Ref: C2121838

31 October 2017

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

www.aemc.gov.au

Dear Mr Pierce

ERC0206 – Submission on the draft rule determination - Contestability of Energy Services

Essential Energy welcomes the opportunity to comment on the Australian Energy Market Commission (AEMC) National Electricity Amendment (Contestability of Energy Services) Rule 2017 (the draft rule), published on the 19 September 2017.

Essential Energy supports the development of contestable markets in behind-the-meter products and services where competitive markets are available to customers. Indeed, there are already many service providers operating in these markets across the more populous parts of the National Electricity Market (NEM) and this number would be expected to naturally increase as markets further develop and technology becomes more affordable. However, where there is inadequate or non-existent competition, the role of distribution network service providers (DNSPs) in offering such services to customers, where they provide a more efficient outcome for all network users, must not be over-looked.

Behind the meter services unlock value for both customers and the network. However, it is worth highlighting that:

- Embedded generation only reduces network costs where it can be specifically matched to network constraints, thus reducing peak demand. This is particularly relevant to a voltage constrained network, like Essential Energy's, where reductions in demand, without a consummate decrease in peak load, regularly require augmentation to be undertaken at a cost to customers. In addition, appropriate levels of spinning reserves must be available to maintain grid stability.
- Given the DNSP will be held to reliability standards under the Service Target Performance Incentive Scheme, it stands that they would only contract for network support payments for behind-the-meter services where the customer has installed (or can install) a reputable system and has a reliable provider for timely, on-going maintenance of the system.
- As a DNSP with no affiliated entities, Essential Energy would have no choice but to seek competitively priced market provided non-network solutions in those areas of our network experiencing existing or potential constraints.

We believe that all rule changes must primarily aim to achieve the National Electricity Objective (NEO). As such, we are concerned to see the draft rule deviate from the achievement of this principle and instead focus on a perceived need to improve competition in markets that we believe are already competitive and in which DNSPs are already unable to participate in by way of existing regulatory obligations.

The remainder of this letter deals with the areas of the draft rule we believe could be better aligned to the NEO.

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The proposed exemption process lacks agility

The AEMC rightly recognises that most customers in rural and fringe-of-grid areas do not have access to an active competitive market for behind-the-meter services and, as such, it is imperative that DNSPs can invest in these services where it will provide a more efficient outcome for all network customers. Under current network pricing arrangements, there is significant cross-subsidisation of the cost to provide services to rural and remote customers by those in urban areas. The sparsity of customers within these remote areas means there is little incentive for companies to supply and maintain behind-the-meter energy services, yet these are the locations that offer the greatest opportunity to both increase the reliability of electricity supply to those customers, whilst also reducing network prices for all customers connected to the network.

The number of behind-the-meter assets potentially operating in these fringe-of-grid areas is likely to be small (in both number and cost terms) and customer remoteness will generally inhibit the ability to access additional revenue streams from such assets. Essential Energy is well established in these remote areas as it has an existing distributed workforce in place that can be mobilised at short notice to resolve equipment failure issues. If we had to instead secure an equivalent maintenance and fault and emergency service from a third party, it would likely come at a far greater cost (in both time to service and monetary terms) than the in-house service model. Such outsourcing costs have the real potential to continue to make poles and wires augmentation more attractive for DNSP's than behind-the-meter technology, which would be a failure of regulation.

The draft rule attempts to allow for DNSP's to own behind-the-meter assets in regional and remote areas through an exemption process operating as part of the DNSP's regulatory proposal process. However, Essential Energy has real concerns with this proposed exemption process as it requires either the DNSP to commit to expenditure for rapidly changing technologies up to seven-years in advance (the time between lodging the draft regulatory proposal and the end of the relevant regulatory period) or a significant event to occur that would give rise to a cost pass through or regulatory proposal reopening.

The issues we perceive with the proposed process are:

> Planning at a distribution level cannot accurately occur seven years out. As such, the agility of DNSPs and their ability to undertake the most efficient outcome at the time of investment as required under the National Electricity Rules (NER) is hampered.

> Rapidly changing technology means the estimated volumes and costs included in the exemption application as part of the regulatory process would, at best, be vague estimates.

> Networks are not static - changing demand requirements and technology improvements may alter the locations that may benefit from such installations within the seven-year window. DNSPs need to be able to change and respond as required.

> The technologies involved in this sphere are developing and improving at a rapid rate. As such, new technologies may appear within the regulatory period that were not envisaged at the time of the exemption application. Similarly, approved exemption applications may contain technologies that are superseded before the end of the regulatory period.

> The number and value of assets involved in the exemption application will be very small in the scheme of a regulatory proposal. However, the process to develop an application exemption would be resource intensive.

> The Australian Energy Regulator's (AER's) obligations under the NER will likely necessitate a narrower view of the exemption application than that envisaged by the AEMC. As such, the AER is just as likely to disallow the proposed exemption expenditure on the basis that the number, type and cost of assets required, as well as the broad locations proposed, lack the specificity to be deemed prudent and efficient.

