

13 August 2018



Mr Chris Pattas
General Manager - Networks
Australian Energy Regulator
GPO BOX 520
Melbourne VIC 3001

Dear Mr Pattas

Draft Service Classification Guideline for Electricity Distribution Network Service Providers

Energex Limited (Energex) and Ergon Energy Corporation Limited (Ergon Energy) appreciate the opportunity to provide a submission in response to the Australian Energy Regulator's (AER's) draft service classification guideline for electricity distribution network service providers (the draft guideline) consultation.

Energex and Ergon Energy broadly support the objectives of developing a service classification guideline, which include providing clarity, transparency and certainty for distributors, and also facilitating competition in markets for energy-related services. As service classification is one of the foundational decisions that the AER makes in the economic regulation of electricity distribution networks, we welcome measures aimed at improving the process for all stakeholders, particularly customers. Moreover, we consider that as electricity distributors provide broadly similar services to customers (except where warranted by jurisdictional policies), service groupings and classifications should be consistent to the greatest extent possible.

In light of the requirement in the National Electricity Rules (the Rules) to develop a service classification guideline, Energex and Ergon Energy welcome the AER's approach to its development. In particular, we support the AER:

- undertaking a fulsome review of service classification in the guideline and an incremental approach in each distribution determination;
- including a baseline list of distribution services in the guideline, with idiosyncratic differences between jurisdictions resolved in individual distribution determinations; and
- allowing for departures from the baseline list subject to providing reasons.

We consider that the AER's proposed approach will promote harmonisation of service classification through time.

Nevertheless, Energex and Ergon Energy have significant concerns with the AER's approach to connection services in the draft guideline. We consider that it is extremely difficult, if not impossible, to develop a common framework for grouping and classifying connection services given the myriad of existing jurisdictional policy and network differences. While Energex and Ergon Energy acknowledge that the service classification guideline is not binding, we do not consider there is any value in developing an ill-fitting baseline connection services list from which most, if not all,

distributors will almost certainly depart. It would be more practical for the AER to retain the current jurisdictional approach to grouping and classifying connections services, and set out high-level principles in the service classification guideline that the AER will consider in classifying connection services on a jurisdictional basis.

In the draft guideline, the AER proposes to group and classify connection services consistent with definitions in Chapter 5A, including 'basic', 'standard' and 'negotiated', where:

- Basic connection services typically involve the provision of an overhead or underground service to residential and small business customers (i.e. premises connection assets) but generally do not require extension and/or augmentation of the shared network; and
- Non-basic connections (standard and negotiated) can include network extensions and augmentation of the shared network in addition to premises connection assets.

Essentially, the draft guideline considers the overall connection service provided to customers. This differs from the approach taken in the recent round of framework and approach (F&A) processes for the New South Wales (NSW), Australian Capital Territory (ACT), Queensland (Qld) and South Australia (SA) distribution businesses. In the F&A processes, the AER grouped connection services largely based on the aspects (or sub-services) that make up an overall connection service, such as premises connection assets, network extensions and augmentations.

Energex and Ergon Energy recognise the appeal of the draft guideline approach to grouping connection services since this is how connections services are offered to customers and we acknowledge there are jurisdictions where connection services are currently grouped and classified largely on this basis. However, we do not consider that this approach is particularly useful for service classification purposes for the following reasons:

- *The draft guideline poses a challenge in applying the definitions outlined in the Rules.*

Energex and Ergon Energy are concerned with the draft guideline's excessive focus on Chapter 5A, noting that Chapter 5 also applies to connections. Of particular concern is the how the Chapter 5A definitions of basic, standard, and negotiated will apply to connections that proceed under Chapter 5, unless the AER's intent is that every connection service that applies the Chapter 5 connection process is 'negotiated'.

Similarly, it is important to highlight that a 'negotiated connection service' is not a defined term in Chapter 5A. A negotiated connection:

- is neither a basic nor a standard connection service; or
- a basic or a standard connection service, however, the customer has elected to negotiate the terms and conditions under which the connection service is provided.

It is unclear how service classification applies in the latter circumstance where basic or standard connection services customers elect to negotiate terms and conditions.

