

19 March 2018



Mr Chris Pattas  
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Australian Energy Regulator  
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Dear Mr Pattas *Chris*

**Issues Paper – Service Classification and Asset Exemption Guidelines**

Ergon Energy and Energex welcome the opportunity to provide comment to the Australian Energy Regulator (AER) on its Service Classification and Asset Exemption Guidelines Issues Paper (the Issues Paper).

The attached submission is provided by Ergon Energy and Energex, the two Distribution Network Service Providers delivering connections to 2.1 million customers across Queensland.

Ergon Energy and Energex look forward to providing continued assistance to the AER in developing the new guidelines.

Yours Sincerely

  
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*Encl: Ergon Energy and Energex comments on the Issues Paper – Service Classification and Asset Exemption Guidelines*

# Service Classification and Asset Exemption Guidelines

Joint response to the  
Australian Energy Regulator's  
Issues Paper

19 March 2018



Part of the Energy Queensland Group



## **ABOUT ERGON ENERGY**

Ergon Energy Corporation Limited (Ergon Energy) is part of the Energy Queensland Group and manages an electricity distribution network which supplies electricity to more than 740,000 customers. Our vast operating area covers over one million square kilometres – around 97% of the state of Queensland – from the expanding coastal and rural population centres to the remote communities of outback Queensland and the Torres Strait.

Our electricity network consists of approximately 160,000 kilometres of powerlines and one million power poles, along with associated infrastructure such as major substations and power transformers.

We also own and operate 33 stand-alone power stations that provide supply to isolated communities across Queensland which are not connected to the main electricity grid.

## **ABOUT ENERGEX**

Energex Limited (Energex) is part of the Energy Queensland Group and manages an electricity distribution network delivering world-class energy products and services to one of Australia's fastest growing communities – the South-East Queensland region.

We have been supplying electricity to Queenslanders for more than 100 years and today provide distribution services to almost 1.4 million domestic and business connections, delivering electricity to a population base of around 3.4 million people via 52,000km of overhead and underground network.



## CONTENTS

1	Introduction.....	4
2	Key Messages .....	4
3	Table of Detailed Comments.....	7

## 1 INTRODUCTION

Ergon Energy Corporation Limited (Ergon Energy) and Energex Limited (Energex) welcome the opportunity to provide comment to the Australian Energy Regulator on its Service classification and asset exemption guidelines Issues Paper (the Issues Paper).

This submission, which is available for publication, is provided by Ergon Energy and Energex as distribution network service providers (DNSPs) operating in Queensland.

Ergon Energy and Energex are committed to providing:

- safe, reliable and affordable electricity supply;
- a great customer service experience;
- customers with greater control over their energy consumption;
- efficient and sustainable energy solutions; and
- access to the next wave of energy linked innovative technologies and renewables.

Ergon Energy and Energex acknowledge that the Issues Paper is the first step in responding to the Contestability of Energy Services rule change, which requires the Australian Energy Regulator to develop new service classification and asset exemption guidelines prior to 30 September 2018.

Our key messages in relation to specific issues discussed in the Issues Paper, and our detailed responses to the questions raised therein are included in sections 2 and 3 of this submission.

Ergon Energy and Energex are available to discuss this submission or provide further detail regarding the issues raised, should the AER so require.

## 2 KEY MESSAGES

### 2.1 Service Classification Guideline

Ergon Energy and Energex are supportive of the harmonisation of service classifications to allow for consistencies and efficiencies to occur over time.

The core services provided by Distribution Network Service Providers (DNSPs) such as planning, design, construction, maintenance and operation of their networks, are not subject to significant change over time, and revisiting service classifications for each new regulatory control period is arguably inefficient and results in increased uncertainty across periods. Consequently, Ergon Energy and Energex consider that a move to harmonise service classifications will improve efficiency and the transparency and predictability of service classification decisions.

However, Ergon Energy and Energex acknowledge there are limits as to what can be achieved due to variations in jurisdictional requirements. Furthermore, Ergon Energy and Energex caution that while consistency will have the abovementioned benefits, this should not be sought at the expense of the certainty needed for long term planning, nor should it result in an increased administrative burden or unfavourable financial impacts.

Consequently, while Ergon Energy and Energex support the harmonisation of service classification, we strongly recommend that an incremental approach be adopted to allow for transitional and jurisdictional factors to be addressed during the harmonisation process.

### 2.2 Asset Exemption Guideline

Ergon Energy and Energex acknowledge the introduction of the asset exemption guideline as a mechanism to explain the circumstances in which the AER may grant an exemption from the prohibition on DNSPs owning a restricted asset. As in the case of the service classification guideline, we acknowledge the benefits of this guideline in improving the transparency and effectiveness of the regulatory process.

While we agree with the AER that any asset exemption granted should be in the long-term interests of consumers and should positively contribute to the development of competition in the market for energy related services, Ergon Energy and Energex strongly recommend that the AER also considers the following issues when prescribing the exemption criteria:

- Market maturity will be relevant to ensuring services are available at an economic cost that provides all customers with an affordable electricity supply. Customers should not be expected to subsidise new electricity products and/or markets – rather this should be left to customer choice.
- Asset exemptions should be granted for regional and remote areas of a DNSP's network which are not conducive to retail competition. Such an exemption could be removed upon market maturity or as technology removes issues associated with distance.



