20 May 2022

Dr Kris Funston
Executive General Manger, Network Regulation
Australian Energy Regulatory (AER)
GPO Box 3131
Canberra, ACT, 2601

Dear Dr Funston,

AER PRELIMINARY POSITION PAPER: FRAMEWORK AND APPROACH NSW, ACT, TAS AND NT BUSINESSES REGULATORY CONTROL PERIOD COMMENCING 1 JULY 2024

Endeavour Energy welcomes the opportunity to provide this response to the AER's preliminary position paper on the Framework and Approach (draft F&A) to apply to the NSW, ACT, TAS and NT Distribution Network Service Providers (DNSPs) for the regulatory control period commencing 1 July 2024.

The F&A assumes increased importance in the context of the *Access, Pricing and Incentive arrangements for Distributed Energy Resources (DER)* Rule change (DER Rule change) and the Energy Security Board's (ESB) Post 2025 energy market transformation. It also brings our F&A into alignment with the AER's service classification guideline which was published subsequent to our prevailing F&A for the 2019-24 period.

The draft F&A addresses a number of matters including service classification, form of control and control mechanism and the application of incentive schemes, depreciation and the AER's forecast expenditure assessment guideline. In general, we support the AER's draft F&A and consider it reflects the detailed and ongoing engagement between the AER, DNSPs and stakeholders on these matters.

However, there remain a few aspects of the AER's service classification decision which are unresolved or open to additional feedback from stakeholders. These include:

- Whether to explicitly classify an 'export service' and if so, whether to distinguish between the concept of 'basic' and 'additional' export services and how to classify these services. We consider the classification should mirror that for consumption services noting the connections and pricing framework provides sufficient flexibility to recover the costs associated with augmenting the network for export hosting on an equitable basis.
- How to account for 'system strength services' associated with the yet-to-be implemented ESB Post 2025 reforms. We agree with the AER's distinction between inputs and discrete and billable services and that a flexible approach to classification will be required as more detail becomes available.
- Whether the AER has any role in classifying the leasing of spare battery capacity and the facilitation of this service. We appreciate the need for the AER to better understand how networks can utilise and share batteries in a manner that does not disadvantage distribution customers but we also do not consider that service classification should be restricted by the ring-fencing guideline.

On the remaining matters, we recommend the AER provide greater clarity by including the formulae to give effect to the form of control as opposed to a description of the amendments. We note however, our support for the proposed amendments, including to the price cap formulae for alternative control services (ACS). We also note and support the intention to apply the Service Target Performance Incentive Scheme (STPIS) once updated for export hosting by December 2022.

We provide our detailed views on the preliminary position paper in Appendix A. If you have any queries or wish to discuss our submission further please contact Patrick Duffy, Manager Regulatory Transformation & Policy at Endeavour Energy at [redacted]

Yours sincerely

[redacted]

Colin Crisafulli

Head of Network Regulation

Appendix A: Our views on key issues raised in the Preliminary Position paper

Export services

Responding to the DER Rule change

The DER Rule change involves a suite of amendments designed to facilitate the transformation of the distribution network for bi-directional services. A key aspect of the Rule was to formally recognise export services as a distribution service which DNSPs provide to facilitate two-way energy flows resulting from the increasing connection of customer-driven DER. Importantly, the Rule change enables export services to be considered on equal terms as consumption services and incorporated within network investment, incentive, pricing, and expenditure assessment frameworks.

In our request to update the F&A for the 2024-29 period, we sought to reflect this expansion to the scope of distribution services by explicitly including an 'export service' in the service classification listing. Given the intent of the Rule to recognise export services as a core distribution service, we considered it appropriate to propose export services as a standard control service (SCS) within the common distribution services group. Our proposed amendment to the listing made the distinction between "basic" and "additional" exports to reflect concepts discussed in the final rule determination.

However, the preliminary F&A paper notes that distributors did not describe 'basic and additional export services' nor does the Rules. Instead, the AER notes "basic export level" is only contained in the transitional provisions in the NER with respect to the calculation of export tariffs[1]. This raised the question of whether DNSPs were proposing an export service that contained multiple elements that could be separately classified.

