



25 July 2018

Mr Moston Neck  
Director  
Australian Energy Regulator  
400 George Street  
Brisbane QLD 4000

Dear Moston

### Service classification draft guideline

CitiPower, Powercor and United Energy welcome the opportunity to comment on the Australian Energy Regulator's (AER) draft electricity distribution service classification guideline. In summary, we consider:

- Negotiated connection services should be classified as standard control to ensure connection applicants do not pay more than their fair share towards network augmentation.
- The guideline should better reflect the AER's intent that the baseline list of services is a starting point rather than a default list.
- The distinction between inputs and services should not depend on whether a payment/price is made.
- Our participation in the Australian Energy Market Operator's (AEMO) Reliability and Emergency Reserve Trader (RERT) scheme is consistent with our ring fencing obligations.

These issues are discussed further below.

We welcome the opportunity to discuss this letter with the AER. Please contact Frans Jungerth on 03 9683 2022 or [fjungerth@powercor.com.au](mailto:fjungerth@powercor.com.au) if you have any questions.

Yours sincerely

**Brent Cleeve**  
**Head of Regulation**  
**CitiPower, Powercor & United Energy**

# 1 Service classification

## 1.1 Connection services classifications

We support the proposed classifications of ‘basic connections’ being alternative control and ‘non-basic standard connections’ being standard control. However, we do not support ‘non-basic negotiated connections’ being alternative control. If these connections are alternative control (rather than standard control) connection applications will pay twice for augmentation. This is described below.

Under the Chapter 5A of the National Electricity Rules (**Rules**), basic connections (typically residential or small commercial customers) cannot be required to make a capital contribution for network augmentation beyond any extension required.<sup>1</sup> Notwithstanding this, the connections impose augmentation costs on the network. The augmentation works to accommodate this load form part of common distribution services, classified as standard control. Therefore every customer’s distribution use of system (**DUoS**) charges includes a contribution towards augmentation costs. This means that on average, each basic connection pays for their augmentation costs via DUoS.

Negotiated connections (typically larger customers) can be required to make a capital contribution for network augmentation. These customers impose higher than average augmentation costs on the network, meaning if they pay DUoS alone, they will not bear the full costs they impose. If, however, these connections are alternative control as suggested by the AER, they will pay for their augmentation cost both through their alternative control charge and through the augmentation component included in DUoS. In other words, they will pay more than their fair share.

Negotiated connections should therefore be standard control and be subject to the AER’s incremental cost revenue test. Under this test, customers are charged for their augmentation cost (based on their demand multiplied by the marginal cost of reinforcement) net of the component of augmentation costs embedded within DUoS (i.e. the incremental revenue offset).

The AER considered there may be a need to classify connection services as alternative control or unclassified if they are contestable.<sup>2</sup> Classifying negotiated connections as standard control will not (and currently does not) undermine contestability. As previously outlined to the AER, should the customer request a third party to complete the constable works, they will receive a rebate from the distributor meaning they would be financially indifferent—assuming the distributors’ and third parties’ charges were the same—between who undertakes the work.<sup>3</sup> The rebate is calculated as follows:

$$\begin{aligned} \text{customer contribution} &= \text{gifted asset value} - \text{rebate} \\ \text{rebate} &= \text{gifted asset value} - (\text{incremental cost} - \text{incremental revenue}) \end{aligned}$$

## 1.2 Connection services definition

To define the various connection services, the AER has adopted terminology from Chapter 5A of the Rules. This terminology does not capture the connections governed by Chapter 5. We suggest the AER include connections made under Chapter 5 of the Rules in the ‘non-basic negotiated connections’ definition.

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<sup>1</sup> These customers can be charged for the premise connection (‘pole to pit’) and so it is appropriate to classify this service as alternative control.

<sup>2</sup> AER, Explanatory Statement; Draft Electricity distribution service classification guideline, June 2018, p. 14.

<sup>3</sup> We have outlined the operation of this rebate in our connections policy and our letter to the AER dated 29 March 2018.

### **1.3 Network ancillary services**

In respect to network ancillary services outlined in the draft guideline, we have the following general comments:

- In our letter seeking a replacement framework and approach paper and at the AER's May 2018 workshop, we discussed classifying 'Connection application services' for processing connection applications. Classifying this service as alternative control ensures connection applicants pay these costs should they not proceed with their connection. We believe excluding this service may be an oversight and we request they be included in the baseline list.
- In Victoria, 'Customer or third party initiated network asset relocations' should be classified as standard control rather than alternative control, to be consistent with the Essential Services Commission (Victoria) Electricity Industry Guideline No. 14.

### **1.4 Departing from the baseline list of services**

We support the purpose of the baseline list of services as described in the AER's explanatory statement. In particular, it is not an agreed or default list that the AER will fall back to in the event the AER does not agree with a distributor's proposal. Rather, it is a starting point.<sup>4</sup> This accords with our understanding from the AER's May 2018 workshop.

