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Mr John Pierce
Chair - Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear Mr Pierce

Review of the regulatory framework for stand-alone power systems

The Australian Energy Regulator (AER) thanks you for the opportunity to comment on the AEMC's review into the regulatory arrangements for stand-alone power systems (SAPS) and your issues paper of 11 September 2018. The issues paper focusses on the transition to a DNSP-led SAPS with the transition to third-party led SAPS to be considered through a subsequent issues paper.

SAPS have the potential to benefit DNSPs and customers. A number of DNSPs are actively considering how to leverage SAPS, so there is some urgency to reforming the regulatory framework to facilitate their implementation. To the extent possible we wish to avoid inefficient investments in fringe of grid connections being locked into the DNSPs' regulated asset bases when these could have been avoided through the implementation of SAPS.

While recognising that a DNSP-led approach to SAPS is not the only option for transitioning customers to SAPS, we consider the consumer benefits SAPS can provide are such that DNSPs should have a path to utilise them. In the longer-term, SAPS could lead to improved reliability and reduced costs for all consumers.

Our submission at Attachment A focuses on key areas of AER interest in light of the questions in the issues paper. We look forward to continued collaboration with the AEMC on development of an appropriate regulatory framework for stand-alone power systems. To discuss any matters raised please contact Dale Johansen on (07) 3835 4679.

Yours sincerely



Sarah Proudfoot
General Manager - Consumers and Markets
Lodged electronically on: 16.10.2018

Attachment A

Contestability of service provision

(Q7 - Defining the SAPS system service(s); Q8 - role of the distributor; Q9 - Provision of retail services)

The AER supports a framework based approach that allows different SAPS delivery models to stimulate competition. This means that a framework should be flexible enough to allow a range of options from a fully integrated system (such as the one mentioned on page 35 of the Issues Paper) that is contracted by the DNSP, through to the individual services being provided to the DNSP to aggregate (e.g. retail, generation and storage) and provide to the customer as a SAPS service.

We see merit in an approach where SAPS and related services are considered to be a distribution service so that DNSPs can provide them, but where the DNSPs are obliged to obtain them from the competitive market rather than providing them directly. Should the AEMC take the approach of separating out a single SAPS into a number of monopoly or regulated network services and contestable services, we would encourage a clear division so all parties have clarity as to what services are contestable. This would allow the clear application of the AER's Ring-Fencing Guideline. Such approaches should take into account the potential costs associated with complexity and it may be appropriate to scale complexity of the solution against the scope of the affected customer base. In identifying a service classification approach to SAPS, we would also encourage a focus on classification of electricity services rather than assets, consistent with the services-based approach to network regulation and DNSP ring-fencing.

An exemptions framework could be used to allow the DNSP to provide services that would ordinarily be contestable, to account for limited circumstances where the competitive market is not able to provide either all of the SAPS or a component of the SAPS. We note that it is conceptually simple to think about the assets required for a single customer and that the DNSP should generally be prohibited from owning them. However, as the size and complexity of a microgrid grows, it may become less feasible for the DNSP to be prohibited from providing any services or owning any assets within the SAPS. In this case exemptions may be appropriate.

Customer consent to moving off-grid and customer protections

(Q3 - Consumer consent provisions; Q15 - Consumer protections specific to SAPS customers; Q16 - Options for providing electricity-specific consumer protections)

We agree that customer consent is of critical importance for the transition of customers to a DNSP-led SAPS model, especially where the customer is not leading the off-grid process. It is crucial that customers have adequate and clear information about the risks and benefits of being off-grid, as well as the costs in the short and long-term before making this decision. While further thought must be given to the nature of customer information, we consider it should include a clear indication of any financial incentives being offered to the customer to go off-grid. It should also include any changes to customer protections, especially if the model being followed does not include a retailer and attendant customer protections (e.g. protections for vulnerable customers that on-grid customers have through the NERL or jurisdictional schemes) that may result from the new arrangement. Once adequate information is provided, it should still be the customer's decision to go off-grid (i.e. explicit consent) where it is an individual or small group of customers going off grid.

For larger groups of customers (i.e. microgrids over a certain size) we consider customer consent is still required, but accept that unanimous consent may not always be possible. We note the consent threshold for embedded network conversions of 85 per cent may provide some guidance in the SAPS context. However, this threshold from the embedded network framework should only be taken as a starting point. The cost of going off grid and then trying to reconnect is likely to be higher for a SAPS customer than for an embedded networks customer and so a higher threshold may be required. It may also be appropriate to blend customer consent with minimum customer outcomes for microgrids of a certain size. Under this approach, customer consent of X percent could be required, with guaranteed minimum customer outcomes so as to protect the customers that do not consent to go off-grid. An aggregate 'no worse off' principle may be appropriate.

We agree with the Commission's suggested general principle that 'energy-specific consumer protections for customers being supplied via a DNSP-led SAPS should be equivalent to those for grid-connected customers'. This relates also to the role of retailers in a SAPS context.

While our preference is to retain retail competition, and at least two potential models have already been proposed, we note it may not be feasible for individual SAPS or small groups of customers. Nonetheless, customer protections provided by the retail regulatory framework, especially around hardship and vulnerable customers, are significant. For this reason it may be preferable to retain the retailer–customer relationship even where the role of retailers in a SAPS context does not fully reflect their role in the broader NEM.

Retaining customer protections in a SAPS context could also be achieved through contract terms, obligations on the DNSP, or other means. Regardless of the mechanism for their delivery, a set of minimum standards and protections that a SAPS proposal must meet to be approved should be determined.

