



Explanatory Statement Asset Exemption Guideline

September 2018

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Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Tel: 1300 585165

Email: AERInquiry@aer.gov.au

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1 Background

Introduction

In its Contestability Rule Change, the Australian Energy Market Commission (AEMC) amended the National Electricity Rules (NER) to prohibit Distribution Network Service Providers (distributors) from including Restricted Assets in their Regulated Asset Base (RAB).

Under the amended Rules, assets are restricted and cannot be included in the RAB if they are on the same side of a customer's connection point as their metering point, unless that asset is a network device, the customer is a distributor, or an exemption is provided by the AER.¹ The AEMC made these rules to respond to significant technological shifts that have made it possible for customers to generate, store, and utilise energy in new ways.² The most prominent types of device affected are generation and battery storage assets. These restricted assets will likely attract considerable investment in the coming years and play a significant role in the energy transformation.

This explanatory statement accompanies our Asset Exemption Guideline, made pursuant to clause 6.4B of the NER, and explains our process for assessing asset exemption applications. The purpose of this Guideline is to provide a flexible and robust approach to assessing asset exemption applications. The focus of this Guideline is on implementing the designation of restricted assets into the regulatory framework in the manner that delivers the most benefits for customers.

The final Guideline seeks to address situations where customers will receive benefits from distributor investment in restricted assets, and those benefits will not impede the development of the market for energy related services. It does so by establishing a two-limbed test for analysing the likely impacts of distributor investment in the assets the subject of an asset exemption. This test takes account of any negative impacts on the development of competition, and weighs them against specific categories of benefit that might result from the investment.

We developed this Guideline in consultation with stakeholders. In February 2018, we released the Key Issues paper, and received eight submissions in response. We incorporated these submissions into our draft Guideline, released in July 2018. In response to the draft Guideline, four stakeholders made submissions. We have considered these submissions in the development of the final Guideline, as discussed further below.

¹ NER, Chapter 10.

² For more information please see: <http://www.energynetworks.com.au/electricity-network-transformation-roadmap>

What expenditure requires an exemption?

As part of the process of making the final Guideline, we have carefully considered the circumstances in which an Asset Exemption might be required. This was a key point of clarity sought by stakeholders.³

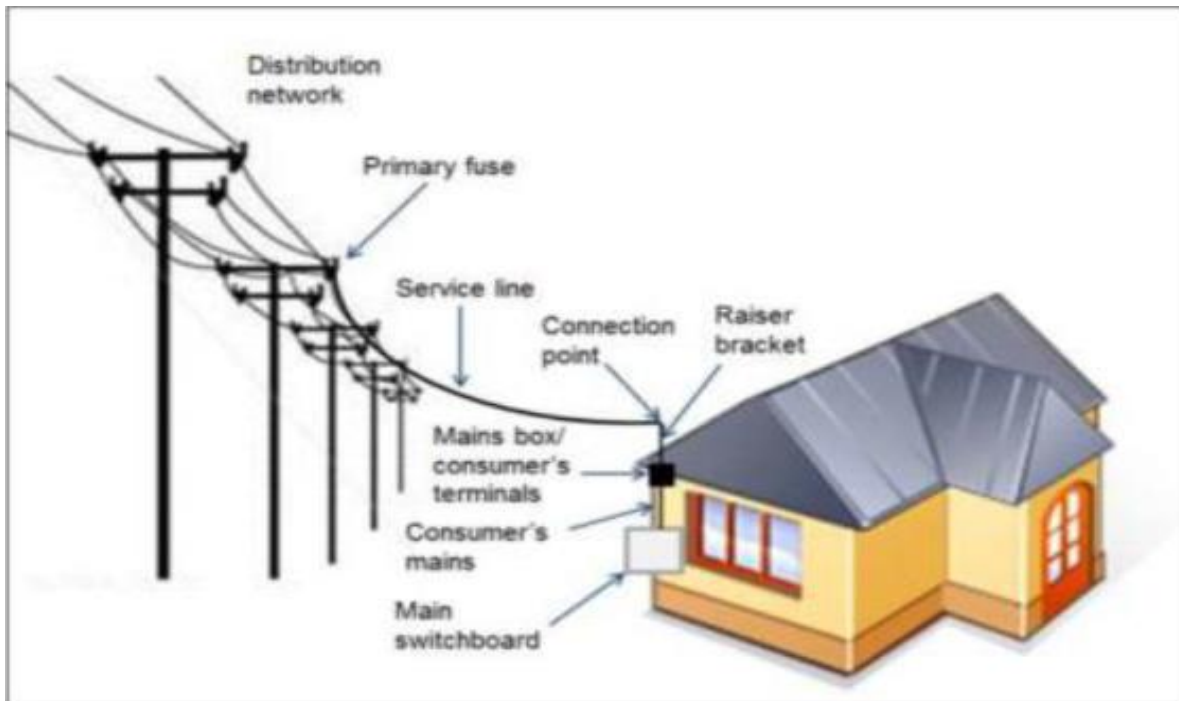
The Rules define a restricted asset as:

"An item of equipment that is electrically connected to a retail customer's connection point at a location that is on the same side of that connection point as the metering point, but excludes:

- (a) such an item of equipment where that retail customer is a Distribution Network Service Provider and that Distribution Network Service Provider is the Local Network Service Provider for that connection point; or
- (b) a network device."⁴

The NER defines a connection point as "the agreed point of supply established between Network Service Provider(s) and another Registered Participant, Non-Registered Customer or franchise customer and includes a parent connection point".⁵ Figure 1 below illustrates the various components of a customer connection and locates the connection point.

Figure 1: Customer Connection point



In response to the draft decision, TasNetworks submitted that we should provide clarification regarding the definition of behind the meter given the variety of contexts that exist across the

³ See, for example, SA Power Networks, *Submission on the AER's draft Asset Exemption Guideline*, 13 August 2018, p. 2.

⁴ NER, Chapter 10.

⁵ NER, Chapter 10. Please note that the definition changes slightly in the case of an embedded network.

NEM.⁶ We consider that, beyond the broad definitions of 'restricted asset' and 'connection point' found in the NER, it is not possible to provide more precise guidance on this issue. As TasNetworks highlighted, the exact point of connection may vary across jurisdictions, and is determined in part by electrical configurations that vary from case to case. In these circumstances, we will examine applications in their circumstances to ascertain the connection point with reference to the NER, and assess the expenditure accordingly.

