

09 October 2018

Mr John Pierce
Chairman
Australian Energy Markets Commission



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Dear Mr Pierce

AEMC issues paper—review of stand-alone power systems’ regulation

SA Power Networks welcomes the opportunity to comment on the AEMC’s issues paper—Review of the regulatory frameworks for stand-alone power systems. As previously stated, we support this review examining ways of extending the suite of options by which Distribution Network Service Providers (**distributors**) can continue to efficiently deliver network services for customers. Our views remain mostly unchanged from our submission to the AEMC’s draft decision on the related Western Power rule change.¹ However, we now comment more specifically on matters raised in the AEMC’s issues paper.

Reform imperative

This reform can potentially drive cost savings to all customers over time. This is particularly true for networks like ours, with large numbers of customers connected to remote rural fringes of the network. In some situations, supplying energy to these customers via an off-grid Stand-Alone Power System (SPS) could become cheaper than grid-supplied energy, particularly when significant replacements of ‘poles and wires’ assets servicing those customers are triggered due to asset condition. In these cases, we could minimise costs for all customers and have the means to ‘right-size’ our network in these rural fringes.

Assessing efficiency of transitioning to off-grid supply

Customers transitioned to a SPS should not be left any worse-off with respect to the price they pay for energy supply. It is imperative that any reform only encourage SPS where it is genuinely efficient for all customers and the market. In our view:

- The Regulatory Investment Test for Distribution (RIT-D) is the appropriate process for evaluating costs and benefits, where potentially avoidable network expenditures are material (i.e. greater than \$6 million). The RIT-D takes a whole of market perspective rather than examining benefits to individuals.
- Evaluations may be simple for Individual Power Systems (IPS), where individual customers are unlikely to impact wholesale market outcomes—the costs and benefits will pertain to the costs of an IPS vs network asset replacement. However, cost / benefit evaluations will be more complex for community SPS (i.e. micro-grids)—customer-side Distributed Energy Resources (DER) might drive material benefits to the broader market and customer base. Therefore:
 - the AEMC should consider how to appropriately value the benefits of customers remaining grid-connected. We have raised this in the AER’s review of the RIT-D Application Guidelines but the issue is yet to be considered;² and
 - at the very least it seems that either the National Electricity Rules (NER) or the Application Guidelines should explicitly allow consideration of classes of market benefits that are included in the RIT-T but not RIT-D. These include: ‘*changes in fuel consumption through different patterns of generation dispatch*’ and ‘*competition benefits*’. Both are pertinent where there is material DER capacity.
- Even where the RIT-D will not apply we expect distributors would undertake cost / benefit analyses as broadly expected by the RIT-D. The capital and operating expenditure objectives and factors already

¹ SAPN, *Submission to AEMC—Draft determination: alternatives to grid supplied network services*, 3 November 2016. Accessible on: [<http://www.aemc.gov.au>].

² SAPN, *Submission to AER—Review of the Application Guidelines and Explanatory Statement for the Regulatory Investment Tests*, 7 September 2018. Accessible on: [<http://www.aer.gov.au>].

require consideration of alternative options and customer views, while the National Electricity Objective requires a whole of market perspective to considering customers' long term interests.

- The triggers for considering SPS supply should be where the condition of the network assets used to supply customers are reaching the end of their 'technical life' or 'economic life' such that the ongoing operating and maintenance costs may be greater than an SPS alternative.³ It may be that network assets meeting these conditions have not been fully depreciated (the usual definition of economic life) and sunk costs must continue to be recovered. The ability to recover sunk costs is an inherent part of the 'regulatory compact' and the AER's approach to considering the risk faced by networks (and required return) is premised on this basis. Therefore, we are somewhat confused by the AEMC's discussion on asset stranding and would encourage further consultation on this subject.

