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Mr Chris Pattas  
General Manager, Networks  
Australian Energy Regulator  
GPO Box 520  
Melbourne VIC 3000

Submitted electronically: [serviceclassification2018@aer.gov.au](mailto:serviceclassification2018@aer.gov.au)

Dear Mr Pattas,

**Re: Service classification and asset exemption guidelines**

Red Energy (Red) and Lumo Energy (Lumo) welcome the opportunity to comment on the Australian Energy Regulator's (AER) service classification and asset exemption guidelines issues paper.

Overall, the proposed service classification guideline will provide greater transparency around the AER's approach to service classification. The asset exemption guideline will help explain the circumstances under which the AER may grant exemptions. As such, both changes are consistent with the National Electricity Objective (NEO).

Red and Lumo have reviewed the AER's issues paper, and provide the following overarching considerations, and have appended responses to specific questions:

- the AER should review the classification of each and every distribution service at every determination
- the AER should apply the form of regulation factors in Section 2F of the National Electricity Law (NEL) to determine the classification of distribution services at each rate review
- within period service reclassifications should only be permitted where competition has developed in what was traditionally a regulated distribution services market
- the AER's service classification decisions should make clear the services the AER has not classified distribution services
- the AER should only grant an exemption under the asset exemption guideline on rare occasions beyond those already provided in the National Electricity Rules (Rules)
- Distribution Network Service Providers (DNSPs) should only be permitted to add an asset located behind the meter (BTM) to its regulatory asset base (RAB) in rare circumstances. The assets must not be capable of storing or generating electricity and would not impact competition in a contestable energy market.
- the Cost Allocation Guidelines should be subjected to a comprehensive review.

Red and Lumo are 100% Australian owned subsidiaries of Snowy Hydro Limited. Collectively, we retail gas and electricity in Victoria and New South Wales and electricity in South Australia and Queensland to approximately 1 million customers.

We look forward to working with the AER in the future to discuss this submission. For further enquiries regarding this submission, call Con Noutso, Regulatory Manager on 03 9976 5701.

Yours sincerely

**Ramy Soussou**  
General Manager Regulatory Affairs & Stakeholder Relations  
**Red Energy Pty Ltd**  
**Lumo Energy (Australia) Pty Ltd**

## Appendix A: Responses to questions

### **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 of distribution services be a feature of the guideline? If so why?**

Given recent regulatory developments and the pace of technological change in the energy sector, Red and Lumo consider the AER’s current incremental approach to service classification is no longer fit for purpose and should be replaced with a more fulsome bottom up approach to service classification to be undertaken at each rate review.

Specifically, the Contestability in Energy Services Rule Change has removed the requirement for the AER to retain a previous service classification unless a different classification is clearly more appropriate. As such, the rule change is intended to move the AER away from its incremental approach to service classification towards a more fulsome service classification review.

Further, coverage of the AER’s Ring Fencing Guideline is determined by service classification decisions. Ring fencing is vital to protecting the competitive neutrality of contestable energy services BTM. It is even more important for the AER to properly distinguish between the distribution services and other services by conducting more fulsome service classification reviews at rate reviews. This will provide confidence to service providers that the regulatory framework can support effective competition and efficient service delivery in emerging areas that were previously considered monopoly services.

Technological innovation combined with the emergence of different business models and different service providers creates opportunities for the development of competitive energy markets. As a result, some distribution services that were regulated in the past may open themselves to greater competition and this can occur at any time, including within regulatory periods. To keep pace with these developments, the AER should conduct a more fulsome review of the DNSP service classifications at rate reviews so it can account for such developments.

Finally, we consider that a more fulsome bottom up approach to service classification should be harmonised and applied consistently across all jurisdictions. Stakeholders would benefit from a consistent application of the service classification guideline across all jurisdictions. This would be in the long term interests of consumers.

Differences across jurisdictions simply create uncertainty for all market participants and will likely undermine the business case for competitive service offerings. This is to the detriment of all consumers, including those in jurisdictions where service classification allows for and encourages competitive service delivery.