It is also important to clarify that the classification of network devices, the operation of the building block model and the transitional provisions of the NER limit the kinds of assets that are restricted.

Network devices

Distributors are not required to seek exemptions for assets that sit behind the meter if those assets are network devices.

Chapter 10 of the NER defines a network device as:

"Apparatus or equipment that:

- (a) enables a Local Network Service Provider to monitor, operate or control the network for the purposes of providing network services, which may include switching devices, measurement equipment and control equipment;
- (b) is located at or adjacent to a metering installation at the connection point of a retail customer; and
- (c) does not have the capability to generate electricity."

This includes load or battery control devices that monitor, operate or control the network in order to provide network services. Distributors will therefore be able to continue recovering expenditure on devices that control loads to manage network congestion. We consider that clause (b) of the definition allows these assets to be placed behind the meter.⁷ It is therefore likely that restricted asset exemptions will focus on assets that have the capability to generate electricity. For the purposes of this definition, we consider that battery storage assets have the "capability to generate electricity" as they are capable of influencing the wholesale market in the same manner as a generating unit.

In response to the draft Guideline, Red Energy & Lumo submitted that distributors should not receive a broad exemption for load control devices that provide network load control.⁸ We consider that the definition of a 'network device' is broad in scope and is likely to encompass devices used for load control, such as to control the operation of a customer's hot water service or other appliances. In its final determination, the AEMC stated that it was, 'particularly concerned that networks should be able to continue to operate and install hot water load control devices'.⁹ Nevertheless, we will consider asset exemption applications in

⁶ TasNetworks, *Submission on the AER's draft Asset Exemption Guideline*, 20 August 2018, p. 2.

⁷ NER, Chapter 10.

⁸ Red Energy & Lumo, *Submission on the AER's draft Asset Exemption Guideline*, 24 August 2018, p. 3.

⁹ AEMC, *Contestability Rule Change Final Determination*, December 2017, p. 59.

their context and will not be providing broad additional exemptions for any kind of restricted asset.

The Building Block Model

Only assets that are required to provide standard control services are restricted. A building block proposal is only required to include the forecast capital expenditure for that will be required to meet or manage the expected demand for standard control services in the relevant regulatory control period.¹⁰ Therefore, if the expenditure will be on devices that will provide alternative control services, a distributor will still be eligible to recover costs via the ordinary mechanisms for recovering this expenditure.

The Transitional Provisions

The NER includes several transitional provisions to ensure smooth implementation of the new restriction. These transitional provisions make clear that the restriction does not apply to assets already in the RAB. This includes the refurbishment of existing assets. Distributors will therefore be able to maintain deployed restricted assets and continue to offer services to customers as they do currently. Therefore, refurbishment of TasNetworks' 20,000 load control time switches would not be subject to the asset restriction.¹¹ Distributors will be able to add expenditure associated with the refurbishment of an existing asset to their RAB.

¹⁰ NER, cl. 6.5.7(a)(1).

¹¹ TasNetworks, *Submission to the AER on the draft Restricted Asset Exemption Guideline*, August 2018, p. 2.

2 Development Considerations

2.1 Rule considerations

We consider that the NER directs us to develop a guideline that will allow distributors to invest in behind the meter assets where doing so does not impede the development of competition in a market for energy related services. When making the Guideline we must also have regard to the National Electricity Objective (NEO). The NEO is to "promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to: price, quality, safety, reliability and security of supply of electricity and the reliability, safety and security of the national electricity system". The AEMC considered that creating conditions for customers to make choices in a robust and competitive market was the best means of addressing the risk that, in operating behind the meter assets, distributors would favour network benefits over system benefits.¹²

We consider that we can best achieve the policy goals of this Guideline by providing exemptions in a robust and repeatable manner that focusses on balancing any negative impacts on competition against other forms of customer benefit. This approach recognises the benefit available from encouraging a competitive market in the provision of energy related services. It also recognises that there may be situations where distributor ownership of assets will assist in the maximisation of value across the system. However, we have been mindful that the benefits from competition in a fledgling market are potentially large but difficult to quantify at this stage. We have therefore decided to implement a principles-based test to take account of the individual circumstances of each asset exemption application.

2.2 Regulatory design principles

In developing the Guideline, we have had regard to the COAG principles for best practice regulation.¹³ In particular, we have had regard to whether the obligations contained in the Guideline are:

- targeted – at markets and services of concern to customers and the AER,
- proportionate – in that information to be provided is only what is required to make a determination,
- predictable – for distributors and other stakeholders,
- promoting confidence – in markets and regulatory outcomes.

This Guideline is a complementary piece of regulation, designed to make the contestability rule change a proportional response to the risks posed by distributor ownership of behind the meter assets. This Guideline does not create a prohibition on distributor ownership of certain behind the meter assets by distributors. It is concerned with providing the flexibility

¹² TasNetworks, *Submission to the AER on the draft Restricted Asset Exemption Guideline*, August 2018, p. 31.

¹³ Council of Australian Governments, *Best Practice Regulation: A guide for Ministerial Councils and National Standard Setting Bodies*, Available at: <https://www.pmc.gov.au/resource-centre/regulation/best-practice-regulation-guide-ministerial-councils-and-national-standard-setting-bodies>.

necessary to apply the rules in a common sense fashion, while also preserving the benefits of competition. Therefore, the Guideline seeks to enforce the broadly beneficial policy of preventing distributors from investing in behind the meter assets, while allowing distributors necessary services where it is in the long-term interest of consumers.

The form of regulation factors found in Section 2F of the NEL also guided the development of this Guideline. These factors direct regulators to consider how regulation should approach the unique competitive features of different markets. We consider that the requirements of the final Guideline are proportionate regulatory responses to identified harms. The Guideline is concerned with providing the flexibility necessary to apply the rules in a way that allows networks to provide effective service to customers, while preserving the beneficial outcomes of customer choice by not allowing distributors to compromise competitive investments.

2.3 Interaction with other regulatory instruments

2.3.1 The Regulated Asset Base

We set a distributor's maximum revenue using the building block model outlined in Chapter 6 Part C of the NEL. One input into this process is quantifying a distributor's regulated asset base (RAB). Including expenditure in the RAB allows distributors to recover their costs, plus an allowed rate of return, from customers.

