AUSTRALIAN ENERGY COUNCIL

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

31 October 2017

Dear Mr Pierce

Draft Rule Determination – Contestability of Energy Services

The Australian Energy Council (AEC) is the industry body representing 21 electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. These businesses collectively generate the overwhelming majority of electricity in Australia, and sell gas and electricity to over 10 million homes and businesses.

As one of the proponents for the rule change the AEC is pleased that the fundamental issues highlighted in our rule change proposal have been the subject of greater examination through the stakeholder engagement process, and have progressed with this Draft Rule Determination to the facilitation of competition in the emerging energy services market.

The AEC accepts the Australian Energy Markets Commission (the Commission) view that proposed changes to the RIT-D, the planning framework and the Cost Allocation Method (CAM) can be suitably considered within a broader review of the incentive framework. We look forward to participating in the 2018 Electricity Network Economic Regulatory Framework Review.

Introduction

The AEC proposed that DNSP's be required to procure behind the meter (BTM) services from the competitive market, which may of course include an appropriately ring-fenced affiliate of the DNSP. Neither the AEC rule change proposal, nor the AEMC Draft rule determination, proposes that DNSPs should not have access to the network support benefits that BTM services can offer. In fact each states that it is essential that they do have access to competitive services in order to achieve a lowest cost system for the benefit of customers.

The AEC contends that where DNSPs actually supply and/or own assets behind the meter, competitive neutrality in the provision of these services to customers is compromised. This is because the DNSP can in practice access the network support benefits far more easily than other participants in the market, allowing them to offer the customer services at a lower cost. Over time, this could allow DNSPs to dominate the market for BTM services in their own service area, which would deny customers the dynamic benefits of effective competition. This is not least because the DNSP will seek to retain as much of the value as possible, so any price differential will only be just enough to keep other competitors out.

The AEC argued that the dynamic benefits of the potential competition for BTM services outweigh any short-term gains to customers from obtaining DNSP provided BTM services slightly more cheaply in the near term, and that over time the dynamic efficiency benefit would be expected to both overtake and outperform the DNSP provision benefit.

Preventing DNSP's from directly investing in BTM assets as the regulatory approach to realising the dynamic efficiency benefit does not require, nor will it lead to requirements for, DNSP's to adopt more expensive solutions to placate an

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under-developed third party[1] market. On the contrary, robust competition for the provision of this type of services will in turn allow the DNSP to deliver its direct control services at the most efficient cost.

Promote the development of competitive energy services markets

The AEC is remains frustrated that discussions about reform to the entire electricity supply chain would still be couched in terms of regulated outcomes being somehow superior to, or more predictable than, those from competition. Competition in our system is as much a political and social prerequisite as it is an economic one. Indeed, efficient regulatory outcomes attempt to closely replicate competitive outcomes, not the other way around. Arguments that the adoption of genuine competition in BTM services is somehow to sacrifice an efficient regulatory outcome are discouraging.[2]

The AEMC draft rule determination also calls to attention that the NEO relates to the entire electricity supply chain[3], not just network services. As noted in our AEC Rule Change Request, DNSPs can be a more sophisticated service, and in many ways more relevant to the future, by exploring opportunities for growth in substitutes to traditional network investments.

The Commission concludes that the best consumer outcomes will flow from robust, functional competitive markets. Not everybody should be a natural monopoly, but anybody can be a commercial business. In the draft decision there are no barriers to the DNSP's ring fenced affiliate participating equally in these competitive services, and no barriers to DNSP's procuring those benefits or value streams.

There are also no barriers to DNSP's establishing legally, financially and operationally separate stand-alone competitive businesses.

Regulation of "behind the meter" assets

The AEC supports the specification of the capital expenditure restriction under the draft rule that splits restrictions into:

a. Control of assets
b. Located "behind the meter"
c. That are capable of providing contestable services

And endorses the Commissions position[4] in each regard.

The AEC also supports the proposed requirement that the AER have regard to the likely impacts on the development of competition in markets for energy related services when determining whether to grant an exemption. The AEC raises in its rule change proposal the potential for DNSP's to crowd out potentially more efficient service providers in the BTM market in the short-term. This diminishes productive efficiency, and would have a chilling effect on competition and technological development in the BTM market in the long-term, which diminishes dynamic efficiency.

