

20 May 2022

Dr Kris Funston
Executive General Manager, Network Regulation
Australian Energy Regulator

Sent via email

Framework and Approach Preliminary Position Paper – Service classification of export services

Dear Dr Funston,

Energy Networks Australia (**ENA**) appreciates the opportunity to make a submission to the Australian Energy Regulator's (**AER**) Framework and Approach Preliminary Position Paper for the NSW, ACT, TAS and NT businesses with regulatory control periods commencing 1 July 2024 (**Preliminary Position Paper**).¹

ENA is the national industry body representing Australia's electricity transmission and distribution and gas distribution networks. Our members provide more than 16 million electricity and gas connections to almost every home and business across Australia.

As highlighted by the AER, the current Framework and Approach process for the NSW, ACT, TAS and NT businesses is being produced at a time of considerable transition in the energy market and has implications for the energy market beyond the businesses the AER regulates for the 2024–29 regulatory control period. It is therefore imperative that the issues explored in the Preliminary Position Paper, such as the classification of services, are addressed at a National Energy Market (**NEM**) wide level.

When considering the classification of services, export services should be treated no differently to consumption services. Export services are now required to be part of a distributor's normal planning and operation following the Australian Energy Market Commission's (**AEMC**) recent regulatory reform² and there is no requirement for export services to be explicitly recognised as a stand-alone activity within the common distribution service, consistent with the current approach undertaken for consumption services.

¹ AER, Framework and Approach: Preliminary Position Paper (NSW, ACT, TAS and NT businesses), April 2022.

² AEMC, Access, pricing and incentive arrangements for distributed energy resources, Rule determination, 12 August 2021.

Given the changes to the National Electricity Rules (NER)³, export services will be consequentially captured under the current list of common distribution service activities, which are regulated as a direct control service and classified as a standard control service (SCS).

As export services involve the use of the shared distribution network to export energy, these are natural monopoly services that should be regulated by the AER and provided for in networks' SCS regulated revenue allowance. Importantly, under a revenue cap, distributors do not face a revenue incentive to grow demand for their services.

Given the pace of transition, networks also recommend that the AER further considers the development of an optimal long-term policy framework for energy storage devices that better facilitates efficient innovative customer focused outcomes, such as community-scale battery programs, without the time, cost and uncertainty of the current case-by-case approval process. ENA welcomes the development of a technology-neutral framework, starting with the classification of services, that ensures consumers can fully benefit from the adoption and use of energy storage devices.

Enabling a distributed energy future

The distribution network now not only conveys electricity to customers (consumption services) but also conveys electricity from customers (export services).

The AEMC's final rule introduced a package of reforms designed to support more distributed energy resources (DER) connecting to the grid, including:

- » introducing clear obligations on distributors to provide export services,
- » enabling new network tariff options that reward customers, and
- » strengthening consumer protections and regulatory oversight.

Significantly, the final rule clarified that distribution services now include export services by removing direction-specific references in associated definitions.⁴ As highlighted by the AEMC in its final determination:

“While DNSPs have been connecting a growing number of customers with DER over the past decade, they have been doing so under a regulatory framework that was developed for a one-way transportation system... The final rules address these issues by making clear that export services are part of the core services to be provided by DNSPs [distribution network service providers].”⁵

Distributors are also required to offer a basic export level without charge whereby a retail customer can export to the distribution network up to this level, set to reflect the network's intrinsic DER hosting capacity, at no additional charge for the next two regulatory control periods. The requirement to offer a basic export level at no charge, however, should not be conflated with a

³ The AEMC's final rule makes changes to the NER to clarify that distribution services include export services.

⁴ The AEMC's final rule makes changes to the NER to clarify that distribution services include export services. To achieve this outcome, the final rule removes “to customers” in the definition of “network” in chapter 10 of the NER to remove the only direction-specific reference within the definitions related to “distribution service”.

⁵ AEMC, Access, pricing and incentive arrangements for distributed energy resources, Rule determination, 12 August 2021, page ii.

minimum export capacity right. The AEMC considered, but did not introduce, requirements in the NER for distributors to offer a specified minimum level of export capacity to DER customers as it could lead to several issues, including the potential for inefficient investment.

In making the rule, the AEMC sought to ensure, to the greatest extent possible, symmetry between the regulation of consumption services and export services. To reflect the change in the NER that an export service constitutes a distribution service, the AEMC's final rule requires the AER to review, and adjust where necessary, the AER's Distribution Service Classification Guidelines and associated Explanatory Statement.

Consistent with the approach undertaken for consumption services, the AEMC considered it remained appropriate that the AER should follow the process outlined in the NER to arrive at a service classification decision (in accordance with its Distribution Service Classification Guidelines) during the Framework and Approach stage of a distributor's regulatory determination.

However, Farrierswier's Insights Report, developed through the rule change process⁶, did explore several possible export service classification options, concluding that the 'augmenting the existing SCS distribution use of system (DUoS) service' has the most straight forward pathway to implementation, highlighting that it was also consistent with an initial AER staff view that SCS is an appropriate classification for export services.⁷

Other scenarios, such as establishing a new alternative control export service and establishing a new negotiated export service, were also analysed. Materially, under those other scenarios, Farrierswier concluded that distributors may face a market making incentive to increase sales of these services beyond what was forecast in the reset process.