Distributors must specify which kind of asset exemption they are seeking in their asset exemption application. The AER can grant four different types of asset exemptions related to proposed increases in capex:

- Increased forecast capital expenditure
- Increased proposed contingent capex
- A pass through application
- Increased capex in relation to a reopened distribution determination.¹⁴

The type of asset exemption sought does not affect our consideration of an exemption, but it does affect the associated process. We consider increased forecast capex and increased proposed contingent capex every five years during the regulatory reset process.¹⁵

Distributors submit pass through applications in response to events that impose extra costs throughout a regulatory control period.¹⁶ Reopening a distribution determination mid-period occurs where changes in circumstances require re-examination of the assumptions made in making a distribution determination.¹⁷

While the primary focus of this Guideline is on competition, other elements of the regulatory framework (e.g. the capital expenditure objectives) evaluate whether the proposed expenditure is efficient. For instance, we will assess whether the proposed expenditure has

¹⁴ NEL, cl. 6.4B.1.

¹⁵ NEL, cll. 6.5.7(c)(2) and 6.6A.

¹⁶ NEL, cl. 6.6.1.

¹⁷ NEL, cl. 6.6.5(f1).

meaningfully considered non-network alternatives. We will only add expenditure to the RAB that we have assessed as efficient.

2.3.2 Ring-Fencing Guideline

In accordance with clause 6.17.2 of the NER, the AER has published the Distribution Ring-Fencing Guideline. The AER is also responsible for maintaining and conducting compliance activities in relation to the Ring-Fencing Guideline. The Ring-Fencing Guideline prevents distributors from engaging in unregulated services, unless they use an affiliated entity separated by information sharing and accountancy barriers. The aim of this restriction is to prevent distributors from providing uncompetitive cross subsidies that would affect the contestable market.

The Ring-Fencing Guideline shares a common goal with the Asset Exemption Guideline: to preserve the contestability of markets. However, during the contestability rule change, the AEMC considered that the Ring-Fencing Guideline mitigated only part of the risk posed by distributor ownership of behind the meter assets.¹⁸ In its submission on the Issues Paper and Draft Guideline, Red Energy & Lumo suggested that we not grant any exemptions for assets that will be sub-leased to Ring-fenced affiliates.¹⁹

We consider it likely that, in some circumstances, the Ring-Fencing Guideline does mitigate some of the risk of harm to the development of competition. We will assess the potential impacts of various business arrangements if they are relevant to our consideration of an asset exemption. The extent to which the Ring-Fencing Guideline mitigates or fails to mitigate certain categories of competitive harm will be a relevant consideration in deciding whether to grant an exemption.

2.4 Guideline Principles

Having taken account of all the relevant considerations, we consider that the Guideline will best deliver its policy intent of protecting the development of competition in markets competition if it:

- Grants exemptions relatively infrequently, and
- Is non-prescriptive, clear and can flexibly respond to changing circumstances.

We consider that these principles reflect the intention of the AEMC to apply exemptions in 'incidental' circumstances,²⁰ and allow the AER to adapt to the fluid development of emerging markets for energy related services. This approach will allow us to appraise the broader context of proposed exemptions, while not limiting our discretion to provide them where we see specific benefits to customers.

In response to the key issues paper, submitters TasNetworks agreed with the approach but noted that the Guideline should take account of jurisdictional differences in competitive

¹⁸ AEMC, *Contestability Rule Change Final Determination*, 12 December 2017, p. iv.

¹⁹ Red Energy and Lumo, *Submission to the Key Issues Paper*, February 2018, p. 3.

²⁰ AEMC, *Contestability Rule Change Final Determination*, 12 December 2017, p. 58.

conditions.²¹ Energy Queensland submitted that they broadly agreed with the approach but that the actual number of exemptions should depend on how rapidly technologies evolve and markets develop.²² We consider that the Guideline addresses this feedback by not limiting the number of exemptions, but instead limiting the circumstances in which we will grant an exemption.

Red Energy & Lumo's submission in response to the draft design supported the principle that exemptions should be relatively infrequent but advocated a more prescriptive approach to developing the Guideline. We consider that the benefits of a non-prescriptive approach outweigh the certainty that stakeholders might gain from restrictive criteria. We have therefore allowed for nuanced consideration via a non-prescriptive test that focusses on competition.

²¹ TasNetworks, *Submission - Key Issues Paper, Service Classification and Asset Exemption Guidelines*, February 2018, p. 4.

²² Energy Queensland, *Submission - Key Issues Paper - Service Classification and Asset Exemption Guidelines*, February 2018, p. 12.

3 Process

This section sets out the process a distributor must follow when submitting an application, the content that must be included in an application and what happens after the AER receives the application. These elements of the Guideline reflect the AER's commitment to a transparent and open process that efficiently provides for the assessment of applications.

3.1 Submitting an application

Pursuant to clause 6.4B.2(a) of the NER, distributors must make asset exemptions in writing. Distributors should submit their asset exemption applications alongside the revenue determination or cost pass through application to which the expenditure application relates.

3.2 Contents of application

Pursuant to clause 6.4B.1(c)(2) of the NER, the AER is required to set out in the Guideline what information will be contained in an asset exemption application. The Guideline identifies this information at section 2.2(1). We have tailored the information necessary to assess the asset exemption. This information may be largely qualitative, although quantitative information will strengthen applications where appropriate. The requirements target areas of concern while remaining mindful of the burden imposed on distributors and information limitations that they might have.

In response to the key issues paper, SA Power Networks submitted that we should be clear about what information is required and how we will assess that information given the timing of the next reset processes.²³ We consider the detailed list of information provided at section 2.2(1) provides distributors with an appropriate level of certainty. No submissions in response to the draft addressed the level of information required.

3.3 AER assessment of applications

The AER will assess applications according to the test outlined in section three of the Guideline. The timelines for this assessment will follow the timelines set out for the expenditure determination to which the asset exemption relates. This will vary depending on the type of expenditure determination the asset exemption accompanies.