For context, the DER Rule change requires DNSPs to offer embedded generation customers a basic export level without charge for the next two regulatory periods. In determining the basic export levels, DNSPs are required to have regard to the intrinsic hosting capacity of the network. This is the level of export hosting a network can accommodate with minimal or no further investment required based on the forecast use of export services[2].

Furthermore, the final rule determination suggested DNSPs have the flexibility to design and propose a mechanism for customers to apply for additional export capacity. The AEMC determined that the regulatory framework is not a barrier to allowing customers to purchase additional export capacity and suggested that improved service offerings could be provided through the negotiated connection process, dynamic operating envelopes or new service/pricing options enabled through export pricing.[3]

Our initial F&A proposal sought to invoke these concepts from the DER Rule change by noting the potential for basic and additional export services. However, upon reflection this distinction is not required or valid for service classification purposes.

As noted by the AEMC in the final DER Rule change[4], the basic export level is not a capacity right (which could be interpreted as a service) but instead a threshold at which an export tariff may be applied. Rather than a distinct service, the AEMC's DER Rule change clarified that export services are part of the core services to be provided by DNSPs by removing direction-specific references within the Rules.

We therefore accept the AER's position that an export service falls within the scope of "*planning, design, repair, maintenance, construction and operation of the distribution network*" as these activities are agnostic to the flow of electricity to or from customers. Further, the NER adequately recognises export services as a core distribution service meaning there is no uncertainty in the provision of these services by networks that necessitates its explicit inclusion in the service listing. As such, we agree with the AER's proposed 'do nothing' option with respect to service classification in recognising the DER Rule change.

---

[1] NER Cl 11.141.1

[2] NER Cl 11.141.13(b)(1)

[3] AEMC, Rule determination, Access, pricing and incentive arrangements for DER, 12 August 2021, p.60

[4] AEMC, Rule determination, Access, pricing and incentive arrangements for DER, 12 August 2021, p.56, footnote 181

We consider this option is consistent with our overall position from our F&A proposal that export services be treated consistently with consumption services and included within the revenue cap and Distribution Use of System (DUoS) pricing principles.

'Basic and additional' export services

We support the AER's draft position that no further amendment to the service classification listing is necessary to give effect to the DER Rule change. However, the AER's position remains open and subject to receiving further information regarding the concept of 'basic and additional' export services. In particular, the AER is seeking more detail on; 1) the precise nature of these services 2) how customers will request these services and 3) what investment may be required to deliver these services.

With respect to 1) as noted above, we do not consider 'basic and additional' export services constitute separate or classifiable services. Instead, the distinction between "basic" and "additional" export levels (rather than services) is relevant:

a) formally (i.e. per the Rules) to the application of export charges as set out in a networks Tariff Structure Statement (TSS); and

b) informally (i.e. by the ordinary meaning of the words) to the application of the basic versus standard or negotiated connection process per thresholds set out in a network's approved Connection Policy and Model Standing Offer. Noting these are load based thresholds which are likely to differ from the 'basic export level' used in determining whether an export tariff applies.

We note questions 2) and 3) seek to understand the cost impacts of classifying export services and the extent to which these costs are directly attributable to the person to whom the service is provided.

Our position is that export services involve the use of the shared distribution network with broad costs and benefits. For instance, increased DER hosting could reduce the need for investment in the distribution network or wholesale market thereby reducing energy prices for all customers. Conversely, augmentations to increase DER hosting could also increase the capacity of the network to accommodate increased demand for consumption services (and vice versa).

As discussed further below, we consider customers can request and access additional export services under a SCS classification with an efficient and equitable allocation of costs via connection charges and/or ongoing export tariffs.

Classifying export services

Clause 6.2.2(c) of the NER sets out the factors the AER must have regard to when classifying a direct control service as a SCS or as an ACS. A service requested by or dedicated to an identifiable customer and/or the prospect of competition support an ACS classification. A service with monopoly characteristics that serves the broader customer base supports a SCS classification.

