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Submitted via email to **AERringfencing@aer.gov.au**

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Draft electricity distribution Ring-fencing Guideline – Version 3, May 2021

AGL Energy (**AGL**) welcomes the opportunity to comment on the Australian Energy Regulator's (**AER**) Draft electricity distribution Ring-fencing Guideline – Version 3, May 2021 (**Draft Ring-fencing Guideline**).

AGL supports an energy market system that empowers consumers to take control of their energy consumption and costs. As such, we are a market leader in the development of innovative products and services that enable consumers to make informed decisions on how and when to use their DER assets to optimise their energy load profile and better manage their energy costs. Our current DER product and services include our leading-edge Virtual Power Plant (**VPP**)[1], Peak Energy Rewards demand response program,[2] retail offer for electric vehicle (**EV**) owners[3] and EV subscription service.[4] Through our EV Orchestration Trial[5], we are also seeking to understand how EVs could help the wider energy system by 'orchestrating' vehicle charging through smart chargers, Vehicle to Grid chargers and API technology.

Our feedback on the Draft Ring-fencing Guideline is based on our experience and knowledge of energy consumers' engagement with DER products and services, our experience in developing network service solutions, and our ongoing involvement in DER policy and regulatory design.

Strategic direction

We believe the Ring-fencing Guideline should be designed to complement the broader economic regulatory framework governing distribution network planning and investment to support the development of a competitive market for DER services, including network services.

As we recently observed in our formal submission in response to the Energy Security Board's Post 2025 Market Design Options Paper[6], there is strong potential for whole-of-system cost savings to be realised through the integration of DER and the associated value streams that can be provided by the orchestration of DER assets. By establishing effective competitive arrangements for the procurement of system security and network services, DER has potential to substitute expensive network build, deliver value to owners and broader consumers, and provide alternative ways of meeting system security requirements.

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[1] For further information regarding AGL's Virtual Power Plant, currently available to customers in New South Wales, Queensland, South Australia and Victoria please refer to https://www.agl.com.au/solar-renewables/solar-energy/bring-your-own-battery?cide=sem-r&gclid=EAIaIQobChMIicjKmKuP5wIVyjUrCh2eXwvVEAAYASAAEgLZRPD_BwE&gclsrc=aw.ds.
[2] See further AGL Peak Energy Rewards, available at https://www.agl.com.au/newcampaigns/peakenergyrewards.
[3] See further, AGL EV Plan, available at https://www.agl.com.au/electric-vehicles.
[4] See further, AGL Electric Vehicle Subscription, available at https://www.agl.com.au/get-connected/electric-vehicles/ev-subscription.
[5] See further, AGL Electric Vehicle Orchestration Trial, available at https://arena.gov.au/projects/agl-electric-vehicle-orchestration-trial/.
[6] See further AGL submission to the Energy Security Board's Post 2025 Market Design Options Paper (10 June 2021), Available at https://thehub.agl.com.au/articles/2021/06/agls-submission-on-the-energy-security-boards-post-2025-market-design-options-paper.

Over the longer term, consumers and communities will increasingly expect greater autonomy, with different options for participation and aggregation in the market, and network connection. Putting in place the right market arrangements and institutions now will open the way for innovation to support customer value while maintaining system reliability and security.

Whilst we support the AER's proposed prohibition on distribution networks from providing contestable services with a battery, we consider that further safeguards should be established in the Ring-fencing Guideline to:

- Facilitate the procurement of network services from market as a first order priority; and
- Prevent misuse of the proposed waiver process that could otherwise lead to economically inefficient outcomes.

On the deployment of stand-alone power systems (**SAPS**), AGL agrees with the AER's proposed approach to establishing an exemptions framework to allow distribution networks to provide generation services to network-led SAPS within a generation revenue cap. We consider there is also a need to establish appropriate safeguards to ensure the exemptions framework is not misused to facilitate inefficient network investments and/or favour investment proposals from affiliated ring-fenced entities.

We also support the AER's proposed incremental improvements to certain obligations to make the Ring-fencing Guideline clearer and less administratively complex.

Key recommendations

AGL recommends:

1. The Ring-fencing Guideline establish standardised network service procurement obligations to provide the market with the best prospect of being able to service network needs in a cost competitive manner.
2. The AER institute a registry through which networks are required to publish network service opportunities, confirmed tenders to third parties for network services and instances where distribution network owned batteries have secured an AER waiver. Network service opportunities also be subject to a 12-week market consultation.
3. In establishing a waiver process for network investment in energy storage, require that distribution networks:
   - Demonstrate contractual arrangements with third parties above a certain investment grade; and
   - Disclose any contractual arrangements for tenders entered with affiliated entities to ensure probity in procurement processes.
4. The AER set a timeframe for a further review of the Ring-fencing Guideline to deal with consequential amendments following the Australian Energy Market Commission's (**AEMC**) conclusion of its rule change deliberation on integrating energy storage and forthcoming review on the treatment of community scale batteries, to deal with consequential amendments and ensure alignment between the regulatory frameworks.