Clause 6.4B.1(a) of the NER requires that we not accept a proposal from distributors to include restricted assets in their regulated asset base unless we grant an exemption. Clause 6.4B.1(c) mandates that we develop maintain and publish an Asset Exemption Guideline that sets out our approach to determining whether to grant an asset exemption and the information we require distributors to provide in order to assess an asset exemption request. When making an asset exemption decision, clause 6.4B.1(b) states that we must consider the likely impacts on the development of competition in the market for energy related services, and the Asset Exemption Guidelines. The Asset Exemption Guidelines are

²³ SA Power Networks, *Submission, AER Issues paper - Service classification and asset exemption guidelines*, February 2018, p. 2.

required to state the information required by the AER in an asset exemption application, as well as the framework we will use for assessing those applications.

3.4 Consultation

Expenditure determinations have consultation processes associated with them, which are adapted to its particular features and circumstances. Distributors will submit their applications alongside an expenditure determination. We consider that this is appropriate and sufficient to conduct our own consultation on the asset exemption application.

However, we encourage distributors to conduct their own consultation prior to submitting the asset exemption, to assist us in understanding the views of market participants and customers on the proposed expenditure. This may allow distributors to reduce potential harms and to propose exemptions that are sufficiently narrow in scope to fit within the requirements of this Guideline.

3.5 An open process that respects confidentiality

It is important that all stakeholders have confidence in the AER's assessment process. Building this confidence requires a transparent process that produces repeatable consistent results that reflect the NER. However, it is also possible that asset exemption applications will include information that is commercial in confidence.

In their submission on the key issues paper, AusNet Services submitted that their applications would be unlikely to contain confidential information, so long as they could exclude price information and commercial in confidence information.²⁴ TasNetworks also acknowledged that some information may be confidential but supported as much transparency as possible.²⁵

We consider that while excluding price information may be appropriate, it is likely to be necessary to publicise the total expenditure that would be included in the regulated asset base, as this may materially affect consideration of the exemption. To assist with these situations, we have published a *Confidentiality Guideline* that outlines the process for submitting confidential information.²⁶ It directs that when making submissions, parties must provide the AER with a version of their report that is suitable for publication and the AER will work with the business to ensure that any information required for effective consultation on the asset exemption be available in some form.

3.6 Submissions

In response to the issues paper Red Energy & Lumo submitted that the AER must consult transparently and allow stakeholders to provide input on all exemption decisions.²⁷ We agree that this is essential to the proper operation of the Guideline. We consider that our

²⁴ AusNet Services, *Submission - Key Issues Paper, Service classification and asset exemption guidelines*, February 2018, p. 5.

²⁵ TasNetworks, *Submission - Key Issues Paper, Service Classification and Asset Exemption Guidelines*, February 2018, p. 4.

²⁶ See <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/confidentiality-guideline-2017>.

²⁷ Red Energy and Lumo, *Submission to the AER on the draft Restricted Asset Exemption Guideline*, 24 August 2018, p. 1.

current consultation processes are well adapted to serve this purpose. These processes require us to seek feedback from stakeholders through a transparent process that exposes our decisions to scrutiny. We consider that attaching the exemption decisions directly to the exemption decisions will allow stakeholders to understand the implications of that decision, and integrate exemption applications with the broader process. This will ultimately allow asset exemption to serve their purpose in the broader framework. We therefore consider that the draft design remains appropriate.

4 Assessing exemption applications

This section outlines the framework the AER will utilise in conducting its assessment. We developed this framework through consultation with stakeholders and consideration of the NER and NEL. The foundation of this framework is a two-limbed test that requires us to be:

- (a) Satisfied that, if the DNSP invests in the assets the subject of the exemption application, that investment is not likely to have any negative impact on the development of competition in a market for energy related services, or
- (b) Satisfied that any likely negative impact to the development of competition in the market for energy related services is outweighed by the benefits delivered to customers by the expenditure for a restricted asset for one or more of the purposes that are listed in section 3(2).

The specific purposes for which distributor investment must be made are:

- (a) Increasing the efficiency or effectiveness of service delivery for rural, regional, or remote customers,
- (b) Efficient and effective provision of safety services that are required in order for the distributor to meet the requirements of good electricity industry practice, or
- (c) Strengthening a distributor's ability to respond to a force majeure event.

For clarity, distributor investment may have multiple purposes, but we will only consider benefits resulting from the above purposes.

In designing this test, we have had regard to the NER, the AEMC final rule determination, and submissions by stakeholders in response to our draft design. The Rules direct that in making asset exemption decisions, we must consider the likely impacts on the development of competition in the market for energy related services.²⁸ We consider that this design will preserve the benefits of non-network ownership and control of restricted assets while allowing distributors to offer efficient services using these new devices where it is appropriate.

The AEMC's final rule determination outlined a range of circumstances in which it considered it appropriate to grant an asset exemption. The assets specifically identified by the AEMC were:

- Generation assets for extremely remote customers,
- Safety equipment for very large customers, or
- Temporary generation assets that do not affect the wholesale market.²⁹

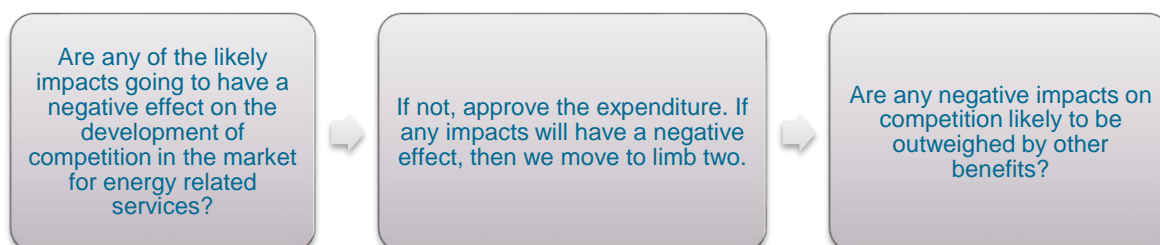
We consider that these represent the key areas of benefit that asset exemptions should address. The final Guideline therefore focusses on allowing networks to provide services where there are specific barriers that mean that the development of competition in relation to

²⁸ See clause 6.4B.1 of the NER.

²⁹ AEMC, *Contestability Rule Change Final Determination*, 12 December 2017, pp. 63-64.

those particular services is unlikely. The cause of these barriers may be the remoteness of the customer, a force majeure event, or safety concerns that are appropriately the responsibility of the network. We consider that the final design takes account of this guidance and the submissions made by stakeholders.

