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Mr Ben Davis
Project Leader
Australian Energy Market Commission

Submitted online: www.aemc.com.au

31 October 2017

Dear Mr Davis,

Contestability of energy services – draft rule and draft determination

AGL Energy (**AGL**) welcomes the opportunity to respond to the Australian Energy Market Commission's (**Commission**) draft rule and draft determination on the contestability of energy services rule change requests (**Contestability rule changes**), August 2017.

AGL is one of Australia's leading integrated energy companies and the largest ASX listed owner, operator and developer of renewable generation. Our diverse power generation portfolio includes base, peaking and intermediate generation plants, spread across traditional thermal generation as well as renewable sources. AGL is also a significant retailer of energy, providing energy solutions to over 3.5 million customers throughout eastern Australia.

AGL is continually innovating our suite of distributed energy services and solutions for customers of all sizes (residential, business and networks). These 'behind the meter' (**BTM**) energy solutions involve new and emerging technologies such as energy storage, electric vehicles, solar PV systems, digital meters, and home energy management services delivered through digital applications.

AGL believes that the energy market transformation presents an important opportunity to empower customers to more fully participate in the broader energy market. Indeed, there is the potential to create personalised ecosystems located BTM that can be co-optimised to deliver substantial value to customers.

AGL agrees with the Commission's view that the best way to support consumer's ability to express their preferences and make meaningful choices is through robust, well-functioning and competitive markets. We firmly support the overarching philosophy of the Contestability rule changes, which seeks to place consumers at the centre of the decision-making process by facilitating competition in the growing energy services market. As we outlined in our submission to the Commission's consultation paper (**Consultation submission**),¹ we believe that, where feasible, contestability and the competitive delivery of services will promote choice and lead to better price and service outcomes for consumers.

AGL strongly supports the Commission's draft rule and draft determination.

We consider that the proposed restrictions to be placed on network businesses earning a regulated return on assets and improvements to the distribution classification framework will be critical to the development of well-functioning markets in DER-related products and services, and indeed the energy market's broader

¹ AGL submission in response to the Contestability of Energy Services, Consultation Paper (9 February 2017), Available at http://aglblog.com.au/wp-content/uploads/2017/03/AGL-submission_contestability-rule-change_Feb2017_Final.pdf



transformation towards a more decentralised electricity grid. Nevertheless, care should be taken in the development of the proposed exemption and enforcement provisions and Distribution Service Classification Guidelines to ensure the establishment of a robust regulatory framework. Our submission elaborates on each of these matters.

Restrictions on network businesses earning a regulated return on BTM assets

In our view, restricting network businesses from earning a regulated return on BTM assets will enable customers to harness the full potential of BTM resources more effectively and at lower cost. BTM and grid-connected DER have an important role to play in supporting efficient grid operation and network investment. By modifying the overall volume and shape of demand, DER can be deployed and operated to avoid or delay more expensive augmentations to the network. Further, smart inverters and local sensing devices enable the provision of voltage and frequency regulation services back to the distribution network.

However, a network support or grid stability service might only be required on a limited number of occasions per year, and this is similarly the case with demand response to meet a wholesale supply constraint. The remainder and majority of the time, customer-owned DER installed BTM is likely to be employed directly for meeting the comfort and consumption needs of the customer. Accordingly, an efficient deployment and use of DER will enable co-optimisation across these multiple uses and value streams. It will also recognise that it is ultimately a customer's choice as to how their BTM resources are deployed and what compensation or reward they expect for participating in different service markets (including providing network support).

AGL sees competition and innovation in technology and business models as the primary means for meeting this co-optimisation challenge and allying the interests of energy service providers with those of the customers they serve. To enable efficient 'value stacking' requires the need for (location, size) of grid support services and their value to the network to be made explicit, so that products and services can be designed by competing energy service providers to address these and build those values into the commercial model. This will directly benefit customers investing in DER by ensuring the least cost deployment and highest value use of those assets are made, and by promoting the availability of a range of retail offers and bundled products to meet distinct customer preferences. Importantly, it will indirectly benefit all customers by ensuring investment in assets or services which support reliable network operation are efficient, thereby ensuring the efficiency of overall network costs.

Accordingly, we consider that the energy market's transformation towards a more decentralised electricity grid requires a clarification of the role of regulated distribution network service providers. Network providers will continue their vital role providing a safe, reliable and well maintained network. Indeed, this network provides the foundations upon which other layers and platforms will be built. As the distribution network become more dynamic, network providers are likely to also require increased visibility of activity on their network. However, it is important that networks do not seek to become market makers or participants in markets enabled by DER, in a role which conflicts with their status as a provider of regulated monopoly services. In a future scenario of high DER penetration, there may be a case for formally separating the network asset management and network operation functions to minimise the potential for conflicts to occur. Indeed, the Contestability rule changes go some way towards resolving these issues.



Method for specifying the restriction

AGL supports the Commission's method of specifying the restriction on network businesses controlling assets located BTM that are capable of providing contestable energy services, which comprises the following three components:

- a) Control of assets;
- b) Located BTM;
- c) That are capable of providing contestable services.