Classifying export services

Service classification determines the type of economic regulation, if any, that the AER applies to services provided by distributors. The *common distribution service* is the bundle of distribution activities used by customers, relating to their use of the shared network. The activities for the common distribution service in the baseline list of services include activities such as:

- » the planning, design, repair, maintenance, construction and operation of the distribution network,
- » works to fix damage to the network, and
- » procurement and provision of network demand management activities for distribution purposes.

These distribution activities are provided by the distributor operating as a natural monopoly. Barriers to entry, such as the requirement for exclusive licences to operate in certain areas, prevent competition for the common distribution service.⁸ Activities within the common distribution service

⁶ Farrierswier, Insights report: Effectiveness of the TSS process and options for implementing export charges, 11 March 2021 Note: During the rule change process, the AEMC engaged an independent expert consultant, Farrierswier, to undertake scenario analysis to test how export pricing may be implemented under the current pricing framework.

⁷ Farrierswier, Insights report: Effectiveness of the TSS process and options for implementing export charges, 11 March 2021, page 38.

⁸ AER, Service Classification Guideline, September 2018.

group are intrinsically tied to the network infrastructure and the systems that support the shared use of the distribution network by customers.⁹

As outlined above, the AEMC's final rule made changes to the NER to make it clear that export services are now part of the core services to be provided by distributors. The final rule removes "to customers" in the definition of "network" in chapter 10 of the NER to remove the only direction-specific reference within the definitions related to "distribution service", as shown below:

network: The apparatus, equipment, plant and buildings used to convey, and control the conveyance of, electricity to customers (whether wholesale or retail) excluding any connection assets. In relation to a Network Service Provider, a network owned, operated or controlled by that Network Service Provider.¹⁰

Export services are now required to be part of a distributor's normal planning and operation and should be treated no differently to consumption services from a service classification perspective. Just like the treatment for consumption services, there is no need for export services to be explicitly recognised as a stand-alone activity within the common distribution service.

Given the changes to the NER, export services will be consequentially captured under the current list of common distribution service activities – for example, the distributor will be required to plan, design, repair, maintain, construct and operate the distribution network to provide both consumption services *and* export services to customers.

The common distribution service is regulated as a direct control service. In classifying a direct control service as a SCS or an alternative control service (ACS), the NER requires the AER to have regard to factors such as:

- » the potential for development of competition in the relevant market and how the classification might influence that potential,
- » the desirability of a consistent regulatory approach to similar services (both within and beyond the relevant jurisdiction), and
- » the extent the costs of providing the relevant service are directly attributable to the person to whom the service is provided.¹¹

Taking into account the NER factors, the AER has classified as the common distribution service as SCS.

As export services involve the use of the shared distribution network to export energy, these are natural monopoly services that should be regulated by the AER and provided for in networks' SCS regulated revenue allowance.

Under this approach, the AER will have the ability to ensure expenditure to provide export services is efficient using the existing regulatory controls on network expenditure, such as assessment against the capital expenditure and operating expenditure objectives, the incentive schemes, regulatory investment test, ex-post review, and benchmarking.

⁹ AER, Explanatory Statement – Service Classification Guideline, September 2018.

¹⁰ AEMC, NER markup (Indicative changes to National Electricity Rules made by National Electricity Amendment (Access, pricing and incentive arrangements for distributed energy resources) Rule 2021).

¹¹ NER, clause 6.2.2(c).

Importantly, as highlighted by farrierswier¹², under a revenue cap, distributors will not have a revenue incentive to introduce export charges, encourage uptake of export services or design tariffs and transitional measures that aim to maximise the number of customers that are subject to export prices in the short-term.

Under the common distribution service, a distributor may provide export services below, at, and above the basic export level, which is a time-limited requirement whereby a retail customer can export up to without charge, rather than a service in of itself.

Similar to the approach for consumption services, the AER's connection charge guideline, which is required to be updated to reflect the AEMC's final rule, and a DNSP's connection policy, approved by the AER during the reset process, will determine if a customer needs to make an upfront payment for a connection to the network.

The AEMC, in its final determination, concluded that the regulatory framework is not a barrier to allowing retail customers to purchase additional access or capacity. In addition to the option for customers to negotiate additional export capacity, the AEMC highlight that NER Chapter 5A allows distributors to offer standard connection services above service levels provided for in basic connections.¹³

Value-stacking opportunities

As acknowledged by the AER, the current Framework and Approach process for the NSW, ACT, TAS and NT businesses is being produced at a time of considerable transition in the energy market. When considering the introduction of potential new services, such as leasing spare battery capacity, networks highlight the need for an optimal long-term policy framework for energy storage devices that better facilitates efficient innovative customer focused outcomes, such as community-scale battery programs, without the time, cost and uncertainty of the current case-by-case approval process.

ENA welcomes the development of a technology-neutral framework, commencing with the classification of services, that ensures consumers can fully benefit from the adoption and use of energy storage devices.

If you wish to discuss any of the matters raised in this letter further, please contact Lucy Moon, Head of Regulation, on [REDACTED]

Yours sincerely,

[REDACTED]

Garth Crawford
General Manager, Economic Regulation

¹² Farrierswier, Insights report: Effectiveness of the TSS process and options for implementing export charges, 11 March 2021, page 36.

¹³ AEMC, Access, pricing and incentive arrangements for distributed energy resources, Rule determination, 12 August 2021, page 60.