### **2. Are there other aspects of the new rule that we should take into account in developing the guidelines?**

The AER has properly accounted for the contestability services rule in developing the service classification guidelines.

### **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?**

Red and Lumo agrees with the AER’s interpretation of the form of regulation factors in Section 2F of the NEL. We consider that the AER’s method of interpreting the form of regulation factors to determine a distribution service classification is appropriate. And that the AER’s form of regulation factors should be applied to every service offered by a DNSP at rate reviews to determine the appropriate DNSP service classification.

As noted in our response to Question 1, the AER's previous application of the incremental approach to DNSP service classifications is no longer fit for purpose. With technology evolving and new business models emerging rapidly, services that were once the sole domain of a DNSP could potentially become competitive. As such, the AER should reevaluate DNSP service classifications more frequently at rate reviews.

**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?**

Red and Lumo support the AER's ongoing application of the form of regulation under section 2F of the NEL factors in the rules to determine a distribution service classification. Nevertheless, we consider the following changes would improve the approach to DNSP service classification:

- improving the guidance to the market on what constitutes an input to a distribution service compared with what constitutes a distribution service. Worked examples in the service classification guideline will provide further guidance to DNSPs and service providers.
- permitting within period service reclassifications - especially where competition has developed in what was traditionally a regulated services market.

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

The AER's service classification decisions should discretely identify the services it has decided not to classify because they are not distribution services.

This is particularly important in the current environment as DNSPs will be permitted to provide unregulated services through a ring fenced affiliate. Market participants, monopoly and competitive service providers alike, require clear and unambiguous guidance about the investment environment and the additional clarity would be welcomed.

As such, the AER's service classification decisions must contain a complete listing of distribution services for the benefit of DNSPs and other stakeholders. This should include those services the AER has not classified.

**7. What criteria should we use to determine whether a DNSP should be permitted to add an asset to its regulatory asset base (RAB). 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?**

Red and Lumo considers the following criteria should be applied to determine whether a DNSP should be permitted to add an asset located BTM to its RAB.

The exempt asset must:

- be unlikely to have an impact on the development of a competitive energy market
- must not be able to store or generate electricity
- not be sub-leased to a ring fenced affiliate
- express permission from the customer to install the asset BTM.

**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?**

Red and Lumo agree there will be few occasions where the AER grants an exemption beyond those already provided in the Rules. There should be a presumption in favour of competitive provision; this means the AER should only grant an exemption when there is a compelling reason to believe that a competitive provider will not emerge and that a DNSP has tested this in the market.

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

Red and Lumo agree that the information a DNSP is required to provide the AER for an asset exemption application remains somewhat uncertain and unclear. Particularly as this information is not commercially sensitive. For example, the timing of an investment and its location is not confidential and should be available or at least foreshadowed in DNSPs' annual planning documents.

Given the importance of these exemption applications, the AER and DNSPs must treat them in a transparent manner and allow interested stakeholders to provide input to any consultation, rather than relying on DNSPs' assertions.

**11. Do you agree that we should review the service classification and the asset exemption guidelines only at this stage but acknowledge the implications this may have for the revision of the other guidelines at a later stage?**

Red and Lumo supports an immediate review of the cost allocation guidelines.

Even with the introduction of the AER's ring fencing guideline, a DNSP still has enough flexibility to allocate the costs for the range of services they provide in a manner that potentially gives them a competitive advantage. For example, a DNSP may choose to provide human resources, legal and accounting services to its ring fenced affiliate. Unfortunately, there is nothing in the ring fencing guideline that prevents this.

In this situation, a DNSP would be required to allocate the costs of providing these services to its ring fenced affiliate on an attributable basis in accordance with its Cost Allocation Methodology. The DNSP would have sole discretion on what determines the attributable value of these services.

DNSPs would have considerable flexibility to allocate the costs of providing these services to their ring fenced affiliate in a way that gives it a competitive advantage. Such an outcome will prove to be detrimental to contestable energy markets.