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16 March 2018

Mr Chris Pattas
General Manager
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Dear Chris

Service Classification and Asset Exemption Guidelines

AusNet Services welcomes the opportunity to make a submission in response to the Australian Energy Regulator's (AER) issues paper on the Service Classification and Asset Exemption Guidelines.

AusNet Services supports the AER in developing both of these guidelines and the additional clarity they will provide.

In relation to the Service Classification Guideline we generally support harmonisation between jurisdictions, however harmonisation should not be the overriding objective of the guideline. It is important to ensure that jurisdiction specific differences are taken into account during the Framework and Approach stage of regulatory review processes.

The Asset Exemption Guideline will clarify restrictions on a DNSP's ability to own, and earn regulated returns on, assets located behind the meter. There are a number of circumstances (outlined in the attached submission) where it is in customers' interests for DNSP to be permitted to add an asset to its regulatory asset base. The inclusion of principle based criteria in the restricted assets and asset exemption guideline would provide DNSPs with the necessary certainty to reasonably invest in efficient modernisation.

We provide a response to the specific questions asked by the AER in the attached submission.

We would be happy to meet with AER staff to further discuss this letter. If you have any queries in relation to this submission, please contact Michael Larkin, Senior Economist on 03 9695 6346.

Sincerely,

C. Eddy

Charlotte Eddy
Manager – Economic Regulation
AusNet Services

Submission on Service Classification and Asset Exemption Guidelines Issues Paper – Response to Questions

Service Classification Guideline

Question 1: Is our existing 'incremental' approach to service classification fit for purpose? Or should the AER review the classifications of each and every service (or service grouping) at every determination? To what extent is harmonisation desirable? Should a harmonised (all jurisdictions) typology and hierarchy of distribution services be a feature or objective of the guideline? If so, why?

We consider that the existing incremental approach is an appropriate way for the AER to approach service classification. In general, service classifications should remain relatively stable across regulatory periods. This reflects that the nature of most services is reasonably stable and that prior decisions have properly considered the manner in which regulation should apply. As such, the AER is not starting from a zero base and there is no need to fundamentally revisit the existing service classifications. In any event we would expect that such a process would end up confirming most of the existing positions. As such, an incremental approach is appropriate and should focus on new distribution services or areas where the nature of services has changed.

We acknowledge that the AER has been incrementally creating greater consistency between jurisdictions and we expect this to continue in the next Framework and Approach process (for the 2021-25 EDPR). Harmonisation is a generally desirable property and we would support the AER in seeking to implement a broadly consistent approach across the NEM. However, this objective should not be pursued without understanding of the different environment in which DNSPs operate. There may be areas where harmonisation is not the overriding concern.

Accordingly, we do not consider that harmonisation should be an overriding objective of the guideline. Rather, we consider the Framework and Approach process is the appropriate time to engage on these issues.

Question 2: Are there other aspects of the new rule that we should take into account in developing the guidelines?

The Issues Paper appears to have adequately considered this issues raised by the rule change.

Question 3: Do you agree with our interpretation of the form of regulation factors included in Appendix A? What aspects of the form of regulation factors are unclear?

The Issues Paper appears to have adequately explained the form of regulation factors.

Question 4: What factors should guide our interpretation of a 'distribution service'? Should our views on what is (or is not) a distribution service occur only at the time of service classification, or at other times within the regulatory control period as well?

The AER's interpretation of a distribution service necessarily must be in accordance with the provisions of the NEL and so while the AER can provide additional guidance, this should not constrain the legislative provisions. A key source of guidance is the Federal Courts decision on Ergons public lighting[1] (referred to in the AER's Issues Paper), this decision found that:

[1] Ergon Energy Corporation Ltd v Australian Energy Regulator [2012] FCA 393

> *There is no doubt that Ergon's street lighting service is not provided "by means of" a "distribution system". The AER did not contend that it was. The analysis, related above, which Ergon made of what definitionally constitutes a "distribution system" and the importance in the application of that definition to the facts of identifying the electrical separation which occurs at the fuse point demonstrates why this concession was correctly made. Street lights do not form part of the "distribution system".*

And later that:

> *The remaining part of the composite phrase, "in connection with", does not require that the service be provided via the "distribution system", as defined, only that the service be connected with that system.*
>
> *… So construed the placement of street lights be they on power poles or on stand alone poles also running along road reserves and the immediacy of the connection between street lights and the "distribution system" falls readily and naturally within the definition of "distribution service".*

This decision on the interpretation of the NEL gives good guidance on the manner in which distribution services should be classified. Importantly, it provides a broad interpretation of a distribution service and the AER should not seek to narrow this definition.

It is unclear what legislative power the AER has to reconsider service classification during the regulatory control period and we would not generally support changes to service classifications during a regulatory period. Where new services become necessary or desirable to offer, an appropriate way to deal with this issue appears to be for the AER to consider a waiver application under the Ring Fencing Guideline, during the regulatory control period. The AER could then properly consider the service classification and form of control in the subsequent regulatory period.

Question 5: Should our service classification decisions make clear those services we have decided not to classify because they are not distribution services?