Figure 2: The Asset Exemption Test



4.1 Will any of the likely impacts on competition have a negative impact?

If the likely impacts of an investment will not include a negative impact, the first limb of our proposed test will allow the AER to approve an exemption application. We consider it reasonable to view distributor investment in environments where competition is feasible as likely to have at least some negative impact, even if it also has other positive impacts. Therefore, there are likely to be relatively few situations in which assets satisfy this limb of the test. This limb is most likely to be relevant where regulatory or technical barriers prevent competition, and we do not consider that it is likely this will change. In such circumstances, we consider that balancing benefits is unnecessary.

The first limb of the test requires that we define and assess the likely impacts on competition. An impact on the development of competition will be negative where the impact has a reasonable possibility of altering the competitive environment in the market for energy related services to the detriment of competition.

While it will likely be necessary to consider the market for energy related services in a broad sense, a proper understanding of the likely impacts of distributor investment may also require a more granular analysis of individual sub-markets. This is likely to increase in importance as the market grows, deepens and diversifies. It will also be necessary to consider the maturity of a given market, for instance the wholesale market

This limb of the test is composed of three steps:

- defining the market,
- identifying the likely impacts of the investment on the development of competition in the market for energy related services within that area of competition, and
- considering whether any of those impacts are likely to have a negative impact on the development of competition in the market for energy related services.

What is the market?

Defining the area, or areas, of competition that a particular asset can or will affect is central to our assessment of an asset exemption. This exercise provides the scope for the inquiry that we will undertake to assess the asset exemption. It includes analysis of the services the assets could provide, as well as any assets that are a reasonable substitute for the proposed assets. This might entail analysing the geographic or demographic characteristics of the customers that the proposed assets will serve, as well as a detailed assessment of the asset's function including ancillary or potential future functions. However, it is also often difficult to draw clear boundaries given the interrelationships between different markets.

The Guideline requires information about the proposed definition of the market at section 2.2(1)(e), which requires that an asset exemption application include a proposed area of competition and supporting information to justify their market definition. The level of information that will be required in order to satisfy the AER that a particular market definition is appropriate will vary from case to case. We will gather supplementary information from interested parties through submissions and through our own inquiries. The following sections outline different dimensions of competitive markets that are relevant to market definition.

Product

The product dimension of a market concerns the features of the product or service. Analysis of the product dimension of markets involves considering the three different kinds of products or services that might compete with a particular product or service: identical, differentiated and substitute products. Identical products are those products or services that are identical to the product the subject of the asset exemption or a service provided by means of that product. Differentiated products or services are substantially similar to the product the subject of the asset exemption or to the services provided by means of that product, but customers see them as different due to various views they have about the product or service. Substitute products or services are different in technical terms from the original product or service, but may provide a sufficient alternative that customers would switch to in response to a change in the price or quality of the original product or service.

Example 1 - Substitute products

If a distributor wanted to implement a smart load control device that draws on battery power at times of constraint, we would also consider the ways that other parties might offer a service that could be used in place of a load control device purchased by the distributor. This could either increase or decrease the scope of impact, depending on whether the presence of this device will affect contestable provision of services.

Geographic

It is also possible to define markets by their geographic features. The location of customers that would participate in the market and the geography of the surrounding area may create differences between the services required for customers, or the services that a competitive

market could theoretically provide. This dimension will be particularly important for distributors when attempting to claim benefits for rural or regional customers.

Example 2 - Geography

If a distributor wishes to install temporary generation assets on residences that are in a city and in a regional area, it may be that the two different locations create different markets. There may also be differences between cities, or different regional centres. Distributors should describe how the geographic differences influence the other dimensions of markets.

Time and Customers

It may also be necessary to consider the period of time across which the investment in the assets will occur and how impactful this will be on deterring investment by other parties and creating further barriers to competition. This will also be important in considering access to customers, which is potentially very important in these circumstances, given that we are dealing with monopoly businesses providing monopoly services.

Example 3 - Consumer dimension of markets

A distributor wishes to offer assets that are also theoretically obtainable from the contestable market. Customers may be more likely to engage with businesses that are familiar to them. Therefore, we would consider this customer attitude when assessing the competitive harm that a regulated business may have on the contestable market.

What are the likely impacts on the relevant market?

Once the relevant market(s) are identified, we must consider the likely impacts of the distributor's investment in the assets that are subject of the asset exemption. To this end, we will list the likely impacts before analysing their effects, in order to understand the outcomes of those impacts. We will describe likely impacts with reference to the characteristics of the product or service the distributor is offering and what features of the market (outlined above) would be impacted.

We will assess all likely impacts of the distributor's investment in the assets the subject of the asset exemption. A likely (or not unlikely) impact is any way in which it is reasonably probable that the distributor's investment in the assets the subject of the asset exemption will influence or otherwise affect a market for energy related services. No submissions received in response to the issues paper addressed the definition of likely impact.

Will any of the likely impacts be negative?

Once we have identified the likely impacts on the relevant market, we will then move to understand whether any of those impacts are likely to have a negative impact on competition.

Where competition is possible and feasible, investment by an entity able to gain a certain return from a broad base of customers (i.e. the regulated business) will usually create barriers to competition for other providers. These providers invest on uncertain terms without the guaranteed rate of return available to regulated businesses. Therefore, in order to demonstrate that the investment will not have a negative impact on competition, distributors applying for asset exemptions should provide evidence that third party providers will not struggle to compete (based on the features of the relevant market) against the services offered by the distributor.

4.2 Are any of the likely negative impacts on competition outweighed by benefits to customers?

This stage of the test deals with circumstances where there may be some negative effect to the development of competition but the potential benefit to customers is significant enough to outweigh the negative impacts on competition. The other benefits to customers are required to outweigh the negative impacts on competition. We will only consider expenditure to be delivering benefit for the purposes described in the Guideline.

Any 'benefit' that is ascribed to expenditure by a distributor must not be able to occur if we do not grant the asset exemption. That is, if a contestable provider could deliver the same benefits, then we would not consider distributor investment to be delivering a benefit. In circumstances where benefits that distributors are uniquely able to deliver outweigh the negative impacts on competition, we may consider that there is merit in granting the exemption.

