliance with any exemptions in its assessment of compliance. This already provides a level of assurance that distributors are complying with the Guideline. Similar to staff registers, we support public summary reporting of SAPS being provided under automatic exemptions. These should be published on distributor's website, with the detail provided subject to privacy and critical infrastructure limitations. A distributor's distribution annual planning report (**DAPR**) is also required to include information on distributor led SAPS projects (Schedule 5.8(o)).
6	In the above criteria do the exemption thresholds satisfy the Distribution Guideline criteria of benefits outweighing costs?	The proposed exemption thresholds for SAPS must be considered along-side the extensive obligations on distributors contained in the AEMC reform package. In relation to SAPS, distributors are required to: • Develop a SAPS customer engagement strategy for engaging with affected network users (proposed clause 5.13B.2). • Develop and periodically review an industry engagement document setting out its industry engagement strategy, which must include details of how distributors will assess SAPS options and negotiate with non-network providers to develop SAPS options. • Identify these in their DAPR. The inclusion of exemptions in the ring-fencing guideline will not remove these obligations. Distributors will continue to engage with industry participants on opportunities for SAPS in their network area. The proposed exemptions will help facilitate the efficient rollout of SAPS and improve customer outcomes.
7	What other benefits, harms or risks should we consider?	As identified by the AER in its discussion about 'value stacking', there are potentially significant customer and market benefits from a distributor or market participant offering services through a battery. These benefits include: - Customer benefits from being able to use a community battery storage service, rather than buying a potentially inefficient behind the meter battery - Market benefits from additional resources participation in FCAS and wholesale markets. At present, many of these benefits cannot be realised. Changes to the Guideline will help 'unlock' this value for the benefit of multiple parties across the value chain, including customers, networks and market participants. Another benefit not considered by the AER is the significant growth in the market that will result from distributor use of network batteries.

#	Question	Proposed response
8	If NSPs use storage devices to offer services in contestable markets, how can any potential harms be managed?	The existing Guideline has controls that reduce or mitigate the risks highlighted by the AER when distributors provide other services using storage devices. These controls include non-discrimination obligations, staff-sharing obligations, cost allocation obligations, and requires an annual publicly available compliance report (including an external independent compliance audit). In the short term, we support extending these controls to the use of storage devices, and the use of a public register to identify the circumstances where distributors are offering services (such as a right of access to community batteries) in contestable markets. In the medium term, however, customers may benefit from some of the services in question being declared as distribution services by the AER. This is because they are provided 'by means of, or in connection with' a distribution system, and there are greater economic benefits from these services being provided through a shared distribution network, as opposed to through contestable markets.
9	How should we weigh these benefits and harms to determine if a waiver should be granted? What are the priorities?	In our view, the AER's existing waiver assessment criteria remain broadly fit for purpose. That is, in deciding whether to grant a waiver, the AER must have regard to the National Electricity Objective, the potential for cross-subsidisation and discrimination, and whether the benefit, or likely benefit, to electricity consumers of the distributor complying with the obligation would be outweighed by the cost of complying.
10	Should we distinguish between direct and indirect uses of storage devices?	We support distinguishing between direct and indirect use of storage devices. However, it is important to recognise that the type of service being offered influences the potential harm. For example, the direct provision of wholesale energy services by a distributor raises concerns about discrimination and inefficient behaviour as identified by the AER in its issues paper. However, the direct provision of a customer battery storage service raises fewer concerns. This is because the locational and shared nature of these services means a network providing these services actually maintains retail competition for customers in the area that want to participate.
11	Should we clarify the scope of clause 3.1(d)I of the Distribution Guideline?	We support the amendment of clause 3.1(d) to make it clearer that it applies beyond 'shared assets' to other circumstances in which third parties might use a DNSP's assets to provide distribution services, transmission services or other services. This will facilitate a greater use of assets and provide a benefit to customers.

#	Question	Proposed response
12	Can improved staff sharing registers provide the transparency of staff sharing that is needed?	We support improvements to the staff sharing registers to increase the transparency of staff sharing between distributors and their affiliates. Many of these improvements can be made without amendments to the Guideline. We support the AER identifying a best practice approach, incorporating industry feedback, that could be used by other distributors for their staff sharing registers.
13	Will changing the term 'confidential information' to 'ring-fenced information', make ring-fencing obligations in relation to information sharing clearer?	We support changing the definition of 'confidential information' to 'ring-fenced information' while keeping the definition of the term unchanged.
14	Will reporting all breaches in relation to substantive Distribution Guideline clauses in 10 business days improve the overall timeliness of breach reporting and reduce the administrative burden on DNSPs?	We support reporting material breaches within 10 business days. However, we do not consider that all breaches should be reported within this time period. This will potentially encourage distributors to come up with convoluted arguments as to why potential issues are not breaches. We support the use of an Energy Queensland styled breach calculator to determine whether breaches are material. If the AER wants more timely visibility of immaterial breaches, the AER should require a quarterly breach report for non-material breaches. This is more in line with other regulatory compliance processes.
15	Will calendar year compliance reporting minimise the administrative burden on DNSPs?	We support calendar year compliance reporting for the Guideline, meaning that compliance reports would be due on 30 April each year. With a transitional period, this approach would mean that we would submit one compliance report covering an 18 month period, rather than two reports six months apart. We agree with the ENA that the ring-fencing independent assessor be allowed to rely on the previous audit findings in assessing compliance with the cost allocation aspects of the Guideline.

#	Question	Proposed response
16	Are the current Distribution Guideline obligations, in relation to branding and cross promotion, proportional to the potential harms? If so, how might the branding and cross-promotion obligations in the Distribution Guideline be amended to make them more targeted?	No comment


Thank you
Ausgrid