Where retail competition is not feasible, regulatory responses should be proportionate to the issue at hand (e.g. regulated prices could be a reasonable alternative to retail price competition). We consider that simply providing a price guarantee, such as a requirement that prices for SAPS customers should be no higher than the standing offer available from the local retailer, may result in SAPS customers paying higher prices than other customers.

The economic test to determine whether SAPS is efficient or not

(Q2a&b - Efficiency pre-condition)

We support the need for an economic test to determine whether utilising a SAPS is an efficient solution. However, as per our 4 October 2016 submission to the Energy Market Transformation Project Team (EMTPT) process we consider it important that a balance is struck between flexibility and complexity when considering the regulatory approach to SAPS and that the general approach be proportionate and responsive.

We also note that due to the need for incentives to drive the transition to SAPS, no matter what test is applied, it is likely that a material net benefit would need to be derived to allow the process to be successful (e.g. the non-network (SAPS) solution may need to be substantively cheaper than the traditional network solution, so cost savings can be shared as the incentive for parties to participate - the Western Power example.) The AEMC should give further thought as to how these benefits should be shared to provide incentives to encourage consumers to transition off-grid where it is efficient for them to do so.

The current RIT-D supporting consultation process and application guidelines would likely be appropriate for SAPS that cover a larger number of customers and/or meet the relevant

thresholds. As the AEMC is aware, we are reviewing the RIT-D application guidelines, and will update our guidance on market benefits under the RIT-D. As a result of this review we are considering adding new classes of market benefits. We have recognised that with the rise in distributed energy resources and the increased sophistication of demand management capabilities, we can expect that distribution investments will increasingly deliver benefits that we have traditionally seen at the transmission level. On this basis, and having considered submissions on our draft RIT-D application guidelines, we are considering including a number of new classes of market benefits in the RIT-D. We also note that RIT-D proponents can propose new classes of market benefits.

Our new RIT-D application guidelines will also provide guidance on external capital contributions, which would be relevant to SAPS. There might be situations where SAPS have non-NEM benefits, such as bushfire risk mitigation, that may not be explicitly captured with the RIT-D economic assessment. For example, a Council might want to support a microgrid that relies on renewable energy as this will provide non NEM benefits associated with tourism, the environment, employment and a sense of community. While the RIT-D would not necessarily capture these non-NEM benefits, the local Council could provide a capital contribution towards the project that would offset the project's costs, thereby increasing the project's net economic benefit under the RIT-D. This is consistent with the RIT-D's role in promoting efficient market outcomes, whilst also permitting other parties (such as governments' or community groups' willingness to make capital contributions) to promote efficient social outcomes.

(Q2c)

As indicated earlier, we support a lighter, targeted test when the RIT-D is either not applicable or proportionate to the number of customers. We encourage the AEMC to consider whether other established tests would be appropriate. For example, the minimum project evaluation requirements in clause 2.2.1 of the AER's demand management incentive scheme (DMIS) could form a reasonable basis for such a test.¹

One highly beneficial component of the RIT-D approach (and DMIS) is that it promotes transparency and consultation. As such, if the AEMC develops a lighter test, there should still be a level of transparency which could involve a summary of the applicable test being provided to the customer. This could help to meet the customer's information requirements, and also demonstrate the benefits of shifting to a SAPS. This could be in the form of a standard information sheet, which could also demonstrate to a regulator that an appropriate process has been followed.

¹ See <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/demand-management-incentive-scheme-and-innovation-allowance-mechanism>

The AER's role

(Q4 - Regulatory oversight role; Q12 - Roles of AEMO and the AER)

The AER is responsible for ensuring energy businesses comply with relevant legislation and rules, taking enforcement action where necessary. This includes both oversight and approval responsibilities, including in relation to the provision of customer protections. We recommend the AEMC give consideration to the administrative burden to both networks and regulators in considering the level of approval and oversight needed for the regulation of SAPS, balanced against the risks and benefits to consumers. A more administratively intensive process could be considered at the outset to ensure consumers are adequately protected.

It may be appropriate to have a streamlined process for the transition of individual customers or small groups of customers to a DNSP-led SAPS. In this scenario, the AER could have an oversight role (for example, where a DNSP could proceed with a SAPS as long as they have met relevant requirements) providing there is clear guidance to networks as to what standards they need to meet to transition these customers. Given the significant impact on customers of being shifted to a SAPS it may be appropriate for the AER to have access to pecuniary penalties for cases of DNSP non-compliance.

For larger SAPS systems, an explicit approval based system may be more appropriate (for example, where a DNSP would be prevented from proceeding with a SAPS unless it gains approval from the AER). However it should be based around standardised processes and information requirements to minimise the administrative burden while ensuring consumers are protected. A key part of both of these processes will be to ensure that customer information and consent requirements are met. Should the AER have an approval role, it is important to ensure that our approval comes early in the SAPS development process. That is to say, AER approval should come before DNSPs, SAPS providers, and affected communities have locked in major decisions and created path dependencies that may affect important elements of our approval.

In terms of other AER roles, we expect to continue to have a role in classifying relevant services and how revenue is regulated. However, these precise roles will be a function of the transition process and regulatory framework that the AEMC sets out and we will be better placed to comment on them then.

Additional questions the AEMC may wish to consider

The AEMC should give further attention to the issues of incentives and information, especially in considering third-party led SAPS. For example, the incentives on the DNSP to support the transition of a customer to a SAPS are complex. Given that the DNSP is the only source of information for regulators and customers alike as to the efficiency of the existing customer connection, it is important that there is some incentive on the DNSP to initiate the conversion process (whatever that might look like). In the absence of an incentive, the DNSP may be less proactive in (a) identifying possible SAPS locations and (b) undertaking the SAPS conversion process.