The Issues Paper suggests that the AER will be providing additional guidance on what constitutes a distribution service. This would appear to be the appropriate manner to proceed, rather than seeking to pre-emptively compile an exhaustive list of services that are not distribution services. As demonstrated by the Ergon's public lighting decision[2] a decision requires a detailed consideration and may need to consider jurisdiction-specific factors.

However, once the AER has made a decision on a particular service, it would be appropriate for the AER to maintain a central point of reference on these decisions. However, the guideline may not be the best mechanism as the AER's decisions will be made in each distribution determination and updating the guideline after each of the AER's decisions may not be practical.

Similarly, the Issues Paper discusses a non-exhaustive list of unregulated distribution services. Again, once the AER has made a specific decision, it is beneficial to provide a central reference point for all such decisions.

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[2] Ergon Energy Corporation Ltd v Australian Energy Regulator [2012] FCA 393

Asset Exemption Guideline

Question 6: Is there any other guidance that should be included in the asset exemption guideline?

Establishing principle based criteria for assessing an exemption application is critical in enabling DNSP to guide our implementation of modernisation programs. Without clear criteria, DNSPs would lack the necessary certainty to develop new technology for deployment and may be reluctant to adequately invest in beneficial initiatives. We recommend the inclusion of principle based criteria in the restricted assets and asset exemption guideline.

Question 7: What criteria should we use to determine whether a DNSP should be permitted to add an asset to its regulatory asset base? What are some examples of restricted assets that should be granted exemptions, and why? Should conditions be imposed on exemptions, for example a limit on the time during which applications for exemption can be made?

AusNet Services' initial thinking is that the following criteria could be considered for inclusion in the guideline:

- Assets are used to provide regulated services;
- Promote efficient provision of regulated services to customers;
- Provide a credible bypass option in the event that contestable service provision is available, but not suitable for network purposes[3]; and
- Ensuring public safety whilst facilitating the deployment of new technologies, where the assets are similar to those assets commonly used in the provision of distribution network services, see examples below.

DNSPs have historically provided "behind the meter" services for configurable timed switching of hot water heating loads. In Victoria with the roll out of AMI meters, most of these behind the meter switching arrangements were consolidated into second controlled load contactor within the AMI meter. The *minimum services specification* for a small customer's meter does not require the provision of a second controlled load. It was on the basis of providing DNSPs with a bypass option for negotiating with contestable metering parties, that the AEMC made provisions for *network devices* within the NER.

Also DNSPs have provided distribution services behind the meter for the primary purpose of ensuring public safety. For example, in rural areas high voltage (HV) *premises connection assets* have historically been provided behind the meter, where the meter is located on the first pole inside the customer's property boundary. These historical arrangements allowed the licenced distributor as an ESV approved *Major Electrical Company* manage these assets more efficiently in accordance with jurisdictional safety requirements, instead of the customer installing more costly AS3000 compliant HV cabling. Over the years, these arrangements become unnecessary with large rural customers opting to either build their own compliant dedicated assets or to allocate easements for use by the DNSP.

[3] As was the case in justifying the inclusion of network devices in the NER, the AEMC expected the threat of bypassing was sufficient to constrain any exercise of market power when negotiating with the DNSP. See AEMC *Final Rule Determination, Expanding competition in metering and related services*. Available from https://www.aemc.gov.au/rule-changes/expanding-competition-in-metering-and-related-serv.html. Nov 2015.

These arrangements are examples of the network providing distribution services behind the meter without impacting competitive markets.

Question 8: Do you agree that there will be relatively few occasions on which we would grant an exemption beyond those already provided for in the rules (i.e. grandfathered assets and network devices)? Please suggest examples of assets that should be granted exemptions.

We are in the process of establishing Rapid Earth Fault Current Limiters (REFCLs) on our network. There is the potential that the efficient design in some instances may involve alterations to the electrical system of high voltage industrial customers, i.e. electricity supply equipment which resides behind the meter. Whilst it is unlikely AusNet Services would own equipment installed for the purpose of REFCL operation, this possibility should not be ruled out where it is the most cost efficient solution in preventing cross-country faults causing bushfire ignition. This would be an example of where ownership of assets behind the meter, may be the most cost efficient outcome, and of situations where no harms to competitive end customer services arise.

Similar circumstances may arise in the future, where establishing easements on customer's premises is not appropriate and DNSPs are required to negotiate with customers for the most efficient network connections. Some new connections or customer initiated upgrades of network assets may be more efficiently provided with the aid of dedicated network assets. It may be more practical and safer to house these dedicated network assets at the customer's site, rather than by the side of the road. Therefore, precluding DNSP ownership of these assets would potentially prevent customers from having access to the most practical, safe and efficient connections.

With the application of principle based criteria such as those suggested above, allowing DNSPs to own assets located behind the meter would not damage competition. Customers could choose the competitive services as falling costs, increasing functionality of electrical technologies and adaptation of Australian safety standards enables other service providers to compete.

Question 9: What are stakeholder views about the likely impact of confidential information affecting the transparency of asset exemption decisions?

The impact of confidential information affecting the transparency of asset exemption decisions is not likely to be material if confidential information is largely limited to price and commercially sensitive information. It would seem appropriate to apply the same confidentiality requirements that currently apply to regulatory determination processes.