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31 October 2017

Ed Chan
Director
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Submitted electronically

Dear Mr Chan,

Re: Contestability of Energy Services: Draft Rule Determination

Summary

Red Energy (Red) and Lumo Energy (Lumo) welcome the opportunity to respond to the Australian Energy Market Commission's (Commission) Draft Rule Determination on Contestability of Energy Services (draft determination).

Red and Lumo strongly support the Commission's draft determination.

The Commission's decision to restrict Distribution Network Service Providers (DNSPs) from owning and controlling assets located Behind the Market (BTM) prevents DNSPs from:

- owning and controlling BTM assets where they may favour network benefits at the expense of maximising the value across the electricity system;
- directly adversely affecting the level of competition in the energy services market for contestable energy services located BTM; and
- potentially cross subsidising a third party affiliate that sells BTM contestable energy services.

The draft rule ensures the expanding market for BTM contestable energy services is supplied in a competitively neutral manner. As such, the Commission's draft determination meets the National Electricity Objective (NEO) by providing benefits to consumers in the long term through encouraging competitively neutral competition for energy services.

Commission's preferred rule change

Red and Lumo support the Commission's preferable rule change as it prohibits DNSPs from including capital expenditure in their Regulatory Asset Base (RAB) for assets located BTM.

Excluding DNSPs from directly investing BTM will facilitate and encourage robust and competitive markets for BTM contestable energy services. Absent this rule change, DNSPs could potentially influence the development of this market leading to some undesirable consequences including:

- *Favouring network benefits at the expense of maximising value across the electricity system*
DNSPs are likely to favour value streams that maximise the benefits to DNSPs from assets located BTM at the expense of maximising the value across the electricity system if they own these assets directly. Competitive markets, where

consumers drive decisions will deliver the development of a competitive contestable services market located BTM.

- *Foreclosing competition in the emerging energy services sector system*
DNSPs may potentially adversely affect the level of competition in the BTM contestable energy services market by installing and operating these assets and recovering their costs through their regulated revenues. New technologies like battery storage is such that once installed at a customer's premises, the customer is unlikely to install additional assets of the same type.
- *Potentially cross subsidising a third party affiliate in the BTM contestable energy services*
Absent the preferred rule change, DNSPs could potentially take advantage of the current weaknesses in the Cost Allocation Guidelines (CAG) to advantageously attribute the costs of shared assets (like batteries located BTM) into their RAB and gain a competitive advantage in the market for BTM contestable services.

In theory, DNSPs attribute costs of shared assets in accordance with their Cost Allocation Methodology (CAM) which need to comply with the CAG.

For example, a DNSP may attribute the shared costs of a configuration of batteries located BTM rolled into its RAB that provides network support to itself (standard control service) and leases those batteries to a ring fenced affiliate (contestable energy services) with 70% allocated of its costs allocated to its RAB and the remaining 30% that do not fall into the RAB.

However, in reality it is almost impossible to identify how the costs of batteries should be attributed between regulated and nonregulated services because they are capable of providing different services simultaneously. For example, a battery may be used to relieve load congestion and sell energy in the market simultaneously. As such, we have serious concerns that DNSPs apply their CAMs in a manner to appropriately attribute the costs of multi-purpose assets like batteries.

The inability of the CAG to adequately deal with the attribution of costs of shared assets like batteries that provide different services simultaneously have the potential to be exploited by DNSPs. DNSPs may choose to attribute the costs of these assets between regulated and unregulated assets in an arbitrary manner that gives them the power to cross subsidise BTM contestable energy services.

We strongly support the Commission's more preferable rule that addresses this concern.

Exemptions to DNSPs owning and controlling assets located BTM not supported

Red and Lumo do not support any exceptions to DNSPs owning and controlling assets located BTM.

The Commission has permitted DNSPs to apply for an exemption to the restriction on investing directly BTM in some limited circumstances.

When granting a DNSP an exemption under this test, the Australian Energy Regulator (AER) is required to have regard to the likely impacts on the development of competition in the BTM contestable energy services.

Prohibiting regulated entities to own and control assets BTM, promotes competition and is in the long term interests of consumers.

Providing for a process that could potentially allow an exemption to this detracts from these benefits. As such, we oppose an exemption process.

Should the Commission insist on allowing DNSPs to apply for exemptions from owning and controlling assets that are located BTM, it must ensure that any exemptions it grants do not impact competition in the BTM contestable services market. As such, it must set a very high threshold for satisfying this test.

Improvements to the processes of classifying distribution services

Red and Lumo support the changes to the service classification framework in the draft determination. Specifically, we support the following recommendations including the:

- *AER requirement to publish distribution service classification guideline*
Red and Lumo support the decision to introduce a distribution service classification guideline. The introduction of a service classification will improve the understanding of the service classification process applied by the AER compared with its previous Framework and Approach process in the past. It will improve the clarity and the transparency of the distribution service classification process.
- *Removal of the obligation on the AER to consider previous service classification when classifying a service*
Red and Lumo support the decision to abolish the AER's requirement to consider any previous service classification decisions when classifying a service.

The decision to abolish this current rule will improve ability of the regulatory framework to respond to the changing nature of the services been provided by different assets in an evolving electricity market characterised by developing technologies.

- *Reduction of the threshold for the AER to change a service classification decision during a determination process*
Red and Lumo support the Commission's decision to reduce the threshold that the AER would apply when it changes a classification decision between the Framework and Approach paper and the distribution determination.

We understand the threshold standard for making changes has been reduced from unforeseen circumstances to a material change in circumstances. The effect of this has been to reduce the threshold for changing a service classification decision between the Framework and Approach paper.

With the changing nature of technology and its ability to provide the market with assets that provide multiple services, it is foreseeable that service classification could change between the different stages of the determination process (e.g. Framework and Approach to Draft decision).

Commission's decision to include the complementary aspects of the AEC rule change in its incentive regulation review next year supported

Whilst Red and Lumo strongly supported the rule change proposed by the Australian Energy Council (AEC), we understand the rationale proposed by the Commission in the consideration of the remaining complementary aspects in the proposed rule to be included in the incentive design review next year.

The AEC rule change¹ proposed incremental changes to the network regulatory framework designed to address perceived biases exhibited by DNSPs under the existing regulatory framework. This included changes to:

- the RIT-D;
- planning requirements;
- cost allocation; and
- shared asset mechanism.

The AEC rule change would have the impact of lowering the RIT-D threshold, providing more information to market participants to engage and respond to RIT-D processes and generally allow for more demand side opportunities in the broader electricity market.

The Commission has rejected the other complementary parts of the rule change. They argue these aspects of the rule change have the potential to have a broader impact than the rule change in isolation. We urge the Commission to reconsider the entirety of the AEC's rule change as part of a broader review of the network incentive arrangements next year.

About Red and Lumo

Red and Lumo are 100% Australian owned subsidiaries of Snowy Hydro Limited. Collectively, we retail gas and electricity in Victoria, New South Wales and South Australia and electricity in Queensland to over 1 million customers.

Red and Lumo thank the Commission for the opportunity to respond to this consultation. Should you have any further enquiries regarding this submission, please call Con Noutso, Regulatory Manager on 0481 013 988.

Yours sincerely

A handwritten signature in black ink, appearing to read "Ramy Soussou". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Ramy Soussou

General Manager Regulatory Affairs & Stakeholder Relations

Red Energy Pty Ltd

Lumo Energy Australia Pty Ltd

¹ See: AEC rule change as published on: <http://www.aemc.gov.au/getattachment/a5c2e9f4-509b-484e-b404-0b2f4c3445b6/Rule-change-request.aspx>