5. With respect to the deployment of SAPS, the Ring-fencing Guideline require that for tenders awarded to ring-fenced entities, all contractual information be provided to the AER for review.

We elaborate our feedback in the **Attachment**.

Should you have any questions in relation to this submission, please contact Kurt Winter, Regulatory Strategy Manager, on 03 8633 7204 or KWinter@agl.com.au.

Yours sincerely

Con Hristodoulidis

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ATTACHMENT

1. Storage Devices

AGL considers that the Ring-fencing Guideline should be designed to complement the broader economic regulatory framework governing distribution network planning and investment to support the development of a competitive market for DER services, including network services. We believe markets are better placed to facilitate co-optimisation between the multiple value streams that adhere to energy storage.

AGL supports the AER's proposed prohibition on distribution networks 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). We agree with the AER's view that there is the potential for harm if a distribution network supplies excess capacity to third parties and that the benefits could be achieved by procuring network service from third parties who can then re-direct excess capacity to other contestable markets.

However, we would recommend that the Ring-fencing Guideline include further safeguards to:

- Facilitate the procurement of network services from market as a first order priority; and
- Prevent misuse of the proposed waiver process that could otherwise lead to economically inefficient outcomes.

In our experience in engaging with distribution networks tenders for energy storage investments, we have observed that networks are at a very early stage in developing appropriate specifications to accurately assess these investments and the kinds of services they are intended to provide. The actual applications of energy storage technologies are poorly understood and the temporal dynamism of networks' requirements (and how these align to market volatility) even less understood. This is in part because energy storage is a relatively new technology.

Nevertheless, as this early stage in the market's development, there is a risk that networks will go to market with a relatively simple tender specification, not secure what they were looking for and in turn decide to invest directly through the regulated asset base (RAB). While it may subsequently transpire that this direct investment proved to be much more expensive or the revenue networks were able to secure from an aggregator was much lower than their modelling anticipated, it will be too late to unwind that investment decision and the differential cost will be borne by the broader consumer base.

Procurement of network services

We note the AER's proposed efficiency criteria for the granting of a waiver includes consideration of whether the network has sought to procure those services and/or alternative services.

Rather than framing this requirement as one of assessing each individual network's approach on a case-by-case basis, we would recommend that the Ring-fencing Guideline establish standardised network service procurement obligations to provide the market with the best prospect of being able to service network needs in a cost competitive manner.

We consider that network service opportunities could be published to market in a Statement of Opportunity through an AER administered registry, providing the market with a 12-week consultation window. As we elaborated in our previous further feedback to the AER[7], the published Statement of Opportunity should set out the following information to maximise the potential for the most cost competitive solutions:

- Solution statement;
- Modelling assumptions;
- Access;
- DUOS charges; and
- Practical location information.

The registry could also serve to publish a range of information to support the continued development of the network services market, including:

- Confirmed tenders to third parties for network services; and
- Distribution network owned batteries (where secured through a regulatory waiver) and their utilisation (where batteries are used by third parties, cost allocation to the RAB and the network need being addressed). We consider that regulating the provision of this information to market is a preferable approach to the AER's proposal that this information be provided to the AER and that networks determine how it would be shared publicly as it would encourage a more standardised approach that support greater transparency.

As we elaborated in our response to the Issues Paper, consideration should be given to the development of a structured procurement digital platform, having regard to the regulatory approach adopted by the UK Government and Ofgem. Competitive-based solutions are at the heart of the UK's approach and since 2017, substantial progress has been made to deliver flexible network services through open market procurement, better and more transparent price signals for flexible action, and provision of transparent network data has enhanced visibility on opportunities to provide non-network solutions. Relevant examples include:

- Four UK distribution business established a joint 'flexible power portal' to broadcast opportunities for flexibility of network services and streamline the procurement process in October 2020. Western Power's contracted flexibility has scaled from 35.3 MW in 2018 to 217 MW in 2020 as a result of this approach.
- UK PowerNetworks publicises its requirements for new network capacity to the market ahead of building network reinforcement and is testing the viability of flexibility network services. By 2023, UK Power Networks estimates its market for flexibility could be over 200 MW.
- SP Energy Networks' FUSION project is also trialling commoditised local demand-side flexibility through a structured and competitive market.