In the case of export services, an ACS classification (outside of non-basic connection services) presents a number of challenges. It would be difficult to plan and augment the network in response to a large number of ad-hoc customer requests and attribute the use of augmented network assets between export and consumption services, particularly when a growing number of customers access both services. Furthermore, recovering all augmentation costs for export hosting from the requesting customer could be prohibitive and create a first-mover disadvantage that constrains the uptake of DER.

An ACS classification under a price cap form of regulation would also encourage networks to maximise export hosting and prevent the revenue from export tariffs offsetting the DUoS revenue cap. It may also unnecessarily complicate SCS tariff reform by introducing a new set of separate tariffs which lack the dynamic signalling capabilities of SCS tariffs.

Instead, a SCS classification, with the exception of non-basic connection services, is the appropriate classification for export services. This is an administratively simple approach and one that reflects the use of the shared network to provide a service that impacts the entire customer base. Under this

classification, a number of regulatory measures are available to the AER to ensure a prudent and efficient level of investment in export hosting occurs. These regulatory controls include the:

- **form of regulation:** as part of the existing DUoS service, export services will be subject to a revenue cap. Under this form of control distributors will not have a revenue incentive to increase the uptake of export services and/or maximise the number of customers that are subject to export prices. Further, under a revenue cap the revenue earned from export tariffs will reduce the revenue required from non-DER customers and thereby alleviate cross-subsidies that may currently exist between DER and non-DER customers.

- **expenditure assessment framework:** The AER has the ability to review and approve expenditure allowances in accordance with:

    - **the expenditure objectives, criteria and factors:** DER related expenditure would need to be consistent with the capital and operating expenditure objectives to meet or manage the expected demand for standard control services, comply with relevant obligations and/or to maintain the quality, reliability, and security of supply. The expenditure criteria and factors outline a range of relevant considerations for demonstrating compliance with the expenditure objectives.

    - **DER Integration Expenditure Guidance note:** the AER provides more direct guidance on what evidence a network must provide to demonstrate the efficiency and prudency of DER related expenditure in its DER Integration Guidance note. In particular, establishing the expectation that DNSPs define a 'base case' scenario of the investment required to satisfy the expenditure objectives. Any investment scenario proposed to increase DER hosting capacity would then need to demonstrably exceed the net benefits associated with the base case scenario.

    - **Value of DER (VaDER) framework:** to conduct the analysis referred to above, networks will be required to propose a VaDER methodology for measuring the costs and benefits associated with DER. This value considers total system costs, i.e. the value is shared by all customers, and the value streams include the network sector, wholesale market, environment, and customer. The AER's Customer Export Curtailment Value (CECV) methodology estimates some of these value streams.

- **incentive framework:** The AER can establish incentive arrangements to provide incentives for DNSPs to provide efficient levels of export hosting services to customers. The VaDER is likely to be a relevant consideration in setting an appropriate incentive rate and revenue at risk that reflects the value the average customer places on (or receives from) DER hosting.

- **connection framework:** Under Chapter 5 and 5A of the NER a customer can purchase additional access to an export hosting service beyond a basic level. These enhanced or non-standard connection services will be subject to a standard or negotiated connection process and classified as a mixture of ACS and unregulated services depending on the connection contestability arrangements of each jurisdiction.

  Following the DER Rule change, updates to the connection charge guidelines and DNSPs connection policies and model standing offers will ensure the framework is adapted for exports and applied in the same way it currently does to consumption. This symmetry may require a retail customer to share in the cost of expanding or augmenting the network via a capital contribution[5] where their request exceeds an export threshold akin to the load based thresholds which are currently specified by DNSPs.[6]

- **pricing guidelines:** the NER allows DNSPs to signal to customers when it is better to consume their own generated electricity and when it is better to export it. Export charges will need to

[5] Except for augmentations associated with a basic connection service application.