Maintaining essential service expectations

Customers transitioned to a SPS should as far as practical continue to receive the same regulatory oversight, conditions and protections expected of an essential service. There may be differing models of SPS service delivery some of which do not involve distributors. In such cases, regulation would need to replicate / duplicate arrangements that distributors must currently comply with, and in effect duplicate the role of the monopoly service provider. In our view the AEMC should not rule out distributors being responsible for SPS service delivery, noting that:

- Existing customers would continue to be protected from a service performance perspective:
 - Distributors would remain responsible for service provision and performance of both on-grid and off-grid supply. Existing registrations and licensing regulations applying to distributors could continue to be used to protect consumers and would avoid needing to design new regulatory frameworks to register / monitor new potential service providers.
 - Existing regulatory requirements which distributors must currently comply with in relation to service performance (quality, safety, security, reliability) of grid supplied network services, could equally continue to apply (perhaps with some minor amendment) to SPS supplied network services. Also, as the AEMC notes, fringe-of-grid customers might actually experience improved reliability and safety.
 - Allowing distributors to be responsible for SPS service provision will not present a barrier to competition as competition can still exist at the service input level. The current regulatory framework already guides distributors to choose to deliver services in-house or procure components of service delivery from third parties as most efficient and prudent in the relevant circumstances. Regulation should not pre-emptively prescribe that outsourcing will always be efficient and prudent.
- Existing customers could continue to be protected from a service pricing perspective:
 - Existing regulatory price oversight of network services could continue to apply to SPS supplied services. The AER would continue to exercise the direct price / revenue oversight it applies to grid supplied network services, avoiding the need to design new pricing regimes.
 - Consideration will be needed on the treatment of parts of SPS supply involving generation, direct customer relationships and billing / retailing. Practicality will be needed given that:
 - ❖ disconnection from the National Electricity Market may make it impractical to simply transplant competitive market expectations to service provision within a SPS. That is, to require that SPS customers should be able to access retail / generation service providers via a competitive market.
 - ❖ generators within a SPS may in most cases (except perhaps in a large community) be monopolies. Equally, although retailing could potentially be competitive, the administrative complexity of retail competition given monopoly generation and network provision may be inefficient.
 - ❖ it may be practical to simply subsume all costs of SPS assets (lines, wires, generation / storage etc) and any operating / maintenance and administration within a regulated tariff that the distributor provides directly to the SPS customers.

³ The AER has recently interpreted 'economic life' to be "when the total cost of providing the required service from the asset no longer represents the lowest long run costs to customers of providing that service (i.e. after considering alternatives). AER, *Draft industry practice note—asset replacement planning*, September 2018, p.5

Consideration is needed on the form of consent required in transitioning customers to SPS supply. We are keen to observe the views of other stakeholders on this issue. Our initial view is that practicality is needed:

- As discussed, a key objective should be to maintain all current forms of regulatory oversight applying to essential network service delivery such that customers see no material difference in service outcomes. In some cases, customers may also see no physical difference, as SPS assets might not always be physically located within a customer's premises.
- Where SPS supply is deemed to be efficient, it seems counter to the reform's intent to allow individual customers to be grid-connected and impose more costs than otherwise required on all customers.
- For communities being transitioned to SPS supply, it may be more practical to consider the embedded networks approach of seeking consent of a majority of customers. Alternatively, distributors could simply be expected to consult with customers with adequate lead-in time, as is the case with similar arrangements in New Zealand as noted by the AEMC.

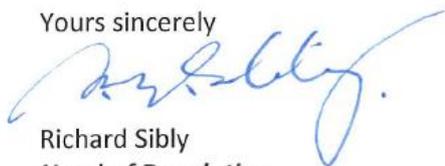
Arrangements for new customers

While the focus of this review is appropriately on regulatory arrangements pertaining to existing customers who may be transitioned to SPS supply, the AEMC's issues paper also queries arrangements that should apply to new customers. In our view:

- It appears that new regulation is not required to send appropriate investment signals to new customers in areas no longer served by grid-supplied energy. New customers seeking grid connection would face what would likely be very material charges for extending the network to their premises, consistent with the AER's Connection Charging Guideline and distributors' Connection Policies. This connection charge could be compared against the costs to the customer of seeking a SPS.
- A more complicated situation may be where a new customer locates in an area in which a large community is now being served a micro-grid SPS. In such cases, the new customer could potentially compare the costs of grid connection vs the costs of either an IPS or connection to the microgrid SPS, where this is a feasible option.

We would be happy to discuss our submission further. If you have questions on any matter we have raised, please contact Bruno Coelho on 08 8404 5676.

Yours sincerely



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