> Essential Energy is in the early stage of trialling the impacts of behind-the-meter technology on network functions and is yet to fully understand the circumstances and locations where this technology may be best utilised to resolve network issues. The draft rule requires Essential Energy to outline its proposed expenditure for these assets as part of its 2019-24 regulatory proposal by

April 2018, yet at this stage, we have not completed a single trial on the operation of this technology.

> There are unlikely to be circumstances that would require a cost pass through or a regulatory proposal reopening. In addition, the value of assets that would likely be installed and owned by a DNSP in remote locations would fall far short of the materiality requirement of the cost pass through and regulatory reopening triggers.

Instead, Essential Energy proposes that an additional exemption trigger be created and available for DNSP's to utilise at any time based on the following conditions:

> The exemption request is in a network area that meets the definition of a 'regional office' under the AER's existing Ring-fencing Guideline;
> There is no increase in the overall capex allowance of the DNSP. That is, the behind-the-meter investment is substituted for the planned capex allowance that would have been spent on traditional network solutions or other alternative options – this approach supports the DNSP's ability to remain agile and invest efficiently;
> DNSP ownership of behind the meter assets is the most efficient option at the time of undertaking the expenditure;
> The assets are purchased via a competitive tender on the open market;
> The expenditure requires the consent of impacted customer(s) before it can occur and prior to any subsequent public consultation process as necessary;
> Approval would be subject to a public consultation process, similar to that applied under the AER's Ring Fencing Guideline. i.e. submission invited after publishing the DNSPs exemption application on the AER's website;
> A threshold limit could be applied and additional reporting criteria introduced to limit the number of exemption applications required to be reviewed by the AER. For example, only behind-the meter expenditure totalling greater than $10,000 at a customer premise would require an exemption application. The specific locations and amounts of expenditure below this threshold could be directly notified to the AER, along with a brief summary of how the expenditure was deemed to be the most efficient outcome for customers.

A simpler rule change, focussed on the National Electricity Objective, is required

At the public forum to discuss the draft rule determination, held in Sydney on 27 September, Essential Energy was particularly disappointed to hear Richard Owens from the AEMC state that the intention of the draft rule is to promote a competitive behind-the-meter market ahead of the achievement of efficiency prescribed in the NEO.

Essential Energy would argue that these 'contestable markets' are already competitive and, as technology improves and prices fall, competition will naturally further increase. As such, we don't see a need for such a focus in the draft rule. We are also interested to understand how the AEMC intends to measure the success of the proposed rule change and, particularly, how it would ascertain whether any 'improvement' is a direct result of the rule change and not attributable to natural market forces. These areas were not discussed in the draft rule determination.

We believe the draft rule must focus on efficiency in terms of meeting the NEO over any other prerogative. If the primary efficacy of the NEO is disregarded, Essential Energy sees a real risk that the draft rule will lead to the inefficient deployment and investment in small scale embedded generation by consumers who have the means and capacity to invest in such technologies, at the expense of the long-term interest of <u>all</u> consumers of grid-connected electricity services – that is, a widening of the gap between those that can afford such investments and those that cannot.

There are numerous existing (and newly expanded) regulatory obligations on DNSPs that work together to promote efficient network investment and restrict participation in the provision of services that are not direct control services, for example:

- the requirement to undertake efficient investment under the NER to meet the NEO;
- new and existing incentive schemes encourage efficiency by allowing DNSPs to share in efficiency gains under the:
  - capital expenditure sharing scheme;
  - efficiency benefit sharing scheme; and
  - demand management incentive scheme;
- the need to consider non-network alternatives for both augmentation and replacement expenditure decisions under the newly expanded Regulatory Investment Test for Distribution; and
- all planned asset retirements and de-ratings that will result in a system limitation or constraint being included in the newly expanded Distribution Annual Planning Report;
- the AER's Ring-fencing Guideline (in collaboration with service classification) limits participation in competitive markets and avoids cross-subsidisation and competitive advantage.

As such, we believe that the draft rule could be simplified by accepting the definition of a "restricted asset" proposed under the draft rule, along with the improved Asset Exemption Guideline we outlined above, coupled with the development by the AER of Distribution Service Classification Guidelines. These three simple changes, working in conjunction with the existing raft of regulatory measures, will serve to achieve both the NEO and the development of a competitive behind-the-meter products and services market.

In conclusion, Essential Energy believes the draft rule will be improved:

- Through simplification and rewording to remove the promotion of the need to establish a competitive market for behind-the-meter services that benefit some customers, ahead of meeting the NEO for all grid-connected customers; and
- By making the exemption process more agile through an additional exemption trigger that recognises the limited opportunities in which DNSPs will need to employ behind-the-meter assets as well as the small values of such likely investments.

Should you wish to discuss any aspect of this submission, then please don't hesitate to contact Natalie Lindsay on (02) 6589 8419.

Yours sincerely

Gary Humphreys
Executive General Manager Regulation & Innovation