

9 February 2017

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

Locked Bag 14051
Melbourne City Mail Centre
Victoria 8001 Australia
T: 1300 360 795
www.ausnetservices.com.au

Via website: www.aemc.gov.au

Dear John

Consultation Paper: Contestability of Energy Services

Introduction

AusNet Services is pleased to have the opportunity to make this submission into the AEMC's (the Commission's) consultation on rule change proposals by the COAG Energy Council and the Australian Energy Council (AEC) under the general heading of Contestability of Energy Services. The rule change proposals are driven by the advent of new technologies which have the ability to be readily deployed on an electricity customer scale and at grid scale, and which can provide multiple benefit streams, including in provision of network services.

Whilst this submission refers to the provision of distribution network services and service providers our submission is equally relevant to the consideration of transmission services.

The inflexibility of prescribing procurement of network service inputs will not facilitate efficiency

Both proposals seek to ensure that DNSP use of such technologies for delivery of its services to customers is provided through contestable markets. AusNet Services view, at this high level, is that the regulatory framework must promote efficient service provision by the DNSP, and it is not clear that imposing constraints on how services are obtained by the DNSP can facilitate this objective.

There is even a risk that imposing such constraints could significantly limit the economic take-up of new technologies by networks for the benefit of customers. It is also worth reflecting on the early stage of market and technical development around new technologies such as battery storage. All sectors of the energy industry are building experience and knowledge around the value of new technologies and it would be premature to impose constraints on procurement at this early stage.

There are numerous mechanisms that facilitate market participation in addressing network needs

The regulatory framework incorporates a broad range of mechanisms to facilitate market solutions to emerging network service limitations. Some of these have only recently been established, and have not had the opportunity to demonstrate their effectiveness. The AEC

proposals are not only unnecessary, but their consideration is premature and reflects their commercial interest.

The AEMC Consultation Paper recognises these mechanisms and arrangements as well, which, at a summary level cover:

- Transparency through public reporting and consultation on impending network constraints, costs, and opportunities for non-augmentation solutions to relieve these, and publication of demand side strategies for engaging with proponents;
- The application of the regulatory investment test, which prescribes assessment of options on technology neutral basis;
- Expenditure scrutiny and rigorous efficiency assessment by the AER, which determines an efficient level of expenditure for the provision of network services, which includes review of options analysis and solution design;
- Incentives to ensure capex is not favoured over opex solutions, and demand management incentives which are currently being enhanced by the AER;
- Ring-fencing of the DNSP, reinforcing the network services focus of DNSP activities and incorporating provisions to address potential related party discrimination and share 'facilities access' revenues, via the shared asset guideline, with customers.

Incentive regulation needs to be enhanced

Prescribing inputs procurement would depart from the principles of incentive regulation, which underpin the Australian regulatory approach. Facing transformational change in the energy sector there is a need for work to make these incentives more effective, not to remove them. This would lead toward the alternative 'cost of service' regulatory approach and would clearly be a backward step, impacting progress toward ever more efficient provision of network services with resulting lower energy supply costs for customers.

The CSIRO / ENA network transformation roadmap includes a number of recommendations for enhancing the regulatory framework, including trialling a TOTEX approach to expenditure categorisation. There are other recommendations around developing the customer orientation of network services, which, subject to the appropriate disciplines, should be encouraged.

Regulatory arrangements should benefit ALL customers

DNSPs objective is to provide efficient network services across the region of their network. Potentially there will be parts of the network to which 'grid service' market participants are not attracted. In these instances, the DNSP must still be able to implement its identified efficient option, based on the optimal mix of assets and other inputs to deliver the services in the particular situation.

This may arise at the extremity of the grid. An example is the choice between continued operation of an overhead network serving isolated customers and the alternative of replacing this with a standalone supply. The obligation to supply these existing customers lies with the DNSP, no other party has equivalent accountability. The standalone supply clearly involves generation, however the model envisaged by AusNet Services for maintaining of regulated network services in these circumstances is one where normal contestable retail services is unaffected. In these circumstances the distribution and / or network service would not be severed. Our model was included in our submission to the COAG EC consultation on standalone power systems in August 2016. A copy is provided as an attachment.

Clarification in the Rules that these services satisfy the definition of distribution services is urgently required, consistent with the rule change request submitted by Western Power¹. AusNet Services currently has situations where the solution outlined in the above example would provide the most efficient solution.

Further attention to services classification proposed by the AER is warranted

In the Consultation Paper the Commission explains that it is services, rather than inputs, that are the subject of classification under the Australian incentive regulation framework. This is not arbitrary, it is inherent feature of the framework.

During the course of the AER's development of ring-fencing guidelines for DNSPs, it was identified that further attention to appropriate service classification was needed to complement and effectively operationalise the ring-fencing guideline. As a result, the AER intends to develop a guideline for classification of services². AusNet Services supports the establishment of a services classification guideline for this purpose.

