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Contact Officer: Chris Pattas
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27 October 2017

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear Mr Pierce

Re: AEMC Contestability of Energy Services draft rule determination and draft transitional rule consultation paper

The AER welcomes the opportunity to provide comments and observations for the AEMC's consideration and supports the changes being proposed.

We note the draft determination's proposal that targets assets in addition to services is a new regulatory approach, at least in regard to chapter six of the National Electricity Rules. The support the proposed changes to the framework for classification of services. We think the changes will to clarify the meanings of terms in the rules, remove ambiguities and improve transparency and predictability. However our submission raises some aspects that could be clarified further in the Commission's final decision.

We also note the draft determination recommends that the COAG Energy Council make breaches of the RIT-D and RIT-T processes subject to civil penalty provisions. We agree this is a preferable outcome to the status quo.

Attachment A provides further details of our response to the draft determination and consultation paper. We look forward to working with the AEMC as it progresses the contestability of energy services rule change and its broader Technology Work Program.

If you have any queries regarding this letter, please contact Chris Pattas, General Manager, Network Pricing, Policy and Compliance on (03) 9290 1470.

Yours sincerely



Paula Conboy

Chair

Attachment A - AER submission to the AEMC Contestability of Energy Services draft rule determination and draft transitional rule consultation paper

Introduction

The AER broadly supports the changes proposed in the AEMC's *Draft Rule Determination* (29 August 2017) (**draft determination**) and *Savings and Transitional Rule Consultation Paper* (19 September 2017) (**draft transitional rule**). However, we consider some matters would benefit from further consideration and clarification.

This submission provides our comments on three areas discussed in the draft determination:

- service classification
- restricted assets, and
- civil penalties.

Service classification

We support the AEMC's aim of improving the clarity, transparency, certainty and predictability of the service classification process, while retaining the AER's discretion to make service classification decisions on a DNSP-by-DNSP basis.

Clauses 6.2.1(a) and 6.2.2(d) of the NER

The draft rule deletes clauses 6.2.1(d) and 6.2.2(d), thereby removing the requirements on the AER, when classifying distribution services, to not depart from a previous classification or the previously applicable regulatory approach unless a different classification is clearly more appropriate. As the COAG Energy Council has noted, clauses 6.2.1(d) and 6.2.2(d) were included in the NER as part of the process of avoiding disruptive service classifications when transferring economic regulation from the jurisdictional regulators to the AER. In our view, those clauses have served their original purpose and are now seen as unnecessary constraints in achieving consistent and more appropriate classifications between jurisdictions. We therefore support the AEMC's proposal to remove these clauses.

Service Classification Guidelines

The draft determination introduces new clause 6.2.3A Distribution Service Classification Guidelines, which requires the AER to develop, maintain and publish guidelines that set out our proposed approach to determining whether to classify a distribution service as a direct control service. Clause 6.2.3A also requires us to set out how we will distinguish between distribution services and the operating and capital inputs that are used to provide such services. Amongst other things, the new guidelines must set out how we will deal with current classification requirements, including how we will apply the form of regulation factors. The AEMC has encouraged the AER to include additional topics in the Service Classification Guidelines if we consider them appropriate.

The AER supports the introduction of new clause 6.2.3A. We consider it is useful to clarify the meanings of terms in the rules, remove ambiguities and improve transparency and certainty. In our view, developing Service Classification Guidelines will assist stakeholders to engage better with the service classification process.

We support the transitional arrangements proposed in the AEMC's draft transitional rule. In particular, we note that the draft transitional rule requires us to develop and publish the first

Distribution Service Classification Guidelines and Asset Exemption Guidelines by 30 September 2018, in accordance with the NER distribution consultation procedures. The transitional provisions also require DNSPs to submit exemption applications to us by 31 March 2018 if they are seeking exemptions within the current regulatory control period. Other aspects of the draft rule would commence operation on 19 December 2017. The AEMC has also proposed transitional arrangements to delay the application of certain provisions in certain circumstances.

Restricted assets

The AEMC's draft rule introduces a new term, 'restricted asset', and prohibits a DNSP from including capital expenditure on a restricted asset in its regulatory proposal and regulatory asset base, except in limited circumstances. We note that the move to regulate assets (rather than just services) is a significant change to the regulatory approach. We anticipate this matter will require continual monitoring as new technologies emerge.

Definitions

Chapter 10 of the draft rule defines a 'restricted asset' as "an item of equipment that is electrically connected to a *retail customer's connection point* at a location that is on the same side of that *connection point* as the *metering point*, but excludes:

- (a) such an item of equipment where that *retail customer* is a *Distribution Network Service Provider* and that *Distribution Network Service Provider* is the *Local Network Service Provider* for that *connection point*; or
- (b) a *network device*."

The AEMC has acknowledged that, while the draft rule may prevent DNSPs from investing in a restricted asset located on the customer's side of the connection point, it would not prevent a DNSP from investing in an asset connected on the network's side of the connection point but still housed at the customer's premises. At issue is whether such an outcome is in conflict with the intent of the rule.

We note that the AEMC has modified the definition of a 'network device' to include apparatus or equipment that does not have the capacity to generate electricity.¹ In this case, the rules would permit a DNSP to own such an item, since it would not fall under the definition of a 'restricted asset'. We understand this change is intended to limit a DNSP's ability to interfere with an energy storage device on the customer's side of the connection point. However, we consider there are circumstances where this definition may not be sufficient to have the intended effect.

¹ The draft rule defines a 'network device' as follows:

network device

Apparatus or equipment that:

- (a) enables a *Local Network Service Provider* to monitor, operate or control the *network* for the purposes of providing *network services*, which may include switching devices, measurement equipment and control equipment;
- (b) is located at or adjacent to a *metering installation* at the *connection point* of a *retail customer*; and
- (c) does not have the capability to generate electricity.