Complimentary changes – RIT-D, planning requirements, cost allocation and shared assets

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[1] AEMC, Contestability of energy services, Draft determination, 29 August 2017, p.98, Energy Queensland *"DNSP's are essentially paying twice…..at greater cost and risk to customers."*

[2] AEMC, Contestability of energy services, Draft determination, 29 August 2017, p.29 "*the ENA argued that the Commission should not sacrifice efficiency in network service delivery in exchange for the promise of competition".*

[3] AEMC, Contestability of energy services, Draft determination, 29 August 2017, p.98

[4] AEMC, Contestability of energy services, Draft determination, 29 August 2017, p.44 - 52.

RIT-D

The AEC proposed additional changes in support of the restrictions on direct BTM investment by DNSP's. The AEC recommended that the RIT-D threshold must be reduced from $5 million for distribution network investments to $50,000. The RIT-D is a cost-benefit test that NSPs must apply when assessing the economic efficiency of different investment options. Our view is that because network peak and energy peak should both be monetised in an efficient investment, then a different procurement option is now required.

The high threshold value of the existing RIT–D, when applied in addressing (or not addressing) both network peak and energy peak, compromises both allocative efficiency and dynamic efficiency. The AEC did not assess the costs of a suitably truncated RIT-D threshold to be material, whereby, the DNSP just needs to list the asset, its location, requirements and its annualised cost on a website in reasonable advance of it having to be replaced/augmented. The DNSP has already done this level of assessment to inform the investment in any case. There was no proposed obligation in the truncated RIT-D placed upon the DNSP to accrue costs by developing any technology alternatives.

DNSP's opposed the changes RIT-D framework proposed by the AEC on the basis of significant costs.[5] However no DNSP submission to the consultation made any real attempt to quantify the costs that would be incurred if the AEC's proposed change was implemented. The nature of the costs is sometimes generally identified in DNSP submission, often mistakenly asserting that the truncated RIT-D process would be as onerous as the existing process, but no serious effort has been made in any of the submissions to provide at any level of detail the quantum of the costs. This makes it difficult to practically assess the DNSP costs. It may be reasonable to assume they are not material.

Planning requirements

Subsequent to the AEC rule change proposal, in December 2016 the Commission released its final determination on the Local Generator Network Credit National Electricity Rule (Rule) change. The Rule change required that the AER publish a template by 30 June 2017 that will reveal opportunities for substitutes to network investment.

The AER proposes to review the DNSP's non network engagement strategies and how DNSP's have complied with the requirements of the template at the end of 2017. We look forward to observing genuine steps towards compliance.

Cost Allocation

The practical effect of cost allocation obligations is to prevent a DNSP allocating or attributing to distribution services costs that properly relate to non-distribution services. The rule change draft determination the exclusion of direct capex investments in BTM assets provides confidence in cost allocation. We remain concerned that where a DNSP's ring fenced affiliate (RFA) provides BTM services to the DNSP through opex that the potential exists, particularly in conjunction with uplift schemes such as the DMIA, for perverse outcomes.

Because of this, and the nature of joint costs themselves, there is a range of outcomes that might be deemed to be "economically efficient" that in fact are not. As part of the Commissions 2018 Electricity Network Economic Regulatory Framework Review NER clause 6.15.2 requires consideration of the cost allocation principles outlined in the NER as they are broad, and offer little guidance beyond high level, generic principles.

Should you have any questions in relation to this rule change request please contact David Markham, telephone 03 9205 3111 or david.markham@energycouncil.com.au.

Yours sincerely

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[5] AEMC, Contestability of energy services, Draft determination, 29 August 2017, p 54, *Submissions to the Consultation paper: ENA, p. 2; AusNet Services, p. 2; Energy Queensland, p. 17; Ausgrid, p. 1; Endeavour Energy, p. 2; Jemena, p. 3; SA Power Network, Citipower and Powercor, p. 1.*

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