We request the guideline better reflect the purpose of the baseline list as outlined in the explanatory statement. The guideline uses phrases such as 'we will accept alternative approaches where there are good reasons to depart' and 'a DNSP should adopt the description set out in this Guideline unless the description is inaccurate with respect to the services it offers'.<sup>5</sup> While we don't disagree with the intent of these phrases, they provide an impression that the baseline list is a default and a distributor must 'convince' the AER to depart from it. Our concern is that over time, the true intent may be lost if it is not clearly articulated in the guideline itself.

### **1.5 Inputs and services**

Several of the AER's criteria for differentiating between services and inputs are based on whether a payment is made/a price is put on the performing the task. This is an unhelpful distinction and is circular because whether a price is charged depends on whether the AER classifies the task.

For example, vegetation management is typically considered to be an input. If however, the AER decided vegetation management costs should be paid for by each customer whose premise requires it, the AER may classify the task as alternative control. At this time, a price would be put on the task and it would change from being an input to a service.

Given the AER may classify services and not inputs, the decision on whether a task is an input or a service must be independent of how it is classified and in turn whether a payment is price/payment is applicable. Therefore we don't consider the AER's criteria accords with the Rules.

### **1.6 Distribution services**

We support the AER's decision to not interpret the term 'distribution services'. The term is widely used throughout the Rules and in the National Electricity Law and any interpretation may not be applicable or correct in all circumstances.

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<sup>4</sup> AER, Explanatory Statement; Draft Electricity distribution service classification guideline, June 2018, p. 11.

<sup>5</sup> AER, Draft guideline; Electricity distribution service classification, June 2018, p. 7, 8, 10.

## 2 Provision of Frequency Control Ancillary Services and participating in the Reliability and Emergency Reserve Trader scheme

In the explanatory statement, the AER states the provision of Frequency Control Ancillary Services (**FCAS**) using distributors' network control systems are distribution services, but are likely to be unclassified. According to the AER, under ring fencing the services must be functionally separated from the provision of regulated services or a waiver must be sought. This example is similar to our participation in AEMO's Reliability and Emergency Reserve Trader (**RERT**) scheme.

As previously outlined to the AER, we believe our participation in RERT (and the possible use of voltage control to support FCAS) forms part of our common distribution services; either as part of operating the distribution network or as activities related to 'shared asset facilitation'. Nevertheless, should the services be unclassified as set out by the AER, a waiver from functional separation is not required as discussed below.

### 2.1 Functional separation

There are three main areas of functional separation under the ring fencing guideline—office sharing, staff sharing and branding. These are considered below.

#### Office and staff separation

Distributors may not use the same offices or staff for the provision of unclassified services and direct control services. According to the AER, the purpose of these obligations is to complement the specific obligations on:<sup>6</sup>

- Not discriminating (i.e. they help to ensure distributors cannot confer an advantage onto the part of the distributor that provides contestable services).
- Information access and disclosure.

The guideline therefore provides an exception to the office and staff sharing restrictions for staff that do not have the opportunity to use electricity information to engage in discriminatory conduct in performing their roles.<sup>7</sup>

To participate in RERT, our control centre staff change voltages by remotely controlling tap changes located at zone substations. They then monitor voltage data collected by Advanced Metering Infrastructure (**AMI**) to ensure voltage levels stay within the Electricity Distribution Code (**Code**) limits. Management of distribution network voltages is a distributor function and obligation under regulation. For this and security reasons, this task can only be performed by our staff, meaning they need to be shared for us to participate in RERT.

Under the ring fencing guideline, control centre staff may be shared because they cannot use information to discriminate or confer an advantage over other RERT providers. Simply put, if control centre staff shared the knowledge and information they have to other parties, the information would not assist those parties to compete more effectively in RERT services. This is because other parties do not possess, and are therefore incapable of, operating a distribution network in a manner to control voltage (nor do they have the regulatory obligation and authority to do so).<sup>8</sup> Other parties provide RERT services by reducing their demand or generating—their ability to do this and compete is not altered by the possession of network voltage information.

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<sup>6</sup> AER, Electricity distribution Ring-fencing Guideline; Explanatory statement, November 2016, p. 36.

<sup>7</sup> AER, Ring-fencing Guideline Electricity Distribution Version 2, October 2017, clauses 4.2.1(b)i.b and 4.2.2(b)i.b

<sup>8</sup> Similarly providing electricity information to other distributors would not be of any value, as the electricity information control centre staff possess is specific to our network (noting general knowledge and skill is not electricity information).