The intention of the test is to protect competitive markets while also allowing flexibility for investment to deliver the services customers require to receive the electricity they need. This portion of the test is about maximising good behaviour because we are encouraging distributors to positively identify benefits and explain why these benefits outweigh the negative impacts of the investment. Analysis of the future without the distributor investment will be a key consideration in this limb of the test - that is, we will consider not just what would happen in the case where the distributor does nothing, but also what would happen where the distributor takes the next best option.

We have defined the other benefits that we will consider in this limb in the Guideline. The following sections describe the process and reasoning for including these categories of benefit.

4.2.1 Benefits for regional or remote customers

One of the key challenges during the electricity transformation will be ensuring effective service delivery for customers outside the capital cities. While there is significant opportunity to decrease costs for regional customers using new technologies, there is also a risk that competitive markets will not find sufficient incentives to serve customers where costs are higher. Therefore, it may be appropriate in certain circumstances for the regulated monopoly business to distribute some costs of servicing these customers among all users of the network. The AEMC highlighted the example of temporary generation assets for remote

customers as a potential case for exemptions.³⁰ Energy Queensland submitted that providing exemptions to rural or remote customers should look closely at how the market is developing in these areas to ensure they receive basic network services.³¹

We consider that including this category of benefit for consideration recognises the different circumstances in which electricity delivery occurs in remote areas and the impacts this may have on competition. However, we will also have careful regard to the benefits that may be available long term from competition and balance those concerns in making asset exemption decisions.

4.2.2 Safety benefits

Distributors have a responsibility to ensure the safety of the network they operate. This includes activities to prevent bushfires, electrocution, or unauthorised work practices.

In the Contestability Rule Change, the AEMC highlighted that safety equipment for very large customers was an appropriate scenario for exemptions.³² In their submission on the key issues paper, AusNet Services submitted that they are in the process of installing Rapid Earth Fault Current Limiters to comply with jurisdictional safety requirements.³³ In some circumstances, the most cost effective solution is for AusNet Services to own these assets. These assets minimise the risk of electrical faults causing bushfires. AusNet Services also highlighted the importance of safety equipment for High Voltage customers in rural areas.³⁴ Energy Queensland submitted that security and reliability of supply be a category for exemption.³⁵

We consider that the Energy Queensland submission provides a broad category of benefit that may go beyond the scope of this Guideline. For instance, a key advantage of behind the meter battery storage is it guarantees supply to the customer, but this kind of asset was the explicit target of the restriction. We have instead chosen to focus on safety benefits to the network. Reliability of the network will be a necessary consideration in relation to other benefits, such as benefits for remote customers or the ability to respond to a force majeure event. We consider that these two scenarios adequately cover the concerns submitters had around reliability, without requiring a broader category of benefit.

We consider that providing distributors with flexibility to ensure the safety of the network is likely to produce benefits where the investment has a low impact on competition. It is important to note that the test proposed in the draft determination will still weigh benefits delivered by these programs against competition concerns, and the magnitude of this benefit

³⁰ AEMC, *Contestability Rule Change Final Determination*, 12 December 2017, p. 63.

³¹ Energy Queensland, *Submission - Key Issues Paper - Service Classification and Asset Exemption Guidelines*, February 2018, p. 12.

³² AEMC, *Contestability Rule Change Final Determination*, 12 December 2017, 63.

³³ AusNet Services, *Submission - Key Issues Paper, Service classification and asset exemption guidelines*, February 2018, p. 5.

³⁴ AusNet Services, *Submission - Key Issues Paper, Service classification and asset exemption guidelines*, February 2018, p. 5.

³⁵ Energy Queensland, *Submission - Key Issues Paper - Service Classification and Asset Exemption Guidelines*, February 2018, p. 12.

will be dependent on the ability of competitive providers to offer a similar service. Distributors will not receive blanket exemptions for any projects with a safety element rather they will have to demonstrate that the benefits that capital expenditure on those assets will have for the purposes of safety will outweigh the detriment to competition.

4.2.3 Ability to respond to a force majeure event

It is possible that in order to respond to force majeure events distributors will need to invest in assets that may sit behind the meter and possibly have impacts on competition.

While we are not aware of any particular examples of these kinds of assets, we consider that it is important to include this category of potential benefit to cover unforeseen scenarios, particularly given that the market is still developing and that market failures may occur during this time. The most likely scenario for considering this kind of benefit will be during a cost pass through application or a proposal relating to contingent capital expenditure. We will be very cautious in considering this category of benefit.

4.3 Conditions

If we consider it appropriate, we can provide an asset exemption that is narrower in scope than the exemption requested, or on conditions which otherwise limit the situations in which distributors may incur the expenditure. These conditions will address circumstances in which distributors may make an investment, rather than their use of that asset following the investment. It is unlikely that the AER would provide an asset exemption where the exemption would need to be conditional on the distributor's behaviour after the expenditure has been incurred (such as by only using the asset for particular purposes), as compliance with such a condition would be difficult to enforce.

The purpose of imposing conditions is to manage the risks of distributor investment in certain areas, while avoiding distributors resubmitting asset exemptions. This will allow us to make decisions appropriate to the circumstances of the individual application that both protect competitive markets and provide distributors with the ability to invest in assets that will provide customers with benefits without unduly harming competition. For clarity, conditions imposed on expenditure do not bind distributors to make any expenditure, once we make a decision distributors may elect to make use of the provided exemption and add expenditure to their regulated asset base or they can elect not to do so.

If a distributor seeks an exemption for a class of assets, we may choose to exclude some assets from the class exemption. For example, if the distributor intends to deploy the assets in multiple locations, we may find that some locations cause harm to a market, while others do not. In such a situation, we may limit the scope of the exemption accordingly. Conditions must relate to concrete factors, such as geographies, asset codes or network types.

Submissions on the Draft Design

In response to the draft design, we received four submissions from stakeholders.

SAPN submitted that the draft design was overly restrictive.³⁶ They submitted that the guideline would not allow for nuanced consideration of co-ownership. In SAPN's view, the categories outlined in clause 3(2) would preclude partnering and flexible arrangements that were the intention of the original rule, and other changes the AEMC has made.³⁷ Additionally, SAPN considered the purposes for investment listed in clause 3(2) unnecessarily restrict the test laid out in 3(1).³⁸ SAPN submit that a broader range of categories should be included in clause 3(2) and that we should modify the wording of clause 3(1) to focus on practical considerations.³⁹ SAPN proposed that we should reformulate the first limb of the test, as 'investment is not reasonably likely to have a materially negative impact on the development of competition'.