For example, if a customer agreed, a DNSP could install a demand management switch on a battery circuit. In this case, the switch could meet the definition of a 'network device', which may be provided by a DNSP, but may still have the ability to control the customer's energy storage device as though it were the owner. Conversely, we consider a DNSP would have legitimate reasons to control, for example, electric vehicle charging load through a switch on an electric vehicle's circuit. Since an electric vehicle is a generating unit, the substituted definition of a 'network device' would constrain a DNSP's capability on electric vehicle load control. We consider it may be beneficial to test the market to determine the extent to which this is a material issue that requires further modifications to the rules.

Asset exemptions

We agree there are circumstances where it would be desirable for DNSPs to be able to provide assets that may otherwise fall under the definition of a 'restricted asset' (for example, outage notification devices and neutral fault detectors). We also note there are circumstances where a customer may be able to benefit by entering into an arrangement with a DNSP to allow control of a restricted asset in exchange for a rebate or reduction in charges. However, we note that constraints are often localised in the network. If a DNSP were to pay a customer in one area to reduce load, this payment may be subsidised by customers in other areas. We note that there is significant development going on in this area and new technologies are still emerging. We therefore consider it is appropriate that the rules provide for exemptions and support new rule 6.4B Asset Exemptions.

New clause 6.4B.1(c) of the draft rule requires the AER to develop and publish Asset Exemption Guidelines that set out the AER's approach to granting exemptions from the provision. Clause 6.4B.1(b) requires the AER to have regard to the likely impacts on the development of competition in markets for energy related services when determining whether to grant an exemption. Clause 6.4B.1(d) provides that the AER may choose to consolidate the Asset Exemption Guideline with the Service Classification Guideline or any other guideline. We support these proposals and consider that Asset Exemption Guidelines will assist to ensure that the rules are working as intended and provide clarity around where exemptions should apply.

Control of restricted assets

The draft determination restricts a DNSP's ability to earn regulated return on and return of capital expenditure on a restricted asset. This will obviously deter ownership but will not prevent a DNSP owning or seeking to control these assets.

We note that even if a DNSP is not able to add a restricted asset to its RAB, it may still be able gain control of a restricted asset, or at least influence the customer's decision making process, by leveraging its position as DNSP—perhaps through contracts or joint ownership. We consider the issue of the effects of DNSP ownership versus control of restricted assets would benefit from further consideration and clarification to ensure the rules will effectively promote the development of competitive energy services markets.

Civil Penalties

The COAG Energy Council RIT-T Review recommended that the AEMC consider as part of the Contestability of energy services rule change request whether the provisions associated with the application of the RIT-T by transmission network businesses should be civil penalty provisions.² We support the AEMC's recommendation to the COAG Energy Council to attach civil penalties to clauses 5.16.3(a) and 5.17.3(a) of the NER. We recommend that the COAG

² See <http://www.coagenergycouncil.gov.au/sites/prod.energycouncil/files/publications/documents/RIT-T%20Review%20report%20%28final%206%20February%202017%29.pdf>

Energy Council also attach civil penalties to clauses 5.15.2(b), 5.15.2(c), 5.16.4(a) and 5.17.4(a) of the NER. Further, we recommend that the size of civil penalties be increased to provide a more adequate deterrent. We consider these changes will positively impact Network Service Providers' compliance with NER requirements that protect consumers from paying for inefficient investments.

Clauses 5.16.3(a) and 5.17.3(a) of the NER

Given the importance of proponents undertaking a RIT-T or RIT-D, and the fact that the other levers the AER has to require a RIT-T or RIT-D are limited, we recommend that clauses 5.16.3(a) and 5.17.3(a) be civil penalty provisions.

The AER does have some measure of control over capex entering the regulatory asset base and therefore being paid for by consumers when it undertakes a revenue determination or a contingent project determination (if a trigger event occurs). This means that if a RIT-T or RIT-D is not undertaken we may be able to take this into account in determining the capex allowance for a Network Service Provider³.

The difficulty with using the revenue determination as a way to enforce the need to do a RIT-T or RIT-D is that there will not always be good alignment between the timing of the revenue determination and the underlying network project. This means that the NSP may not have undertaken a RIT-T or RIT-D by the time it needs to submit its regulatory proposal (over 12 months prior to the start of the period), especially if the project is not expected to start until later in the period.

Other RIT-T and RIT-D clauses

Recently, we have found that some RIT-T and RIT-D proponents have not been sufficiently comprehensive in their RIT-Ts and RIT-Ds. In particular, proponents do not always adequately explore non-network alternatives as credible options for meeting identified needs.

We therefore propose that civil penalties also attach to the following clauses:

1. Clauses 5.15.2(b) and (c); and
2. Clauses 5.16.4(a) and 5.17.4(a).

This will allow us to seek a civil penalty where a RIT-T or RIT-D process is not adequately completed, including the level of consultation with interested parties, or credible options not fully explored. While the penalty is small compared to the size of the project, the reputational impacts may also help encourage the proponent to consider all options.

Finally, we also note that the AER considers that the current level of civil penalties set out in section 2 of the NEL is inadequate. The current level may not provide enough of a deterrence function. We note that increasing civil penalties would require a change to the NEL.

We would be happy to provide further explanation in support of these proposals on request.

³ See for example the capex factors for distribution which include the final report of a RIT-D process: clause 6.5.7(e)(11). In making a determination for a contingent project these factors must also be considered: clause 6.6A.2(f)(2). Similar provisions exist for transmission.