AUSTRALIAN ENERGY COUNCIL

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Economic Regulation Authority
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Framework and approach for Western Power's fifth access arrangement review

The Australian Energy Council (the "**AEC**") welcomes the opportunity to make a submission to the Economic Regulation Authority ("**ERA**") on the scoping paper for the framework and approach for Western Power's fifth access arrangement review (the "**Scoping paper**").

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 State Government has made changes to the Electricity Networks Access Code ("**ENAC**") as part of its Energy Transformation Strategy to address the changing nature of the energy sector and to provide more opportunities for new technologies, maximise the existing Western Power network and improve the access arrangement process.

As a result of the ENAC amendments, the process and some of the regulatory requirements for reviewing and approving Western Power's fifth access arrangement ("**AA5**") has changed. In particular, the ERA is required to publish a framework and approach document and four new guidelines prior to Western Power submitting AA5.

Requirements for framework and approach and new guidelines

The required content of the framework and approach is specified in section 4.A2 of the revised Access Code and they include:

- The investment adjustment mechanism.
- The gain sharing mechanism.
- The service standards adjustment mechanism.
- The demand management allowance.
- The form of price control that will set the target revenue.
- A list of, and classification of, services, including whether services are reference services or non-reference services. This may include the eligibility criteria for each reference service, the structure and charging parameters for each distribution reference tariff and a description of the approach to setting each distribution reference tariff.
- The method for setting the service standard benchmarks for each reference service.

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Under ENAC section 4.A13, the ERA may include matters in the framework and approach that are not listed in section 4.A2.

The four new guidelines the ERA is required to develop and publish under the ENAC are:

- Acceptable methods for valuing net benefits.
- Factors the ERA proposes to consider when determining whether expenditure meets the requirements of the new facilities investment test.
- The approach the ERA proposes to take to apply the multi-function asset principles.
- A demand management innovation allowance mechanism.

The ERA has requested feedback from stakeholders on the matters that should be included in the ERA's issues paper on the framework and approach and new guidelines.

The AEC appreciates the opportunity to provide feedback to the ERA and recommends that the ERA focus on the areas of the framework and approach that will have the greatest impact on reducing the long-term costs of the network, such as the price control and the investment adjustment mechanism. Other matters for the ERA to consider and address in the issues paper on the framework and approach and new guidelines include:

1. ENAC code objective

Significant changes were made to the ENAC code objective. Reference to the promotion of competition in markets upstream and downstream of the networks were removed and three new objectives were added: promoting the long-term interests of consumers in relation to price, quality, safety and reliability and security of electricity supplies; the regulation of access to the services of networks, in relation to quality, security and reliability of covered networks; and a focus on the environmental implications of the supply of electricity.

The AEC raised concerns about these changes during the consultation process[1] and seeks ERA guidance on how it will interpret and apply the new ENAC code objective in relation to the framework, approach and guidelines.

2. Alternative options

Under the ENAC changes, Western Power must engage with providers of alternative options and consider alternative options for addressing transmission and distribution system constraints. But while Western Power is compelled to engage and consult with potential providers of alternative options, it is not even required to procure or implement alternative option solutions from non-network providers. A network operator may instead choose to implement the non-network solutions in its own capacity.

The ENAC also fails to give the ERA clear direction on what should occur if alternative option solutions are more efficient than that proposed by the network operator.

The AEC encourages the ERA to consider how alternative options will be selected, the process for determining if the least cost solution is adopted, and the mechanism for addressing situations where the least cost option is not chosen. The AEC considers the least cost solution should be implemented irrespective of whether this is provided by the network operator or a network user.

3. Demand management innovation allowance ("DMIA") guideline

The ENAC changes introduced a new DMIA mechanism for ex-ante funding of the network operator's research and development into innovative projects related to demand management with the intent that it has the potential to reduce long term network costs.

Under WA's linear access regime, it is not reasonable for network users to fund any activity for a monopoly network operator at the expense of the network user's own business and where there is no benefit or return to the investor.

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[1] See AEC submission on the proposed changes to the Electricity Networks Access Code

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The AEC advocates for a robust framework and guideline that ensures the DMIA mechanism only funds projects that are genuinely innovative and likely to provide consumers a positive cost/benefit outcome within a reasonable period, does not duplicate other projects either nationally or internationally, and does not fund new lines of business for the network operator in competition with network users.

4. Priority projects

The ENAC now includes the concept of 'priority projects' that are identified as part of the Whole of System Plan ("**WOSP**"). If a project is determined as a priority project as part of the WOSP, then the requirement to undertake a regulatory test is automatically waived and the ERA will only be entitled to review the efficiency of expenditure.

The ENAC starts from the basis that if the WOSP identifies a priority project then it is not reasonable for the ERA to retest the prudency of the project.[2] The AEC noted in its submission to Energy Policy WA that stakeholders may have concerns over the validity of a nominated priority project in the first place or, over time, questions could be raised over the need, size, timing and solution of the priority project.[3]

The ENAC affords the ERA a restricted role in assessing the efficiency of the investments in relation to priority projects and is limited to determining that the unit costs for priority projects do not exceed the amount that would be incurred by a network service provider efficiently minimising costs.

