Initiation notice – Assessment for a distribution ring-fencing class waiver for projects funded under the Commonwealth Government's Community Batteries for Household Solar Program

The AER is considering granting a class waiver under section 5.3A of the AER's electricity distribution ring-fencing guideline. This would waive the current restrictions on Distribution Network Service Providers leasing battery capacity to third parties for batteries funded under the Commonwealth Government's Community Batteries for Household Solar Program. Before deciding whether to grant a class waiver, we invite submissions from interested stakeholders. We seek your submissions by 12 January 2023.

Background

The Australian Energy Regulator (AER) is the regulator for electricity and gas networks in every state and territory in Australia except Western Australia.

Ring-fencing, in relation to distribution network service providers (DNSPs), refers to the separation of distribution services provided by a DNSP from the provision of unregulated or contestable services by a DNSP, or an affiliated entity. Ring-fencing operates to separate regulated activities from competitive business activities to support competitive markets. The electricity distribution ring-fencing guideline (the Guideline):

- Prevents DNSPs providing unregulated or contestable services that could be cross-subsidised by its distribution services;
- Prevents DNSPs discriminating in contestable markets in favour of themselves or affiliated entities;
- Ensures DNSPs handle ring-fenced information appropriately.

The ring-fencing arrangements also provide a framework for waivers to be granted by the AER from certain provisions where, among other considerations, the costs of compliance with the obligation are greater than the benefits to consumers of the DNSP complying with those obligations.

Why does the AER consider that a class waiver may be required?

The Commonwealth Government has announced a Community Batteries for Household Solar Program, which will allow eligible project proponents, including DNSPs, to apply for funding to contribute to the cost of [1] 400 new community batteries on low voltage networks across Australia. This program will be administered by the Commonwealth's Business Grants Hub and ARENA.

Under clause 3.1 of the Guideline, DNSPs are prevented from leasing excess capacity of any new energy storage devices to third parties to deploy in competitive markets. Clauses 4.2.1 and 4.2.2, respectively, require DNSPs, in providing direct control services, to use offices and staff that are separate from any offices or staff that are used by a related electricity service provider in the provision of contestable electricity services.

We expect that some DNSPs may receive funding through the Program and may seek to lease spare battery capacity to third parties to realise additional value from those batteries. The AER recognises the practical role that DNSPs will have in the roll-out of projects under the Program. In addition, leasing capacity will expand the services the battery can provide to the grid through the third party being able to use the battery in wholesale energy markets.

Batteries funded under the Community Batteries for Household Solar Program are expected to be subject to a degree of review, oversight and information sharing requirements that other DNSP batteries are not, along with a requirement for delivering other benefits, providing an important guard rail to ensuring outcomes are in the long-term interests of consumers.

The AER considers a class waiver may be beneficial to provide certainty to the market as to the ability of DNSPs to apply for funding under this program, and to optimise the benefits of these batteries to the community through allowing DNSPs to lease battery capacity to third parties to provide non-network services. The proposed class waiver includes conditions to ensure cross subsidisation and discrimination risks are mitigated.

[1] We note that we do not yet know whether the program will provide funding to offset the regulated or unregulated costs associated with the batteries. Our waiver approach enables either model to proceed subject to certain conditions and criteria.

The class waiver proposal can be found at Attachment A.

Other relevant upcoming AER processes

We also intend to consult with stakeholders on updating our streamlined waiver process to include assessment of waiver applications from clauses 4.2.1 and 4.2.2 of the guideline. At this stage we anticipate this consultation will occur before June 2023.

Stakeholder involvement

Before deciding to grant a class waiver, we are seeking feedback from interested stakeholders.

The AER will host a virtual feedback session on **Tuesday 13 December 2022**. This session will provide an opportunity for stakeholders to provide verbal feedback on the potential class waiver.

Stakeholders are also invited to provide written submissions to AERringfencing@aer.gov.au by **12 January 2023**.

We prefer that all written submissions be publicly available to facilitate an informed and transparent consultative process. Submissions will be treated as public documents unless otherwise requested.

Parties wishing to submit confidential information should:

- clearly identify the information that is the subject of the confidentiality claim
- provide a non-confidential version of the submission in a form suitable for publication.

All non-confidential submissions will be placed on our website.

Timing

The proposed timing for our decision is:

13 December 2022	Virtual feedback session
12 January 2023	Submissions close
3 February 2023	AER issues decision and statement of reasons
30 June 2038	Expiry of class waiver

For more information

Information on the AER's role for distribution ring-fencing is available on our website: www.aer.gov.au.

Emails to the AER ring-fencing team should be sent to AERringfencing@aer.gov.au.