Control of assets

In the evolving energy market, customers will increasingly seek to optimise value across a range of value streams, notably comfort and bill optimisation, network support services, peak load shaving, voltage and frequency control, wholesale and ancillary services. It is therefore essential that customers retain control of BTM assets.

AGL agrees with the Commission's view that whilst it is important that network businesses are able to access the services provided by new technologies, granting control of BTM asset to networks risks distorting competition in the energy services market, to the detriment of customers. Indeed, network businesses may favour network benefits at the expense of maximising the value across the electricity system as a whole. Moreover, the nature of these assets (installed at the customers' premises) risks network businesses utilising their incumbent status as monopoly operators, which would adversely affect the level of competition in the market. As we elaborated in our Consultation submission, we believe that the absence of effective competition in the delivery of services will stifle innovation, customer choice, and greater efficiency of network spending.

Accordingly, we support the Commission's broad approach to restricting network businesses' ability to earn regulated returns on assets located behind a retail customer's connection point.

We appreciate the Commission's assessment that a restriction on capital expenditure directly links to control of assets by network businesses given that the accounting principles underpinning network businesses' capitalisation procedures identify control as one of the key features of capital expenditure.

We also note the Commission's conclusion that changes to the service classification framework are not likely to be effective in addressing concerns regarding the regulatory treatment of BTM assets and other new technologies and the boundary between regulated and contestable services. We agree with the Commission's view that this issue is better addressed by imposing a direct restriction on a network businesses' ability to earn regulated returns on assets behind a retail customer's connection point. The Commission's preferred approach would also allow network businesses to procure the functionality provided by these assets from the contestable market. We also appreciate that tying the restriction to regulated revenue from capital expenditure has a number of other benefits, including linking its direction to the provision of standard control services, leveraging existing National Electricity Rules (**NER**) frameworks, and enabling enforcement through existing procedures.

Located BTM

AGL agrees that the spatial specification of "behind the meter" should entail a restriction on assets electrically connected to the network on the customer's side of the connection point, given that the connection point is



commonly the point where responsibility for supply transfers from the network business to the customer and therefore represents the most logical boundary for the end of network business control and investment in assets.

Capable of providing contestable services

AGL supports the Commission's determination that it is preferable to start with a restriction on all asset types that provide standard control services, given that network businesses do not need to control assets on the customers' side of the connection point. We believe this approach is more appropriately adapted to ensuring flexibility as new technologies and services enter the energy services market. It also reflects the reality that the majority of time, customer-owned DER installed BTM is likely to be employed directly to meet customers' individual comfort and consumption needs rather than for network support and grid stability services.

Exemptions

In AGL's view, the Contestability rule changes are primarily an opportunity to redesign the energy market to deliver greater value to customers. Customers are seeking to reduce their bills and exert more control over their energy supply. They increasingly see the grid as a gateway through which to export, as well as import, electricity and are also becoming interested in understanding how they can share energy or participate in wholesale or network services markets with a view to be compensated and reduce their bills. BTM energy ecosystems systems could be drawn upon individually or as a fleet to respond to changing network conditions or conditions in the wholesale market.

However, for the majority of time, AGL envisages that customer-owned DER installed BTM is likely to be employed directly to meet customers' individual comfort and consumption needs. A network support or grid stability service might only be required on a limited number of occasions per year, and this is similarly the case with demand response to meet a wholesale supply constraint.

Accordingly, AGL has major reservations in relation to the Commission's view that three types of exemptions are necessary from the overall exemption, namely AER exemptions, network devices and existing assets and existing refurbishments of existing assets. Allowing these kinds of broad exclusions in the Contestability rule changes would severely undermine the potential for these reforms to deliver better value and service outcomes to consumers.

In terms of AER exemptions, whilst incidental arrangements including remote supply may warrant an exemption in certain circumstances, we consider that network businesses should be required to test the competitive market in the first instance to ensure that the best value is being delivered to customers. Current arrangements may deliver optimal value to networks. However, in a more robust competitive market, customer would be able to optimise their assets across a range of value streams whilst still delivering network outcomes. Customers would also be in a better position to receive fairer compensation of the use and orchestration of their assets in the energy market or for network support purposes.

An exemption for network devices would also be counter-intuitive to the purpose of the Contestability rule changes. It would enable network businesses to continue to operate regulated businesses in contestable markets. It would continue to restrict customers from accessing all value streams attaching to their assets and would result in continued investment inefficiencies.

We also consider that the proposed exemption for existing assets is unnecessarily broad in its application to all existing assets and investments in network businesses' current regulatory control periods. We believe that



the Contestability rule changes should apply to the next round of regulatory control periods for all network businesses. At their commencement, the Contestability rule changes should apply to *all* existing assets and investments. Ensuring access to existing assets and investments will be critical to enabling customers to realise the value of their own assets, from which they are not currently able to benefit. It would also ensure an equal playing field between contestable energy services providers and network businesses and indeed between all network businesses operating under the NER.

Bearing in the mind the long-term interests of consumers, AGL would urge the Commission to decline prescribing such broad-based exemptions.