[6] Consistent with current arrangements, a capital contribution should only apply if the incremental cost of the standard control export service exceeds the estimated incremental revenue expected to be derived from the standard control export service.

adhere to the export tariff guideline and the general principle that export charges of any kind, whether variable or fixed, should recover only costs associated with providing the export service.

We are still developing and consulting on our DER expenditure forecast, connection policy and export tariff strategy for the 2024-29 regulatory period. However, we agree with the AEMC that there is sufficient flexibility within the updated expenditure, incentives, pricing, and connection frameworks to ensure the additional costs of facilitating customer exports are efficient and can be appropriately allocated as per the policy intent of the rule.

System strength services

The efficient integration of DER into energy markets is being coordinated by the ESB through the DER Implementation Plan. This plan is a roadmap on progressing a suite of prioritised reforms to unlock value for customers from the integration of DER and flexible demand into energy markets. The reforms will be completed by 2025.

In facilitating the energy market transition the Roadmap highlights the role of DNSPs leveraging Distribution Service Operator (DSO) platform technologies to interact more closely with other network and system operators to ensure system security and stability is maintained. Given this, we proposed to introduce “System support services” as an SCS in the expectation of the DSO role or services that may be requested by other networks or AEMO. Importantly, this service grouping would only include services not competitively available that could only be provided by DNSPs by virtue of our unique role as a network operator.

The F&A process typically requires DNSPs to be clear and explicit when proposing to classify new services. However, the role and services provided by DNSPs will change substantially between now and the end of the 2024-29 regulatory period following the completion of the DER reform package. As a result, there remains uncertainty regarding the specific nature of these system security and support services and under what circumstances they will be provided. As a result, the service classification process needs to be sufficiently flexible to enable DNSPs to provide these services when the need for them arises.

Nevertheless, we agree with the AER that the prospective system support activities may be either inputs to a distribution service, already captured within “common distribution service” grouping, or a discrete and billable service. We are currently working with other networks and market bodies to gain a clearer understanding of the future needs of the system and what services we might be able to provide. This way, we will be able to identify how system support activities might fit into the above categories.

It is likely that we will have better information on these services over the next 12-18 months as rule changes and reforms are progressed. We note the AER has the power to vary the service classification from the final F&A paper where there is a material change in circumstance and we support the potential inclusion of new services via this provision.

Leasing of excess battery capacity

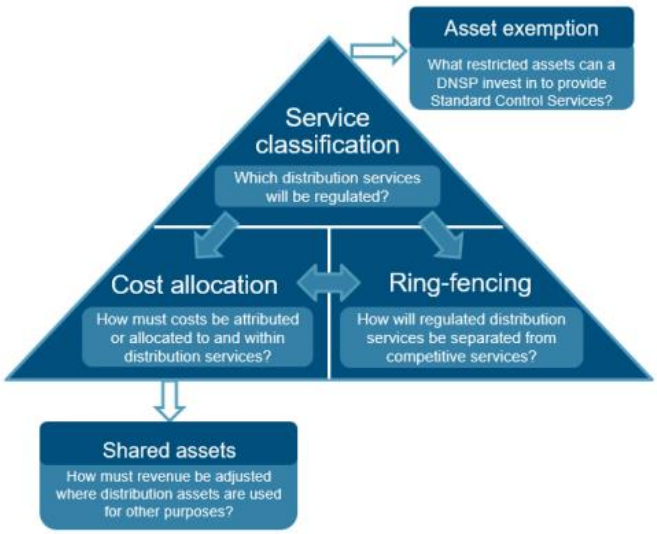
Batteries provide significant network benefits in improving network reliability and/or managing demand but at times these assets will be idle. There are significant opportunities to improve the utilisation of network batteries, and more importantly the value they can provide customers, by leasing excess capacity to third-parties. We also support the principle that distribution customers should only fund the costs associated with providing a network service. We consider controls such as cost allocation and revenue sharing should be used to maximise the value of batteries while ensuring network customers do not cross-subsidise non-distribution services.

