2 November 2017

Mr Richard Owens
Senior Director
Australian Energy Market Commission

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Dear Mr Owens

Draft rule determination – Contestability of energy services

SA Power Networks welcomes the opportunity to comment on the Australian Energy Market Commission (AEMC) draft rule determination on the contestability of energy services.

The proposed draft rule primarily seeks to restrict Distribution Network Service Providers (DNSPs) from investing in assets located behind a customer's connection point. In our view the draft rule represents a retrograde step in the evolution of the regulatory framework. We do not support it as it:

- Undermines the regulatory framework—best practice regulation should not be technology or asset specific nor seek to prescribe which delivery options are likely to be most efficient to the National Electricity Market (NEM);
- Is imprudent and potentially inefficient—as it narrows options by which DNSPs can seek to manage their networks and lower costs to both their customers and the broader market, including by way of partnerships and co–investment with third parties;
- Is not required to protect competition in services involving Distributed Energy Resources (DER)—there are sufficient safeguards for competition in the existing regulatory framework to ensure that any capital investment proposed by a DNSP will be assessed to determine if there are more efficient alternatives (including those involving third parties) that could maximise benefits to the NEM; and
- Is pre–emptive—there is no evidence of market failure under current regulation that supports the proposition that DER markets are or might be distorted by the possibility of DNSPs investing in DER to alleviate network constraints.

We also comment in our submission on other aspects of the draft rule, including:

- The specific drafting of the asset investment restriction applying to DNSPs—amendments are required to ensure sufficient scope for DNSPs to submit asset exemption applications to the Australian Energy Regulator (AER) and to have these assessed on their merits, that is, assess if they will maximise benefits to the NEM; and
- The aspects of the draft rule pertaining to the service classification process administered by the AER—these are accepted in the form proposed in the AEMC's draft rule.

If you wish to discuss any of our comments further, please contact Bruno Coelho on 08 8404 5676 or by email on: bruno.coelho@sapowernetworks.com.au

Yours sincerely

Sean Kelly

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General Manager Corporate Strategy

Rationale for prescribing service delivery options

SA Power Networks considers that the draft rule will not be in the long–term interests of consumers as required by the National Electricity Objective (NEO). In not supporting this rule it should be noted that we:

- are not proposing that DNSPs, in having the option to invest in DER assets to manage their networks, be allowed an exclusive right to invest in and deploy DER assets;
- support rules that promote competition and firms competing to deliver customer services efficiently (from the perspective of the whole NEM); and
- consider that these arrangements are already reflected in the current regulatory framework.

Our reasons for not supporting the draft rule are set out below.

The draft rule is likely to be imprudent:

- Rapidly increasing volumes of DER being connected to distribution networks are creating new challenges for maintaining secure and reliable distribution network services for customers.
- The AEMC appears to have correctly accepted in its Distribution Market Model review that there are uncertainties resulting from these new challenges and recommended exploring what minimum level of control DNSPs need to have over DER to maintain compliance with their regulatory obligations.[1] This mostly goes to identifying the type of interaction with customer DER that DNSPs require to maintain network security and reliability. However, there are also questions on whether DNSPs should be allowed to invest or co–invest in DER assets for the same purposes.
- Potential investment by a DNSP in DER assets to maintain network security and reliability would likely be limited to discrete locations where the network faces a constraint. The decision by the DNSP on how to invest in DER (full investment, full procurement from a third party or co–investment with a third party) could depend on various factors:
  - There might be merit in partnering with third parties to co–invest—DER can provide multiple services at different times (e.g. network support and wholesale market services) and DNSPs are prohibited from wholesale generation and retailing services. There might be cases where third parties simply cannot install DER as efficiently as a DNSP in an area with a likely network constraint. Third parties might prefer to partner with DNSPs for certain aspects of DER deployment, with the third–party perhaps taking on the direct customer interface / negotiation. The Energy Storage for Commercial Renewable Integration project undertaken by Electranet and AGL is a key example of how networks and third parties can partner and co–invest to maximise benefits to the NEM.[2]
  - There might otherwise be limited cases where there is merit in DNSPs fully investing in DER, such as in locations where the network faces potential constraints and there are:
    - no other firms competing or no third parties willing or able to take on the risk of their DER assets not performing when required to alleviate network constraints; or
    - no third parties such as retailers with a critical mass of customers in these areas to be able to deploy DER for the purpose of alleviating the network constraint.
- Given these challenges, it is imprudent for regulation to limit the range of options by which DNSPs can seek to manage challenges facing their networks, that is, options by which to efficiently "keep the lights on".