Attachment A: Class Waiver Proposal

In anticipation of the Commonwealth Government's Community Batteries for Household Solar Program, the AER is considering granting a class waiver from clauses 3.1, 4.2.1 and 4.2.2 of the Guideline for DNSP-led projects funded under the Program.

The classes the waiver would apply to: DNSP-led projects where the battery asset is funded under the Commonwealth Government's Community Batteries for Household Solar Program (administered by the Commonwealth's Business Grants Hub or ARENA), where:

a) the asset is not allocated to the Regulatory Asset Base (RAB); or

b) what is allocated to the DNSP's RAB is only the part of the total residual cost of the asset that reflects the proportionate share (that relates to *direct control services*) of the total quantified benefit that is forecast at the time the investment decision is made, where:

   i. prior to the RAB allocation at the DNSP's next regulatory proposal, the DNSP includes in its regulatory proposal evidence, such as the Net Present Value assessment that informed the investment decision, and a report from an independent auditor that confirms compliance with this provision b).

   ii. definitions:

      1) the total quantified benefit is the sum of both the quantified benefit derived from the deployment of the asset for *direct control services*[2] and the quantified benefit derived from the deployment of the asset for *other distribution service* and *other services* over its economic life; and

      2) total residual cost is the cost of the asset net of any government funding provided/approved as part of the Program.

Example:

- A DNSP invests in a battery where the total residual cost of the battery asset equals $1m.
- The asset is forecast to provide a total quantified benefit equal to the sum of $1.5m derived from the deployment of the asset for *direct control services* and $1m derived from the deployment of the asset for *other distribution services* and *other services*.
- Total quantified benefits are $2.5m. The benefits relating to *direct control services* are $1.5m, or 60% of the total quantified benefits.
- Therefore, 60% of the $1m residual costs ($600,000) can be allocated to the RAB.
- While the investment occurs in 2023, the DNSP's regulatory proposal is received in 2024 and costs allocated to the RAB if they are accepted per this methodology once the new reg period commences in 2025.

The following criteria would apply to projects that fall within class (b) above:

1. A DNSP must comply with the Cost Allocation Principles that require a DNSP to appropriately allocate and attribute costs for use of the asset between *direct control services*, and *other distribution services* and *other services*.

2. A DNSP must provide, as part of that DNSP's regular ring-fencing annual compliance reporting under clause 6.2 of the Guideline, an independent audit report that covers:

   a. the total quantified benefit derived from the deployment of the asset for all services over the most recent calendar year,

   b. the total quantified benefit derived from the deployment of the asset from *direct control services* over the most recent calendar year, and

   c. the total quantified benefit derived from the deployment of the asset from *other distribution services* and *other services* over the most recent calendar year.

   (Note: the benefit in 2.a. should be the sum of the value in 2.b. and the value in 2.c.)

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[2] DNSPs should calculate total quantified benefits from the provision of *direct control services* with reference to the AER's DER integration expenditure guidance note and in particular, the benefit streams identified therein.

d. a comparison of the uses (volume and frequency) of the battery that confirms the usage by the DNSP and usage by its retail partner (or other third party), including the initial proposed allocation as a baseline against which actual usage of the assets can be compared.

The following criteria would apply to projects which fall within class (a) or (b) above:

3. Information as to the terms and conditions of the contracts entered into with third parties for the leasing of battery capacity. This information should include:

    a. The name of the contracting party or parties;

    b. The volume of capacity leased to that party or parties;

    c. The price the capacity is leased for;

    d. Which party controls the operation of the battery and on what terms.

The waiver would be active until 30 June 2038.

The AER expects DNSPs to continue to follow all other obligations in the Guideline, including in relation to mitigating the potential for discrimination. For example, the AER expects DNSPs would undertake a competitive process to select a third party, addressing potential discrimination risks.

Reasons for criteria

The criteria will provide us with transparency over the use of the battery and ensure that the risk of cross-subsidisation impacting consumers is minimised.

The AER is concerned that actual total quantified benefit derived from the deployment of the asset for *direct control services* may differ significantly from modelling undertaken by the DNSP. Where the actual benefit is smaller, this presents a risk of cross-subsidisation where a DNSP may charge consumers for battery costs through their RAB, while customers are not receiving an equal or greater benefit, leaving them worse-off. It may also suggest that the DNSP is providing the battery on more favourable or cross-subsidised terms to the party it is leasing it to, potentially negatively impacting competition in battery services markets. The criteria are designed to avoid this and to provide for additional protection against it through the revenue determination process which will give scrutiny to any costs that are to be recovered through the RAB.

One of the objectives of the Community Batteries Program is ensuring that consumers are better off, and the AER expects DNSPs who own batteries are prepared to demonstrate this is the case throughout the economic life of any battery projects funded.

(Note: Terms defined in the *National Electricity Law*, *National Electricity Rules* or the Guideline have the same meaning as set out in those instruments.)