Therefore, while sharing staff allows us to compete, it does not provide an unfair advantage or enable us to engage in discriminatory conduct. Sharing control centre staff is also consistent with our published office and staff sharing register.<sup>9</sup>

No additional information needs to be shared with control centre staff for them to participate in the RERT, meaning RERT participation also does not undermine the information access and disclosure requirements.

For these reasons, a waiver is not required to share control centre staff. The same reasoning would apply for any future participation in FCAS services that could be provided through the control of distribution network voltages.

### **Branding**

The ring fencing guideline requires separate branding for direct control services and contestable services. The explanatory statement outlines the purpose of this is 'the risk of using consistent branding potentially results in a DNSP's related electricity service provider gaining an unfair advantage over its competitors by reason of its relationship with the DNSP.'<sup>10</sup>

In the context of the RERT, use of the same brand will not cause an advantage or market harm because:

- AEMO is the only purchaser of services and it understands the role of all market participants.
- AEMO's selection of our RERT provision is based on contractual agreements on our abilities, not based on brand awareness or perceptions.

Nevertheless, CitiPower and Powercor participate in the RERT under the Victorian Power Networks brand, which is consistent with the guideline.

United Energy has ongoing contract to provide RERT services using its brand. As this contract has already been executed, United Energy may need to report an immaterial breach in its next compliance report (although noting we believe RERT is a common distribution service, in which case there would be no breach).

## **2.2 Cross subsidies**

The AER outlined concerns that our participation in RERT may lead to cross subsidies.<sup>11</sup>

### **Correct cost allocation**

The AER considered distributors may be encouraged to over invest in control systems and attribute the cost to network requirements.<sup>12</sup>

We have been careful to ensure that no incremental costs associated with providing RERT services have been included in our regulatory accounts or regulatory forecasts. Rather:

- AEMO and the Australian Renewable Energy Agency provided us with \$11 million which we used to prepare the network to participate in RERT—the costs were not recovered by us from regulated customers under the regulatory framework. We also note these costs will be stranded if we cannot provide RERT services.
- Staff costs associated with operating the network for RERT were recorded to a specific cost code that was deducted from our regulatory accounts.

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<sup>9</sup> CitiPower and Powercor <<https://www.powercor.com.au/about-us/electricity-networks/codes-and-guidelines/>>

<sup>10</sup> AER, Electricity distribution Ring-fencing Guideline; Explanatory statement, November 2016, p. 49.

<sup>11</sup> AER, Explanatory Statement; Draft Electricity distribution service classification guideline, June 2018, p. 23.

<sup>12</sup> AER, Explanatory Statement; Draft Electricity distribution service classification guideline, June 2018, p. 23.

- It would be inconsistent with regulations and our policies to seek to recover revenue for RERT from regulated customers. Our accounts are subject to independent audits annually to ensure we are complying.
- The AER and stakeholders review our revenue proposal to ensure only costs related to providing network services are included.

### Shared asset guideline

The AER considers sharing revenue from the RERT with regulated customers under the Shared Asset Guideline (**SAG**) may not remove cross subsidies because the sharing ratio is not intended to reflect the correct allocation of assets' costs.<sup>13</sup>

To avoid a cross subsidy, it is the incremental cost of participating in the RERT that may not be recovered by regulated customers.<sup>14</sup> It is not a requirement that historical costs be allocated to regulated and unregulated services in accordance with the proportion of their use or the revenue derived from them (or any other sharing method) as the AER appears to suggest. As discussed, we have been careful to ensure no incremental costs associated RERT has been allocated to regulated customers.

The AER also outlined we must ensure that providing RERT does not prejudice the provision of standard control services. We agree and are ensuring customers' voltages remain within the limits stipulated by the Code.

### 2.3 Implications of any RERT restrictions

Should distributors be required to stop participating in the RERT, it would mean:

- The third largest RERT provider would be taken out of the market;
  - potentially putting electricity supply-demand balance at risk
  - reducing competition and increasing RERT costs to electricity customers
  - increasing the economic cost of the RERT. There is an economic cost associated with demand response—be it households or industrial businesses (such as Alcoa) having to curtail their electricity demand and therefore their consumption/production. However, when distributors provide RERT, there is no economic cost because electricity supply is not interrupted
  - reducing the ability of the electricity system to adapt at a pace necessary to accommodate the forecast increases in intermittent renewable generation to maintain system security
- Set a precedent that distributors may not be able to use their assets to provide new services. This lessens innovation and customers' choice
- Strand \$11 million of payments already made to us to participate in the RERT.

None of these outcomes are in in the long term interests of consumers.

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<sup>13</sup> AER, Explanatory Statement; Draft Electricity distribution service classification guideline, June 2018, p. 23.

<sup>14</sup> Cross-Subsidization: Pricing in Public Enterprises, Gerald R. Faulhaber, The American Economic Review, Vol. 65, No.5 (Dec., 1975), 966-977.