The draft rule might increase costs to consumers:

- Regulation should not pre–empt which service delivery options are likely to be most efficient. There is no evidence to suggest that requiring DNSPs to fully procure DER capacity from a third party will always be the most efficient option compared to either DNSPs fully investing in a DER asset or co–investing with a third party as discussed above.

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1 AEMC, *Distribution Market Model—Final Report,* 22 August 2017, p.iv.

2 Information is available on the Australian Renewable Energy Agency website: http://arena.gov.au/blog/southaustraliabattery/

The draft rule is unnecessary as a means of safeguarding competition:

- The current regulatory framework applying to DNSPs is sufficient to enable a workably competitive market. Any intended DNSP investment in DER will be:
  - Subject to AER and stakeholder scrutiny—by way of the distribution determination and the Regulatory Investment Test for Distribution (RIT–D). If a DNSP is at the point of planning investment in DER by either proposing capital expenditure to the AER or undertaking a RIT–D, and it has not adequately considered alternative available options that better maximise benefits to the whole market, the investment will not be approved.
  - Subject to AER expenditure incentive schemes—which encourage DNSPs to only invest in the most efficient solution. Should procuring DER capacity (to alleviate a network constraint) from a third party by way of spending operating expenditure be the most efficient option, DNSPs would gain financially by incurring less capital expenditure.
- In situations where a DNSP invests in a DER asset, we disagree with the AEMC that there is any incentive on DNSPs to foreclose access to that asset by third parties. In fact the reverse is true: it is in the financial interests of DNSPs to seek opportunities to enable third parties to share these assets to access value streams that are not available to the DNSP (e.g. providing services into wholesale markets) when the DER are not required by DNSPs to alleviate network constraints, as this will maximise the value of the asset and reduce costs for the DNSP.
- There is no evidence of market failure under current regulation—the behaviours that the rule change seeks to prevent do not occur in practice.

Approach to implementing service prescription

Should the AEMC proceed with making the rule to restrict DNSPs from investing in assets located behind a customer's connection point, consideration should be given to the following.

Scope of Investment restrictions

- The restriction must, as currently drafted, apply only via the Regulatory Asset Base and forecast capital expenditure, such that it will not apply to services provided by DNSPs which are classified by the AER as Alternative Control Services (ACS).
- We strongly agree with the AEMC's intent to not apply the restriction to assets used to provide ACS.[3] This avoids significant implications that would otherwise result from restricting the provision of services that are appropriately within the remit of a DNSP's regulated responsibilities—examples include the various services associated with DNSPs' existing metering stock (i.e. types 5 and 6) for which they will remain responsible after the 1 December 2017 metering contestability start date.[4]

Restricted assets

- 'Restricted assets' should only pertain, as currently drafted, to assets that are "...behind <u>a retail customer's</u> connection point". The AEMC should confirm that the drafting of the rules does not unintentionally capture situations where a DNSP seeks to invest in grid–scale DER assets connected directly to the distribution network.[5] Deploying grid–scale DER is highly likely to be a viable option by which DNSPs could seek to efficiently maintain network safety and reliability. As the draft rule does not intend to capture such investments, we do not comment further on these.
- The spatial element of defining 'restricted assets' must be 'behind <u>the connection point</u>', as currently drafted. This avoids significant impediments to DNSPs undertaking their responsibilities, which might have otherwise occurred if the draft rule had referred to 'behind the meter' or 'a customer's premises'. In some situations SA Power Networks' distribution lines cross over rural properties (i.e. on a

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3 AEMC, *Draft rule determination—Contestability of energy services*, 29 August 2017, p.45.

4 SA Power Networks also has devices to control hot water and other controlled loads.

5 We note that for example, if a battery was connected directly to the distribution network and was to provide services into the wholesale market, that a National Metering Identifier (and perhaps connection point) might need establishing. However, the provider of the wholesale market services is unlikely to be a 'retail customer'.

customer's premises), while in other situations customers house their metering within SA Power Networks sub–stations (i.e. these are situations where it is unclear what is actually in–front of, or behind, a customer's meter).