Given the number of distribution networks operating in Australia and the relatively nascent market, we would recommend that a harmonised approach be developed by the AER to facilitate a market for third party network service providers.

[7] For more detailed commentary, see AGL Feedback on AER forum (23 March 2021), Available at https://www.aer.gov.au/system/files/AGL%20-%20Feedback%20to%20AER%20forum%20on%20Electricity%20distribution%20ring-fencing%20guideline%20-%2023%20March%202021.pdf.

Waiver process

We note that the AER has not proposed a preferred approach with respect to controls on cost allocation and intends to assess each proposal on a case-by-case basis. We consider there are substantial risks in this approach that the waiver process could be misused to support inefficient outcomes. As is illustrated by the case example discussed in the Explanatory Statement where an asset is used to support network services and subsequently has excess capacity, there is currently no well-established approach to ensure consumers realised the benefits and are not unfairly exposed to investment risk.

We would also refer the AER to the recent analysis undertaken by Oakley Greenwood for the Australian Energy Council[8] that sought to assess whether changes to the Network Access Code in WA which enable Western Power to own grid-side connected batteries and bundle these costs in the RAB, impacts market competition as a result. While we acknowledge the different regulatory framework in WA, the analysis highlights some of the risks that could also apply to the regulatory framework in the NEM. Under the WA regulatory settings, the distribution network could 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 (productive efficiency), ultimately creating an uneven playing field for those competitors providing these services in the market who face investment exposure and risk with differing rates of return due to market uncertainty (dynamic efficiency).

To support efficient outcomes where a battery investment is used for multiple value streams, we consider the AER should develop some additional safeguards, including:

- Requiring that distribution networks demonstrate contractual arrangements with third parties above a certain investment grade; and
- Disclosure of any contractual arrangements for tenders entered into with affiliated entities to ensure probity in procurement processes.

Further reviews to support DER market development

We note the AER's commentary on associated regulatory settings that could also substantially impact the economics of competitive market investment in front on the meter batteries, including network access agreements and the potential for preferential access to network assets, and the treatment of community scale batteries. While we appreciate that these matters are intended to be addressed by the AEMC in the context of current and forthcoming rule change proposals and reviews, we consider that the Ring-fencing Guideline will also need to reflect the regulatory approach to these issues to ensure that the regulatory frameworks are aligned.

Accordingly, we would recommend that the AER signal a further review of the Ring-fencing Guideline to deal with consequential amendments.

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[8] See further 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 (energycouncil.com.au).

2. Stand-Alone Power Systems

AGL agrees with the AER's proposed approach to establishing an exemptions framework to allow distribution networks to provide generation services to network-led SAPS within a generation revenue cap as categorised in the Ring-fencing Guideline. As we observed in our submission to the Issues Paper, we agree that an exemptions framework would be prudent in accommodating situations where a distribution network providing generation services to a SAPS is proven to be more efficient than procuring those services from the competitive market.

Nevertheless, we consider there is also a need to establish appropriate safeguards to ensure the exemptions framework is not misused to facilitate inefficient network investments and/or favour investment proposals from affiliated ring-fenced entities.

In this regard, we support the proposed reporting obligations on networks providing generation services through a public registry, that will provide information to prospective third-party providers and assist in the market development for these services.

We also consider that tenders awarded by a distribution network to its ring-fenced entity should be subject to a higher level of regulatory oversight to ensure these proposals are supporting the most efficient outcomes. This could be achieved by requiring that all contractual information with respect to these tenders be provided to the AER for review. Given that distribution networks are monopoly businesses, it is important that the Ring-fencing Guideline facilitates a higher level of scrutiny to support market confidence in an equal playing field. This is underscored by the Oakley Greenwood analysis referred above and the potential unintended consequences to market competition.

We note the AER's view that whilst a future review of the Ring-fencing Guideline is likely to be appropriate, it is difficult to indicate a timeframe for that review given uncertainty in the introduction of the AEMC's proposed SAPS regulatory framework. We do not agree with the distribution networks that such a future review should be contingent upon the SAPS market becoming 'sufficiently established'. Rather, the lack of maturity in the market could be due to biases in the economic regulatory framework. Review early will help to identify if this is the case and address it before it is too late (i.e only ring-fenced entities bid and win SAP services). We consider three years to be an appropriate milestone.

3. Improving the Ring-fencing Guideline

AGL supports the AER's proposed incremental improvements to certain obligations to make the Ring-fencing Guideline clearer and less administratively complex.