The AEC asks that the ERA address in the issues paper how unit costs will be defined; what information the ERA requires, and the factors it needs to consider, so that it may determine whether the costs are efficient; and the mechanism for considering and addressing any disputes.

5. Conflict of interest

The ENAC clearly contemplates the network operator connecting and using stand-alone power systems and storage works.[4] The connection process for these assets is unclear, however it raises the prospect of a conflict if the network operator who uses the assets is also assessing and managing the connection of those assets as well as third party assets. The ERA raised this issue in its 'Report on the effectiveness of the Wholesale Electricity Market 2020', saying:

> "Western Power's ownership of batteries could represent a conflict in the same way it would be conflicted by owning generation. The possible conflict in this expansion of Western Power's responsibilities was recently raised in several submissions to EPWA's consultation on proposed changes to the Access Code. Many submissions expressed concern or reservations about Western Power's move to install batteries, including one from the market operator. Western Power is prohibited from owning generation facilities as this would provide an incentive for it to limit competitors' access to the network. For example, Western Power may have an incentive to make it difficult for third parties to invest in batteries that would compete with its own investment in batteries, by setting onerous technical performance standards or unfavourable network tariffs."[5]

The AEC is concerned about the impact of Western Power's ownership and use of storage assets on competition in the WEM. The changes to the ENAC also incentivizes the network operator to over-invest in grid-side storage solutions, at the detriment of competition, to take advantage of 'unregulated' revenue streams.

The AEC is seeking the implementation of a robust framework and guideline to address the process for identifying conflicts of interest and how actual or potential conflicts of interest are managed.

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[2] See p23, Energy Transformation Strategy: Proposed Changes to the Electricity Networks Access Code consultation paper
[3] See AEC submission on the proposed changes to the Electricity Networks Access Code
[4] See p21, Energy Transformation Strategy: Proposed Changes to the Electricity Networks Access Code consultation paper
[5] See p14, Report on the effectiveness of the Wholesale Electricity Market 2020

6. Ring fencing

The ENAC now allows the network operator to compete with users, under various mechanisms, in the provision of contestable services such as battery storage.

A number of stakeholders made submissions to Energy Policy WA raising the view that given the network operator's expanded roles and functions may potentially be in competition with network users those activities should be ring fenced. The concern is that retailers exit or other potential providers of these assets and services do not enter the market because they cannot compete with the monopoly network provider in the provision of competitive services. This would not be in the long-term interests of consumers.

Energy Policy WA respond to the stakeholder submissions by stating:

> "…In respect of the claim in submissions for the application of ringfencing arrangements, Chapter 13 of the Access Code already allows for the ERA to develop such arrangements for a covered network. Under section 13.11 of the Access Code, the ERA can develop ringfencing rules where it considers that a covered network is not adequately adhering to the ringfencing objectives. In developing any ringfencing arrangements, the ERA can consider the costs and benefits as appropriate, which may include the impacts on competition from covered networks interacting with third-party providers of network services."[6]

The AEC strongly encourages the ERA to assess whether ring fencing is required under Chapter 13 and section 13.11(h) of the ENAC specifically in relation to:

- alternative options;
- multi-function assets;
- demand management innovation allowance;
- stand-alone power systems; and
- storage devices

In addition, the AEC notes that the Australian Energy Regulator is updating its ringfencing guidelines to reflect the changing nature of services offered by network service providers through technologies such as stand-alone power systems and storage devices. Therefore, the AEC considers there is value in the ERA leveraging from the work[7] of the Australian Energy Regulator in relation to the ringfencing guidelines for stand-alone power systems and energy storage devices.

7. Process to approve departures from the framework

Under section 4.A11-12, any proposed access arrangement or proposed revisions submitted by a service provider to the ERA must be consistent with the framework and approach that applies to it. The service provider may propose departures from the framework and approach if there has been a material change in circumstances in which case it must provide reasons for the departure. The ERA must not approve a proposed access arrangement or proposed revisions that departs from the framework and approach unless there has been a material change in circumstances, in which case it must provide reasons for the departure.

The AEC supports a process that is transparent and includes stakeholder consultation. In the interest of regulatory certainty and transparency it is important for users to understand how a departure from the framework will be permitted, what constitutes the basis of a material change in circumstances, what stakeholder consultation will be involved, and to what extent the ERA will give regard to the ENAC objective in making such a decision.

[6] See p 6, Proposed Changes to the Electricity Networks Access Code 2004: Stakeholder Submissions Summary

[7] Australian Energy Regulator – Updating the ring-fencing guidelines for stand-alone power systems and energy storage devices – Issues paper, November 2020.

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To recap, the AEC appreciates the ERA inviting feedback for the proposed issues paper and encourages the ERA to consider the issues raised above.

Any questions about our submission should be addressed to Graham Pearson, Western Australia Policy Adviser by email to graham.pearson@energycouncil.com.au or by telephone on .

Yours sincerely,

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