- An asset exemption should be granted in respect of existing programs which were established in the long-term interests of customers, and are aimed at providing solutions within immature markets.

### 3 TABLE OF DETAILED COMMENTS

Issues Paper Feedback Question	Ergon Energy and Energex response
<p>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 and hierarchy of distribution services be a feature or objective of the guideline? If so, why?</p>	<p>The core services provided by all DNSPs (planning, design, constructing, maintaining and operating networks) are not subject to significant change over time, and revisiting service classifications at every determination is considered to be inefficient. Ergon Energy and Energex are therefore of the view that a harmonised set of service classifications applied consistently across the National Electricity Market should be developed.</p> <p>While harmonisation is expected to improve the transparency and predictability of service classification decisions, we acknowledge there are limits as to what can be achieved due to differences in jurisdictional requirements and obligations. Furthermore, notwithstanding the benefits of harmonisation, consideration should also be given to the fact that complete harmonisation may potentially restrict innovation and the evolution of service improvement by DNSPs.</p> <p>Nevertheless, over the long term a harmonised approach would allow DNSPs to abbreviate the Framework and Approach and service classification process by linking directly into an agreed set of services, flagging where exemptions/different treatments are appropriate.</p> <p>Therefore, an incremental approach to harmonisation is supported.</p>
<p>2. Are there other aspects of the new rule that we should take into account in developing the guidelines?</p>	<p>As a general comment, if the guidelines are consolidated, it may be beneficial to clarify which sections of the guideline refer to which National Electricity Rules (NER) provisions to facilitate appropriate compliance with specific provisions (particularly where a guideline provides for exemption applications).</p>



Issues Paper Feedback Question	Ergon Energy and Energex response
<p>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?</p>	<p>While the AER’s interpretation is considered reasonable, Ergon Energy and Energex question the AER’s comment in Appendix A regulation factor (c), particularly with reference to “non-distribution services”.</p> <p>Specifically, the AER’s Ring-Fencing Guideline – Electricity Distribution prevents a DNSP from providing non-distribution services. An issue is that the relevant definition of “distribution system” refers to the national interconnected grid, meaning that the services provided in Ergon Energy’s isolated networks are by definition “non-distribution services”. Factors like this should be taken into consideration.</p>
<p>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?</p>	<p>Ergon Energy and Energex are of the view there is still some ambiguity around the range of services which fall within the definition of a distribution service. Specifically, the NER definition of the term requires that the service be provided by means of, or in connection with, a distribution system.</p> <p>While it will generally be clear whether a service is provided ‘by means of’ a distribution system, whether or not a particular service is one provided ‘in connection with’ a distribution system is less clear. In fact uncertainty around this later issue has been the subject of past judicial consideration in the Federal Court’s 2012 decision in the case of <i>Ergon Energy Corporation v Australian Energy Regulator</i>, QUD 194/2010. In that case the court was asked to consider whether the services provided via Ergon Energy’s street lighting system were a distribution service. Contrary to Ergon Energy’s submission in the case, the Court found that Ergon Energy’s street lighting service fell within the NER definition of a distribution service. The Court suggested that in deciding what is/is not a distribution service, consideration should be given to:</p>

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	<ul style="list-style-type: none"> <li>• the text (of the legislation) itself</li> <li>• the context in which a definition is found</li> <li>• the purpose or object of the NER as a subordinate part of the National Electricity Law (NEL) and</li> <li>• historical treatment.</li> </ul> <p>Given the potential for uncertainty evidenced by this case, Ergon Energy and Energex consider there would be strong merit in the AER including its views on what constitutes a distribution service in the service classification guideline.</p> <p>It is anticipated that more stakeholders will participate in the development and subsequent review of the guideline than in respect of particular distribution determinations. Consequently any decision regarding the definition of distribution service should be made as part of the development of the guideline, rather than on a continual and evolving basis at the time of each service classification decision.</p> <p>Ergon Energy and Energex are also of the view that the classification of a distribution service should not be asset based but rather service based, thus ensuring the delivery of the most efficient service regardless of the solution. Factors to consider could include whether the delivery of an efficient service is focussed on ensuring network security, reliability or safety.</p>
<p>5. Should our service classification decisions make clear those services we have decided not to</p>	<p>Ergon Energy and Energex consider that a list providing clear examples of the services which are not classified and the basis on which it was determined that they were not distribution</p>