Exemptions to asset restrictions

- 'Restricted assets' should as currently drafted not capture the following:
  - Assets already installed by DNSPs—this would otherwise represent a break in the regulatory agreement present in the current regulatory framework which does not seek to unwind investments after they have been made (i.e. no ex–post investment risk).
  - Assets already installed and which are to be refurbished by DNSPs. In doing so, should any regulated expenditures be proposed by DNSPs for refurbishing existing assets, we would expect these to be assessed by the AER or via a RIT–D according to current regulatory expectations of efficiency.
  - Assets that are 'network devices' which might or might not be located behind a customer's connection point. This important current feature in the National Electricity Rules (NER) ensures DNSPs are not prohibited from installing devices that can facilitate their management of the network by monitoring, operating or controlling the network for the purposes of providing network services. Again, we would expect that any regulatory expenditures proposed by DNSPs to invest in 'network devices' would be subject to current AER / RIT–D expenditure assessment processes.

Exemption applications

- In general, the approach of applying an ex–ante restriction on asset investments while allowing DNSPs to submit exemption applications to the AER introduces imprudent delays in the ability of DNSPs to respond quickly to emergent network challenges.
- In proceeding to introduce the asset restriction, DNSPs should be allowed to apply to the AER for asset exemptions. However, the asset exemption process should:
  - Allow DNSPs to deal with legitimate situations warranting exemption consideration as they arise.
    - It is unreasonable to disallow DNSPs from providing asset exemption applications together with their revised regulatory proposals given the significant amount of time between the required submission of a regulatory proposal and a revised regulatory proposal.
    - We agree with the draft rule's intent in allowing DNSPs to submit asset exemption applications together with a cost pass–through application should circumstances arise over the five–year regulatory period. However, such applications should not be bound to the materiality thresholds that the AER has applied to cost pass–throughs. An exemption application will only be submitted if there has been unintended capture of a core network asset, or there is need to undertake an efficient investment. In these cases, materiality thresholds are irrelevant and could increase costs to customers should the exemption application not be approved on materiality grounds.
  - Require the AER to consider if the exemption application is in the long–term interests of consumers as the NEO requires. Further guidance should be provided by the AEMC as to the scope of factors that should be considered in reviewing asset exemption applications. Factors could include:
    - Whether or not there is competition present for the particular investment in the location in which it is proposed to be made; and
    - Whether the DNSP's investment in the location in which it is proposed will affect competition. To this end, the AEMC should comment on how any proposal for a DNSP to co–invest with a third party to unlock multiple value streams and maximise benefits to the market (as discussed in this submission) should be viewed in the context of exemption applications. We note that the AEMC has in past rule changes recognised the merit of these co–investment options in other reform processes such as its development of rules to expand competition in metering services.[6]

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6 The AEMC's final determination on the metering competition rule changes specifically intended to allow regulated DNSPs to have the option of recovering some regulated funds for co–investing with retailers / metering coordinators for advanced

Service classification framework

On the aspects of the draft rule that pertain to service classification, our views are:

- We agree with the AEMC's approach of not re–opening service classification decisions during a regulatory control period. This would have introduced significant ex–post investment risk to DNSPs;
- We agree with allowing changes to service classification between the time of the Framework and Approach and the distribution determination, should relevant circumstances arise;
- While the NER should not bind the AER to have to maintain a previous classification, in reality this has never been the case. In any case, in order to provide sufficient regulatory certainty, changes in service classification from one regulatory control period to the next should only be made where there are appropriate circumstances warranting a reclassification; and
- There might be merit in requiring that the AER prepare a service classification guideline to clarify general expectations across all DNSPs. This might extend to providing general clarifications as to its interpretation of definitions which do not have formal status from a service classification perspective but have important implications via the Ring–Fencing guideline. This includes definitions as to what comprises:
    - a distribution service as opposed to inputs to distribution services; and
    - an unregulated distribution service as opposed to other types of unregulated services.[7]

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meters to be installed in network areas where these could be used to assist with network issues. AEMC, Rule determination—Expanding competition in metering and related services Rule 2015, November 2015, p.82.

7 These distinctions have important ring–fencing implications. For example, while an unregulated distribution service can be provided by a DNSP, other types of unregulated services would need to be provided by a separate legal entity / affiliate business. Further, an unregulated service that is deemed to not be electricity related, is not subject to the staff and office location separation requirements of the ring–fencing guideline.