- *The draft guideline does not facilitate engagement on contestability.*

Energex and Ergon Energy note that the AER states that the classification of connection services is largely driven by whether or not a connection service is contestable.¹ However, the approach in the draft guideline does not facilitate any engagement on contestability. This is because only particular aspects of the overall connection service can ever be contestable; certain connection sub-services will always be provided on a monopoly basis because they are intrinsically linked to the distributors.

Consequently, to the extent that contestability is the primary determinant of the classification of connection services, Energex and Ergon Energy consider that it would be more appropriate to break down connection services into their constituent services. However, we also concede that developing a common framework based on a breakdown of connection services might be futile, as contestability frameworks vary significantly across jurisdictions. For this reason, we consider that it might be advantageous to exclude a baseline list of connection services altogether from the service classification guideline.

- *The draft guideline does not consider that aspects of connection services can be classified differently.*

Putting aside the issue of contestability, the draft guideline implicitly assumes that all activities which comprise the overall connection service are classified similarly. That is, the draft guideline does not consider that aspects of connections services can be classified differently. This is certainly the case in Queensland and other jurisdictions where different aspects of connection services have different service classifications. For example, a network augmentation required to connect some customers might be classified as a standard control service, while other aspects of the connection service might be classified as an alternative control service.

It is also worth noting the Rules and AER's *Connection charge guideline for electricity retail customers* contemplate that different service classifications can apply to different aspects of a connection service. The Rules recognise that customers can face connection charges associated with different aspects of the connection service. For example, under the Rules:

- Chapter 5A recognises that customers can face charges for premises connection services, extensions, augmentations and incidental costs; and
- Chapter 6 stipulates that distributors' connection policies must specify, amongst other things, aspects of the connection service for which a connection charge may be made and includes an example where the

¹ AER, *Explanatory statement, draft electricity distribution service classification guideline*, June 2018, p14

distributor might make separate connection charges for the provision of a distribution connection asset and for making any necessary extension to, or other augmentation of, the distribution network.²

Similarly, the connection charge guideline stipulates that the total connection charge is calculated as the sum of alternative control connection service charges, capital contributions for standard control connection services and pioneer scheme charges.

In our view, this reinforces the importance of breaking down connection services into their constituent services for service classification purposes.

- *There is no sound basis for differentiating the classification of connection services based on the guideline approach.*

The draft guideline essentially groups and classifies connection services on the basis of their complexity, with basic connections being the simplest and negotiated connections being the most complex. However, Energex and Ergon Energy do not consider that there is any economic rationale for differentiating the classification of connection services and, in turn, customers' connection charges on such basis. The rationale for the proposed default service classification in the draft guideline, where customers are required to fully fund basic and negotiated connection services while customers only pay for the 'incremental cost' (if any) for standard connection services, is unclear.

Furthermore, Energex and Ergon Energy note that the proposed default service classifications for basic, standard and negotiated connections are inconsistent with the AER's view in the Explanatory Statement that:

"... we consider SCS is the best classification for connections where connection services are not contestable because incremental revenue is taken into account when considering the efficiency of a new connection."³

Given that the AER assumes there is no contestability for the purpose of the guideline, it would logically follow that all connection services (i.e. basic, standard and negotiated) would be classified as standard control services. Energex and Ergon Energy consider that, at the very least, standard control is the most appropriate default service classification for basic connections. The incremental revenue for these connections almost certainly exceeds the connections costs.

In summary, Energex and Ergon Energy reiterate our support for the development of the service classification guideline and a baseline list of services. However, we consider that there is merit in excluding connection services from the baseline list in light of the difficulties of developing a reasonable baseline list. Instead, Energex and Ergon Energy recommend that the baseline list for connection services should be replaced by an agreed set of high-level principles to guide the determination of connection service groupings and classifications.

² NER, CI 6.7A.1 (b) 2(ii)

³ AER, *Explanatory statement, draft electricity distribution service classification guideline*, June 2018, p14-15

In the event the AER maintains its position of developing a baseline list of connection services, Energex and Ergon Energy consider that the approach adopted in the recent F&A decisions is more useful.

Should you require additional information or wish to discuss any aspect of this submission, please do not hesitate to contact either myself on (07) 3851 6416 or Trudy Fraser on (07) 3851 6787.

Yours sincerely



Jenny Doyle
General Manager Regulation and Pricing
Telephone: (07) 3851 6416 or 0427 156 897
Email: jenny.doyle@energyq.com.au