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

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

Dear Chris,

**Re: Preliminary framework and approach - NSW**

Red Energy (Red) and Lumo Energy (Lumo) welcome the opportunity to comment on the Preliminary Framework and Approach (F&A) that will be applied by the Australian Energy Regulator (AER) to the NSW electricity distributors Ausgrid, Endeavour Energy and Essential Energy (collectively, the DNSPs) for the 2019-2024 distribution determination.

The F&A represents the first step in the AER process to determine efficient prices for electricity distribution services. The process determines the services that it will regulate and the broad nature of the regulatory arrangements it will apply over the course of the rate review.

The key focus of this submission is on the classification of services.

Specifically, we are concerned at the lack of clarity in the rules regarding the treatment of single assets with multiple uses; that is - shared assets. For example, this might include an asset that is used to provide a regulated network service while simultaneously providing a contestable service. This has the potential to threaten competition in the emerging contestable energy services market that is located Behind the Meter (BTM).

With the market for the supply of BTM services in energy expected to grow dramatically in the next 20 years, market participants will all be vying for a share of this market. The size of Distributed Energy Resources (DER) market was highlighted in a recent study by the Energy Networks Association (ENA) and the CSIRO titled the Electricity Network Transformation Roadmap (Roadmap). The Roadmap highlighted that between \$225 billion to \$340 billion dollars of capital would need to be invested between now and 2050 to satisfy the demand for emerging DER.

As potential competitors in this emerging market it is important that we get the opportunity to compete against DNSPs in a competitive neutral manner. Such an outcome will guarantee that resources are allocated these markets located BTM in an efficient manner.

The F&A consultation paper provides some examples of shared assets and their implications for competition for contestable services located BTM. For example, it refers to the hypothetical situation of a DNSP that earns non-regulated revenue by permitting NBN to hang its wires from the electricity poles in its network. It also refers to a situation where

regulated assets that form part of the RAB are leased to a third party.<sup>1</sup>

One specific scenario that could have serious implications for the competition in the contestable services market located BTM is where a DNSP invests in a battery configuration that supplies network services to itself to meet its regulatory obligations. In such a case, the DNSP has the potential to earn a regulated revenue stream (by rolling in a portion of the asset into the RAB) and combine this with an unregulated revenue stream by leasing batteries to its ring-fenced affiliate at a discount. Such an outcome would give it a competitive advantage in the contestable energy services BTM.

To allay any competition concerns, the DNSP would need to clearly identify how the battery configuration that is rolled into the RAB and supplies network support to itself while simultaneously earning an unregulated revenue stream would be used precisely and attribute the cost allocations in accordance with the DNSP Cost Allocation Manual (CAM). The AER has developed the Cost Allocation Guidelines (CAG) that DNSPs must comply with through their CAMs. For example, the costs attribution could be (70% RAB to 30% non-RAB).

Of course, the DNSP may use the same batteries that are in the RAB to earn unregulated revenue subject to the Shared Asset Guideline (SAG) where the use of the batteries does not materially prejudice their use for standard control services. Under the current rules, the DNSP would only be required to return 10% of the unregulated revenues earned by the batteries to consumers that pay for standard control services if they earn more than 1% of the Maximum Annual Revenue (MAR).

So, in theory it is possible to avoid cross subsidising the ring-fenced affiliate in this scenario if the cost of the battery configuration is properly allocated to each service that it is used to provide under the AER's CAG and its SAG. But, in practice there are a number of significant problems with this. Some potential issues include:

- it is unclear how the costs of a battery configuration located BTM that provides network support to itself and leases these batteries to a ring fenced affiliate at a discount would be allocated;
- the allocation of costs of a battery configuration located BTM that provides network support to itself and leases these batteries to a ring-fenced affiliate at a discount is particularly challenging because the batteries provide different services at the same time;
- we have yet to witness how a DNSP that rolls a battery investment into the RAB and provides network support to itself while simultaneously leasing the batteries to a ring-fenced affiliate at a discount would allocate the costs between the different services. This raises serious questions regarding the capacity of the current regulatory instruments (including the CAM & the SAG) to appropriately allocate costs across services classifications in this situation;

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<sup>1</sup> AER Preliminary Framework and Approach - NSW - p. 34 "For example a distributor may earn additional revenue say from NBN Co. by permitting NBN Co. to hang its wires from the same poles. The service is "providing access to electricity poles". Similarly, some other access to a network asset that forms part of the regulatory asset base (RAB) may be rented to a third party. The service for classification is "access to a RAB asset."

- even if the AER applied initial cost allocations for a DNSP battery configuration located BTM which is rolled into the RAB and supplies network support to itself while simultaneously earning unregulated revenue which ended up being incorrect, rectifying this mistake would be difficult given the lack of any experience on this matter;
- the current arrangements that allow DNSPs to roll in a battery configuration into its RAB while simultaneously earn unregulated revenue by leasing the batteries to a ring-fenced affiliate subject to the SAG (and its 1% MAR materiality threshold) has the potential to provide a significant cross-subsidy to its ring-fenced affiliate. This is especially true where the batteries are leased to a ring-fenced affiliate at a discount. Where the unregulated revenues from shared assets of a DNSP represent more than 1% of a service provider's total annual revenue (1% of 2016-17 Ausgrid smoothed revenues = \$1,627.7 million x 0.1 = \$162,770,000 million) the AER will reduce a service provider's regulated revenues by around 10% of the value of unregulated revenues earned from shared assets. The potential cross-subsidy that a ring-fenced affiliate could get under the battery arrangement described above - even before any of the non-regulated revenue is clawed back and remitted to consumers - would be significant.

For all these reasons, the AER must refrain from approving any DNSP capital expenditure (capex) for a configuration of batteries located BTM that is rolled into the RAB and provides network support to itself while simultaneously leasing those batteries to a ring-fenced affiliate at a discount. The AER must review the effectiveness of its current regulatory instruments (CAG and its SAG) and their ability to precisely allocate the costs of any assets that can be used for two or more purposes simultaneously before it approves any capex of this form for the next regulatory period.

### **About Red and Lumo**

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

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