Examination of the National Electricity Rules and National Electricity Law does not indicate any explicit guidance for service classification, although course of conduct is a focus on the degree to which services are contestable. More broadly though, AusNet Services supports findings and milestones of the Electricity Network Transformation Roadmap in relation to the regulatory framework³. Milestone 3 in the Key Concepts Report promotes regulatory frameworks that are more adaptive to emerging competition. This would incorporate testing as to whether regulation is needed, and processes for shifting services out of regulation, implemented in the context of an overall integrated plan for the regulatory framework.

The truncated RIT process is unnecessary, as recently finalised Rules will provide the market facilitation desired

The Commission has only recently established new reporting obligations for network constraints, in its final determination on the LGNC rule change. The Commission's webpage reference states that:

The final rule would require DNSPs to annually complete a 'system limitation report' providing the following information:

- *The name or identifier and location of network assets where a system limitation or projected system limitation has been identified during the forward planning period;*
- *The estimated timing of the system limitation or projected system limitation;*
- *The proposed solution to remedy the system limitation;*
- *The estimated capital or operating costs of the proposed solution; and*
- *The amount by which peak demand at the location of the system limitation or projected system limitation would need to be reduced in order to defer the proposed solution, and the dollar value to the DNSP of each year of deferral.*

We note that the Commission's final determination was made subsequent to the AEC rule change request.

¹ Western Power rule change request, September 2016, referenced as 'Alternatives to Grid-supplied Network Services' on AEMC website

² AER, Electricity Distribution Ring-fencing Guideline, Explanatory Statement, November 2016, page 80

³ ENA-CSIRO, Electricity Transformation Roadmap: Key Concepts Report, December 2016, page 49

Separately, the networks have undertaken to maintain the Network Opportunity Maps tool developed by the Institute of Sustainable Futures, which provides a transparent, granular, user friendly view of impending network constraints and their importance to the networks. This information is provided in the public domain and its coverage is across the NEM.

The current framework does not inhibit the realisation of value from assets providing multiple service streams

The AEC rule change request is based in part on its claim that there is an inability of demand response and network support services to monetize the value they produce with regard to both network peak and energy peak [demand]⁴.

AusNet Services experience is that this is not the case. The Commission should not take this contention at face value, and should explore whether there are actual barriers to realizing the full value the assets can offer into various markets.

By way of example, AusNet Services contracts for the provision of network support services for its Traralgon zone substation. The arrangements were established as an efficient solution to relieve network constraints, deferring investment in additional transformation. The services are provided by 10MW of embedded generation, constructed in conjunction with the network need. However, the arrangements with the service provider specify the network support service only, and do not restrict the generator from operating in the wholesale energy market, subject to satisfying its network support obligations.

The majority of AusNet Services demand management are struck directly with large load customers. One example is an agricultural facility near Euroa. This customer utilises their own on-site backup generation to reduce their net load at times of network peak demand. Under a Network Support Agreement, AusNet Services makes a payment to the customer to reflect the network value of the load reduction. This arrangement demonstrates that customers who are normally load customers are able to access 'grid service' value. They are also free to contract with other parties to access the energy market value of such load reductions.

If, however, the services were clearly more efficiently provided by the DNSP owning and operating the plant (and there are clearly regulatory disciplines around such decision making) then participants in other markets would have the opportunity to contract with the DNSP to access the facilities. The regulatory regime encourages this, through the Shared Asset Guideline, and there is strong evidence that DNSPs will be open to such opportunities.

A further example involves the 1MWh AusNet Services Grid Energy Storage System. This facility is owned by AusNet Services and is an innovation project to trial the value of large scale storage to the electricity distribution network. We identified early on that exploring the full range of value streams was important in understanding the viability of energy storage. A number of discussions were held with an energy retailer about partnering to explore the traded wholesale market value of the facility. However this offer was not taken up.

Our experience from evaluating opportunities for energy storage to provide non-network services is that the relative magnitude of the different value streams is highly case specific. For network applications, the network value is often dominant and the energy value might not be large enough to overcome the additional costs to access the value.

⁴ AEMC, Consultation Paper, Box 5.8, page 71.

Where the energy value is material, networks have an ability and incentive to contract with other parties that are able to access that value. As contemplated under the Demand Response Mechanism proposal, an opportunity for regulatory reform is to allow a greater range of parties to compete in the provision of this energy value into the wholesale market and to lower the costs of accessing the energy value. On the flip-side, retailers also have the ability to offer network support services based on new technologies that they own or manage, and networks already have established processes to invite and evaluate such proposals.

We look forward to further engagement with the Commission as the review progresses. Please contact Kelvin Gebert, our Manager Regulatory Frameworks, if you have any queries regarding this submission.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Tom Hallam', written in a cursive style.

Tom Hallam
General Manager Regulation and Network Strategy