Currently, service classification recognises the unregulated distribution service of “distribution asset rental” and the associated SCS of facilitating the shared use of network assets. The latter relates to the administrative costs of assessing the availability of network assets for sharing and entering into asset sharing agreements that ensure the network use of the asset is not prejudiced in doing so.

We note that the AER is not obliged to classify services that it does not regulate as either a direct control service or negotiated service. In the case of "distribution asset rental", and some other unregulated distribution services, the AER does so in order to provide clarity from a ring-fencing perspective given 'other distribution services' and 'non-distribution services' are treated differently.

In our view, the leasing of batteries and facilitation of this leasing should be covered by the existing service classification. However, in the draft F&A the AER has decided not to classify the leasing of batteries or clarify that it is captured within the existing "distribution asset rental" service. This is because the treatment of this service has already been set out in the AER's ring-fencing guideline. Specifically, the ring-fencing guideline allows DNSPs to grant a third-party the right to use a network asset with the exception of new energy storage devices.[7]

We accept the AER's rationale that it has no role to classify this service given the ring-fencing guideline. However, we consider this to be a sub-optimal regulatory outcome that is inconsistent with how elements of the regulatory framework ought to interact. As set out in the AER's service classification guideline the ring-fencing guideline is subordinate to service classification[8]:



It is not appropriate for the ring-fencing guideline to restrict how a service can be classified. The ring-fencing guideline also effectively classifies batteries in a way that is inconsistent with the AER's technology neutral approach of classifying services rather than inputs (an asset in this case).

A ring-fencing waiver based approach is not an efficient long-term regulatory control and the conflicts outlined above ought to be resolved as soon as reasonably practicable. In our view, service classification should not be restricted by the ring-fencing guideline meaning there should be no asset based exemptions to the existing "distribution asset rental" service. Instead, the cost allocation and/or shared asset guideline should be updated (as necessary) to introduce appropriate controls for the sharing of batteries and that no ring-fencing requirements specific to batteries should be necessary. Ideally, the elements of the regulatory framework pictured above would be updated and harmonised in time for the AER's final determination for the 2024-29 period.

However, we appreciate that batteries are an integral input to the emerging market(s) for energy services and that the AER is seeking to better understand how networks can own, lease and/or share these assets in a manner that supports competition without creating cross-subsidies or other harms. The existing arrangements may therefore represent an intermediate step designed to trial and gather information on potential regulatory controls. We therefore wish to understand whether this matter is likely to be resolved as part of the 2024-29 determination process and if not, what the process will be for updating the above arrangements following a period of waiver based trials.

[7] NER Cl. 3.1(d)(i)
[8] AER, Electricity distribution service classification guideline – Explanatory statement, September 2018, p. 2

In the preliminary paper, the AER also raises the issue of shared asset facilitation and whether this applies (or should apply) in the case of batteries or new assets more broadly. This is an existing service that relates to reviewing and assessing proposals to share existing network assets. In the case of a battery, or any new asset, the question arises of whether an SCS service exists where an SCS asset is not yet technically in existence.

The principle is that for shared assets, customers can share a portion of the unregulated revenue earned by the DNSP where this is material. It therefore follows that customers share in the costs of facilitating the unregulated service.

In our view the costs of facilitating the shared use of a prospective network asset, such as a battery, should be captured by this service (or a separate, new SCS if necessary). The costs associated with this service are minimal and the service is concerned with ensuring the network use of the asset is appropriately identified, costed, and protected in any agreements entered into. In this case customers benefit from the reduction in the costs allocated to the SCS RAB through the sharing of the asset and/or benefit from the additional services provided. It therefore follows that customers should share in the costs that give rise to the cost allocation.

It is also worth noting the staff involved in conducting this assessment require technical network expertise and it would be costly and/or impractical for the ring-fencing provisions associated with other distribution and/or non-distribution services to be applied if a non-SCS classification is determined. The alternative, noting we consider SCS is appropriate, may therefore be an ACS classification or SCS to the extent these costs are not recovered from a third party (e.g. emergency recoverable works) rather than a non-direct control classification.