Issues Paper Feedback Question	Ergon Energy and Energex response
<p>classify because they are not distribution services?</p>	<p>services would prove helpful for network businesses.</p>
<p>6. Is there any other guidance that should be included in the asset exemption guideline?</p>	<p>A list of the service exemptions granted to DNSPs would provide guidance on the AER's approach to asset exemption and would be a useful resource.</p>
<p>7. What criteria should we use to determine whether a DNSP should be permitted to add an asset to its regulatory asset base? 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?</p>	<p>The AER should consider the following criteria in its assessment of whether a DNSP is permitted to add an asset to a regulatory asset base:</p> <ul style="list-style-type: none"> <li>• Geographical location and market maturity– Whether there are locations within a DNSP's network where particular restricted assets are required to enable the ongoing provision of services and those services would not otherwise be accessible on a competitive basis.</li> <li>• Security/Reliability of Supply – Where assets are required to ensure the security and reliability of the network until a load control/demand management market matures.</li> </ul> <p>Ergon Energy and Energex recommend that exemptions be granted for:</p> <ul style="list-style-type: none"> <li>• legacy network control programs/arrangements where capex continues to be required to purchase future assets for use in the legacy program.</li> </ul> <p><i>For example, the Energex electricity network experienced record demand on three consecutive days in February 2018, with demand reaching a record limit on 14 February at 4824 MW. The load on the network during the week 11-15 February 2018 was a 50-100 per cent increase on the load of the hot preceding week. It is estimated that this record demand was largely attributable to air conditioning load, and to a lesser extent additional refrigeration load.</i></p>

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	<p><i>Energex was able to utilise its PeakSmart air conditioning program to signal over 80,000 PeakSmart air conditioners into Demand Response Mode 2 as per AS/NZ4755, capping them to operate at 50 per cent. This helped prevent area troubles and outages for customers.</i></p> <p>While we understand that the restriction on a DNSP including a restricted asset in its RAB only applies to assets purchased from commencement of the new rule, we strongly recommend that the use of capex to purchase assets that would otherwise be restricted assets be permitted going forward where there are apparent and ongoing network and customer benefits, such as those noted above in relation to Energex's PeakSmart program. In this regard, Ergon Energy and Energex note there is currently a non-existent to immature market for the provision of demand response from air conditioning loads in Queensland. Should another heatwave occur resulting in peak demand on the network, Energex would not be able to call on a third party to provide sufficient demand response for air conditioning load to prevent area troubles or outages. Consequently, continuation of the PeakSmart program is needed to ensure network reliability and customer interests are protected.</p> <ul style="list-style-type: none"><li>• Regional or remote areas. In regional and remote areas, DNSPs may be the only party with a material and undistorted incentive to offer 'behind the meter' energy services. In some cases, the customer may not be exposed to cost reflective tariffs due to jurisdictional arrangements, and the area may not be open (or conducive) to retail competition as customers are too remote to be serviced competitively in a contestable market. In addition, DNSPs remain incentivised under the existing regulatory framework to employ all appropriate means to minimise the total cost of supply to these communities, regardless of whether the assets are owned by the customer or the DNSP.</li></ul>

Issues Paper Feedback Question	Ergon Energy and Energex response
	<p>While at some future time new technologies may provide customers with the same access to services as urban customers, Ergon Energy and Energex strongly recommend that an exemption should be considered until such time as this occurs.</p> <p>Both Ergon Energy and Energex agree that such exemptions could be subject to conditions such as time limits tied to market maturity or a DNSP’s regulatory control period. Such a transitional approach would enable demand response markets to evolve without jeopardising the capacity of load under control or impacting customer choice. Switching to third party provision of services without a transition period could result in outcomes that are contrary to the National Electricity Objective (NEO).</p>
<p>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.</p>	<p>Whether additional exemptions are required is difficult to determine at this time. Exemptions will depend on how rapidly technologies evolve and markets develop. It is also possible that exemptions will be required for certain DNSPs serving remote areas. Consequently Ergon Energy and Energex are of the view that additional criteria permitting exemptions must be included while a market is immature and incapable of supporting current network reliability needs.</p> <p>Assets such as those that are a part of a long standing existing demand response program should be granted an exemption.</p>
<p>9. What are stakeholder views about the likely impact of confidential information affecting the transparency of asset exemption decisions?</p>	<p>Ergon Energy and Energex have no comment on this question.</p>

Issues Paper Feedback Question	Ergon Energy and Energex response
10. How can the asset exemption guideline address uncertainties about future market development when these markets may often be in their infancy?	<p>Ergon Energy and Energex consider that the exemption guideline cannot pre-emptively provide for every future scenario. As such, the guideline should include a transition process which does not limit a DNSP's ability to invest in restricted assets where the investment is in the long term interests of customers. Switching to third party provision of services without a transition period could result in outcomes that are contrary to customer interests and the NEO.</p> <p>Consequently the guidelines should incorporate measures around market maturity in regulated jurisdictions to ensure that network security and reliability will continue to survive prior to the removal of exemptions. Such exemptions should then be assessed on a regulatory control period by regulatory control period and region by region basis, allowing them to evolve if and when a suitable market emerges.</p>
11. Do you agree that we should review the service classification and asset exemption guidelines only at this stage but acknowledge the implications this may have for revision of the other guidelines at a later stage?	<p>Ergon Energy and Energex are of the view that the revision of other guidelines at this stage will be necessary given the current inconsistencies associated with the interpretation of service classifications.</p>