AusNet Services supported the inclusion of exemptions for based on benefits provided to regional or remote customers.⁴⁰ AusNet Services submitted that clause 3(3) places unreasonable restrictions on a distributor's ability to deploy assets that are in a customer's best interest and would ultimately prevent distributors from improving services efficiently.⁴¹ AusNet Services submits that this restriction would ultimately force distributors to risk their reputations by engaging in unequitable deals with third parties.⁴²

TasNetworks submitted that a number of elements of the guideline required further clarification including the definition of rural, regional or remote customers and that the existence of competition will vary by region.⁴³ TasNetworks also submitted that restricting ownership of behind the meter assets to parties other than distributors would allow third parties to pursue commercial benefits that would be detrimental to the electricity system as a whole.⁴⁴ Additionally, TasNetworks considered that the AER should consider that the length of exemptions on the basis that resubmission of identical exemption applications may create undue regulatory burden.⁴⁵

AusNet Services and TasNetworks both raised concerns that if our assessment approach was too restrictive, then this may harm customer perception of distributors by increasing prices and decreasing service quality.⁴⁶

Red Energy & Lumo submitted that the information the draft guideline required was indeterminate.⁴⁷ Red Energy & Lumo suggested that more defined criteria for approving an

³⁶ SA Power Networks, *Submission to the AER on the Draft Restricted Asset Exemption Guideline*, 13 August 2018, p. 1.

³⁷ SA Power Networks, *Submission to the AER on the Draft Restricted Asset Exemption Guideline*, 13 August 2018, p. 1.

³⁸ SA Power Networks, *Submission to the AER on the Draft Restricted Asset Exemption Guideline*, 13 August 2018, p. 1.

³⁹ SA Power Networks, *Submission to the AER on the draft Restricted Asset Exemption Guideline*, 13 August 2018, p. 2.

⁴⁰ AusNet Services, *Submission to the AER on the draft Restricted Asset Exemption Guideline*, 20 August 2018, p. 2.

⁴¹ AusNet Services, *Submission to the AER on the draft Restricted Asset Exemption Guideline*, 20 August 2018, p. 2.

⁴² AusNet Services, *Submission to the AER on the draft Restricted Asset Exemption Guideline*, 20 August 2018, p. 2.

⁴³ TasNetworks, *Submission to the AER on the draft Restricted Asset Exemption Guideline*, August 2018, p. 3.

⁴⁴ TasNetworks, *Submission to the AER on the draft Restricted Asset Exemption Guideline*, August 2018, p. 4.

⁴⁵ TasNetworks, *Submission to the AER on the draft Restricted Asset Exemption Guideline*, August 2018, p. 4.

⁴⁶ AusNet Services, *Submission to the AER on the draft Restricted Asset Exemption Guideline*, 20 August 2018, p. 2 & TasNetworks, *Submission to the AER on the draft Restricted Asset Exemption Guideline*, August 2018, p. 4.

⁴⁷ Red Energy and Lumo, *Submission to the AER on the draft Restricted Asset Exemption Guideline*, 24 August 2018, p. 1.

exemption would allow the AER to obtain information that is more objective. Red Energy & Lumo suggested that assets must:

- Be unlikely to have an impact on the development of a competitive energy,
- Not be able to store or generate electricity,
- Not be sub-leased to a ring fenced affiliate
- Receive express permission from the customer to install the asset Behind the Meter.⁴⁸

Response to Submissions on the Draft Design

We consider that the draft Guideline allows for nuanced consideration of the context in which expenditure will occur. We agree with SAPN that there is likely to be an increase in partnerships between distributors and third parties. We will assess the impact on competition in the context of the partnership proposed by the distributor in its exemption application. Therefore, distributors should seek to structure ownership arrangements to reduce the negative impacts that may stem from distributor ownership of restricted assets.

The test proposed in the draft, and retained in the final Guideline, is a two-limbed alternative test. If we consider that expenditure meets the test in clause 3(1) then the test presented in clause 3(2) is not considered. In response to SAPN's submissions regarding clause 3(2), we consider that clause 3(2) does not modify clause 3(1)(a). Therefore, if investment is not likely to have a negative impact on competition it will be eligible to receive an exemption. We consider that this test design remains appropriate and will best serve the policy intent of the Guideline.

We consider that the requirement for impacts to be 'likely' provides sufficient certainty that our decisions will focus on practical, material considerations. SAPN's suggested modification to clause 3(1) would not provide additional clarity and instead, would require further interpretation and clarification. Modifying the test proposed in the draft risks detracting from the intent of the relevant NER provisions, which direct us to consider all likely impacts. We therefore consider that the definition used in the draft design remains appropriate.

We consider that AusNet Services' submission overstates the effect of clause 3(3). Clause 3(3) provides clarification about when expenditure of the kind otherwise described in clause 3(2)(a) will be capable of being the subject of an exemption – namely, when the purpose of the expenditure is to address issues that cannot be addressed by other means. The effect is that, under clause 3(1)(b), a benefit is only relevant as far as it cannot be delivered by other solutions. For example, in the scenario AusNet Services presented, the cost effectiveness of a distributor solution may provide substantial benefits to the rural customer, over and above what another provider may offer. The mere fact that another provider can offer the same service is not determinative. Accordingly, we consider that the Guideline adequately takes account of the scenario outlined by AusNet Services.

We consider that including further definitions for the phrase "rural, regional, or remote customer" has the potential to limit the scope of the exemptions that the AER may be willing to grant. We intend this phrase to have its broad ordinary meaning. However, it is important

⁴⁸ Red Energy and Lumo, *Submission to the AER on the draft Restricted Asset Exemption Guideline*, 24 August 2018, p. 1.

to note that benefits to regional customers will be relevant where the proposed expenditure remedies some aspect of disadvantage caused by the distance of the customer from a more viable solution. Therefore, in some contexts it may be that the bulk of TasNetworks' network is in fact regional, given Tasmania's particular geographic context. However, in other contexts the benefits the service provides will not remedy disadvantage caused by a remote position. Therefore, we will consider the benefits of granting exemptions in the particular circumstances for which they are sought, rather than through a formal process of classifying a particular customer as rural, regional or remote.