Should the Commission be minded to proceed with establishing an exemptions framework, the rules of that framework should be carefully prescribed beyond the parameters discussed in the draft determination. We consider that there are substantial risks in empowering the AER through a broad Asset Exemption Guideline to make case-by-case determinations on exemptions. To ensure a robust regulatory framework for this emerging market, the AER's discretion to grant exemptions should be limited as far as possible within clearly defined rules. In our view, the preferable approach would be for the Commission to explicitly limit the exemptions framework to situations involving maintenance and security of supply. The onus should then be placed on network businesses to proactively report on those circumstances where network businesses have relied upon this prescribed exemption.

Enforcement

We note the Commission's view that enforcement of the Contestability rule changes will be able to be undertaken by the AER through established procedures, utilising existing information gathering techniques for monitoring. We agree with the Commission's view that this should include excluding actual capital expenditure on restricted assets during the relevant regulatory control period from adjustments to the RAB where no exemptions have been granted.

AGL appreciated the Commission's view that because restricted assets are located on the customer's side of the customer's connection point there is a high level of visibility where a network business undertakes material capital expenditure that could be reported to the AER by retailers or metering providers. Nevertheless, we consider that because the Ring-fencing Guideline has not established a sufficiently robust reporting, compliance and enforcement framework in respect of ring-fenced entities, there remains a substantial risk that network businesses could circumvent their compliance with the Contestability rule changes. Realistically, ring-fenced unregulated network businesses would not have any incentive to report on their compliance.

Accordingly, AGL would urge the Commission to consider developing additional safeguards to ensure accurate reporting on compliance. This may entail imposing further reporting requirements on ring-fenced unregulated network businesses.

Classifications framework for distribution services

AGL supports the requirement that the AER develop, publish and maintain a distribution service classification guideline that sets out the AER's approach to classifying distribution services including as either a direct control service or a negotiated distribution service, a standard control service or alternative control service. We consider that this will greatly improve the clarity, transparency and regulatory predictability of the service classification process.



We also support the Commission’s determination to remove the requirements that the AER must not depart from a previous classification or the previous applicable regulatory approach when classifying a distribution service, unless that classification is “clearly more appropriate”. As we elaborated in our Consultation submission, this provision was originally included in the rules to prevent disruptive reclassification decisions on the transfer of economic regulatory responsibility from jurisdictional regulators to the AER. However, it is unnecessary in the current environment and leads to an unjustified bias towards maintaining the *status quo*. The infrequent opportunities that exist to reclassify services risks impeding the emergence of contestable markets in energy services as technologies continue to evolve.

Greater transparency and flexibility in the AER’s approach will enable the development of classifications that more accurately reflect technological developments that support competitive efficiencies.

Nevertheless, we remain concerned that in the absence of clear delineations on what services are appropriately characterised as contestable, there remain substantial risks that network businesses will continue to direct regulated funding towards services that would be more efficiently delivered by the competitive market. Accordingly, as far as possible, we would urge the Commission and AER to develop strict delineations in classifications.

Commencement

Given the rate of development in contestable energy services, we strongly support the Commission’s view that the Contestability rule changes should apply to the next round of regulatory control periods for all network businesses.

Complementary reforms

AGL appreciates the Commission’s view that the proposed changes to the RIT-D, planning framework and cost allocation of network businesses would be more appropriately addresses within a review of the overarching design of the incentive regulation framework for network businesses, rather than within the rule change process. Nevertheless, we consider these to be critical complementary reforms to enabling the energy market’s transformation towards a model that better serves the interests of consumers. AGL intends to provide more comprehensive feedback to the Commission in relation to these matters in the context of the *2018 Electricity network economic regulatory framework review*.

Whilst we appreciate that the *Local Generation Network Credits (LGNC) rule change* may go some way to improving transparency in the planning framework by requiring network businesses to publish system limitation reports, it will be necessary to assess the extent to which this requirement enables more efficient investment in embedded generation and non-network solutions and whether additional reform is required. Similarly, it remains to be seen whether the requirement for network businesses to procure inputs from assets located on the customer side of the connection point will lead to less reliance on the cost allocation and shared asset mechanisms such that these proposed changes are no longer needed.

AGL also notes that the contestability rule changes are part of a larger suite of reform processes, that include:

- the introduction of more cost-reflective network tariffs;
- the implementation of more stringent electricity distribution network ring-fencing;
- modifications to the regulatory investment test via the Australian Energy Regulator’s replacement expenditure rule change proposal;



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- the Commission's review of the economic regulatory framework as this applies to network businesses; and
 - the work of Standards Australia and associated agencies in the development of appropriate technology standards, particularly in relation to energy storage and DER.

We would like to reiterate our view that these reform processes need to be effectively coordinated and a national focus is maintained to ensure a smooth transformation of Australia's electricity system. AGL is keen to ensure that governance and regulatory frameworks evolve to deliver benefits to energy users into the future, within the context of rapidly advancing technology and community expectations.

Should you have any questions in relation to this submission, please contact Kurt Winter, Manager, Policy and Research, on 03 8633 7204 or myself on 03 8633 6836.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'Stephanie Bashir', written in a cursive style.

Stephanie Bashir

Senior Director, Public Policy