We consider that aligning asset exemptions with expenditure determination processes will create clarity for stakeholders, while allowing the AER to adapt to changing markets. We consider that these benefits outweigh any slight administrative burden that may accrue because of the need to resubmit identical asset exemption applications over multiple periods. Distribution determinations (where most repeat asset exemptions will likely be required) already contain large amounts of information. Any detrimental impact is relatively small in this context, particularly given that the distributor will need to allocate the expenditure as part of its RAB roll-forward. Additionally, a periodical reassessment period will provide us with a picture of the expenditure and an ability to assess its ongoing suitability. For clarity, we also note that once an asset is included in the RAB, it is included for the life of the asset. The length of the exemption does not affect this. We therefore consider that the approach outlined in the draft remains appropriate.

We consider that the Guideline is suitable for assessing the competitive context of proposed exemptions. In relation to TasNetworks' submission about the possible behaviour of other parties, it is possible that a self-interested party will pursue commercial benefits in relation to restricted assets in a way that is detrimental to the electricity system. However, the reason why the AER has been required to make this Guideline is to mitigate the risk that *distributor* ownership of restricted assets may diminish electricity system value. Balancing these risks is a key concern of the Guideline.

In particular, it is important to note that the Guideline focusses on negative impacts on the *development* of competition. Where there are third party providers who have the ability to affect a market, as implied by the scenario presented in TasNetworks submission, it may be less likely that distributor investment will negatively affect the development of competition. The benefits to customers of that investment may also be greater. We consider that the Guideline is appropriately adapted to examine the precise context of every exemption application and judge the harms and benefits accordingly.

As discussed in section 2 above, we consider that implementing strict criteria, of the sort that Red Energy & Lumo suggest would serve to limit the Guideline in a way that does not serve its policy intent. For instance, barring all exempt assets from storing or generating electricity would severely reduce the scope of the Guideline, because setting criteria for granting exemptions for these assets is the aim of the Guideline. We also consider that the combination of Guideline and associated regulatory instruments, such as the Ring-fencing Guideline, adequately address the risks targeted by Red Energy & Lumo's other suggested criteria. We therefore consider that the test and information requirements laid out in the draft guideline remain appropriate.

Appendix A - Summary of submissions table

Copies of all submissions are available on our website.

Name	Summary of Submission	AER Response
SA Power Networks	<p>The Draft Guideline does not give effect to the rule because:</p> <ul style="list-style-type: none"> • It does not recognise the potential for distributor co-investment • The categories proposed in clause 3(2) of the Guideline unnecessarily restrict the consideration of potentially beneficial projects and a broader list of considerations should be considered <p>We should provide clarity regarding the scope of assets that will be restricted.</p>	<p>We consider that the Guideline recognises the potential benefit available from distributor partnerships with third parties to resolve issues. Rather, the Guideline seeks to enable this partnering to include flexibly assets in the RAB where that partnership will not create undue detriments to the development of competition.</p> <p>The categories in clause 3(2) do not restrict the test proposed in 3(1). Clause 3(2) only operates where the test in 3(1) is not met. We consider that the categories laid out in 3(2) represent sensible adjustments where likely negative impacts to the development of competition exist.</p> <p>We have provided the requested clarity.</p>
TasNetworks	<ol style="list-style-type: none"> 1.1. Greater clarity is needed regarding the location of devices that will be captured as restricted. Connection point is variable depending on jurisdictional and electrical arrangements. 1.2. Exemptions should be provided for longer periods to reduce administrative burden. 1.3. We should provide clarity regarding what happens to assets that have a longer life than the length of the asset exemption. 1.4. Tasmania has a paucity of competition even in parts of the supply chain that have been open to competition for some time; the AER should consider this. 	<ol style="list-style-type: none"> 1.1. We consider that, due to the diversity of potential arrangements, it is difficult to provide this clarity. Attempting to do so may lead to perverse outcomes. We will consider applications in their circumstances. 1.2. We consider that the clarity and utility of periodically reassessing exemption applications outweighs the extra administrative burden. 1.3. Once we add assets to the RAB, the ending of an exemption will not remove them. An asset exemption entitles distributors to add expenditure during the period defined in the final exemption. 1.4. We will consider the future

Name	Summary of Submission	AER Response
	<p>1.5. Geographic location should not be a consideration in assessing an application for a restricted asset exemption. This restriction would reduce the economy of scale available to TasNetworks.</p> <p>1.6. Restricting ownership of behind the meter assets to parties other than DNSPs will allow third parties to pursue commercial benefits that would be detrimental to the electricity system as a whole.</p>	<p>prospect for the development of competition in making any exemption decision.</p> <p>1.5. Geographic location is not a mandatory consideration in an asset exemption application. If a distributor wishes to claim this benefit, they may, but if the benefit is not relevant, it does not impede our consideration of other benefits.</p> <p>1.6. We consider that the overall regulatory framework works to minimise this possibility. This Guideline adopts a flexible and nuanced approach to allow for distributor investment where it is beneficial.</p>
AusNet Services	Clause 3(3) unnecessarily restricts the consideration of benefits provided by 3(2)(a).	The purpose of clause 3(3) is to emphasise that the benefit of distributor investment in assets the subject of an asset exemption is only considered as far as those benefits exist over and above what non-network ownership of the assets would provide. It does not restrict or otherwise constrain clause 3(2) in the way AusNet Services' submission suggests.
Red Energy & Lumo	<p>The AER should impose the following criteria before considering an asset exemption:</p> <ul style="list-style-type: none"> • Be unlikely to have an impact on the development of a competitive energy, • Not be able to store or generate electricity, • Not be sub-leased to a ring fenced affiliate • Receive express permissions from the customer to install the asset Behind the Meter 	<p>As stated in our draft decision, we consider that these criteria are not preferable to the broader, principles based approach that we have adopted in the Guideline. We consider that our chosen approach will contribute to robust decision making, thus better fitting with the broader regulatory framework.</p> <p>We agree that exemptions will be relatively infrequent but do not propose to impose a quota or other mechanism in the Guideline to enforce this.</p> <p>We agree that devices (other than</p>

Name	Summary of Submission	AER Response
	<p>Exemptions should be relatively infrequent.</p> <p>Ownership of load control devices should be focussed on ensuring a competitive market for these services is not impeded.</p>	<p>network devices, which are not restricted) should be exposed to a rigorous process to assess the impacts on competition that may result from distributor investment.</p>