AUSTRALIAN ENERGY REGULATOR

GPO Box 520
Melbourne VIC 3001
Telephone: (03) 9290 1444
Facsimile: (03) 9290 1457
www.aer.gov.au

Our Ref: **D19/35135**
Your ref: **EMO0037**
Contact Officer: **Olivia Boyd**
Contact Phone: **02 6243 1248**

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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 frameworks for stand-alone power systems - Priority 2

Thank you for the opportunity to comment on the AEMC's *Review of the regulatory frameworks for stand-alone power systems – priority 2* consultation paper. We welcome the AEMC's review and acknowledge the need for an appropriate regulatory framework for establishing and operating third-party stand-alone power systems (SAPS). From our work engaging with stakeholders across multiple aspects of the current regulatory framework, we see how increasing commercial availability and reducing costs of microgrid technologies is creating demand amongst customers for alternative forms of supply, even if that means disconnecting from the grid.

We commend the assessment framework that the AEMC has adopted for this review. That is, starting from first principles to assess the role of regulation, if any, in third-party led SAPS, and the extent of regulation where it is justified. We recognise that SAPS are likely to be provided to customers as a vertically integrated service offering in many cases. As such, care will be needed to retain appropriate consumer protections available under the National Energy Retail Law (NERL). With respect to consumer protections and safety, we suggest that a preferable assessment framework may be to start with on-grid arrangements and remove or adapt regulations that are clearly unsuited to SAPS.

We see merit in examining a nationally consistent framework for regulation of third-party led SAPS, to the extent that this is possible. This would help to reduce barriers to entry for SAPS providers and give customers greater choice between different providers as a result. However, we recognise that harmonisation of regulations across jurisdictions should not be an end in itself: the long-term benefits to customers must outweigh the cost of transitioning from current arrangements.

In appendix A to this submission, we provide further comment on the AEMC's assessment framework, customer consent for the creation of a SAPS, and the seven areas of regulation discussed in the AEMC's consultation paper.

We look forward to working with the AEMC on developing an appropriate regulatory framework for third-party led stand-alone power systems.

Yours sincerely,

Angela Bourke
A/g General Manager, Consumers and Markets

Attachment A

Assessment framework for the regulation of third-party stand-alone power systems

As noted in our cover letter, we see merit in the assessment framework that the AEMC has adopted in the consultation paper. We can see that in some respects a scaled down version of regulations that would otherwise apply to on-grid customers under the NEL and NERL would be appropriate. This reflects a number of factors, some of which are quite distinct from the assessment framework informing priority 1 of the AEMC's review, on DNSP-led SAPS. The decision to create/enter a SAPS reflects a customer exercising their choice between different modes of electricity supply (i.e. on-grid, embedded network, IPS, or SAPS supply) in a competitive market. By contrast, not all customers on the grid have the option to create/enter a SAPS. For example, renters and customers on low incomes have little practical choice between different models of supply and will continue to rely on the traditional grid to provide essential electricity services. Moreover, many customers who choose to enter a SAPS may do so because they want to achieve objectives that are not well met by on-grid arrangements. Regulations should allow sufficient flexibility for customers to negotiate supply arrangements with SAPS providers that meet their specific objectives. In addition, the small scale of SAPS and potentially the smaller scale of SAPS providers compared to on-grid authorised retailers may also justify a 'lighter touch' regulatory framework in some cases.

In addition to the assessment framework set out by the AEMC in the consultation paper, we suggest a number of other factors for the AEMC to consider.

The customer consent process for the creation of a SAPS is an important area of regulation that we consider requires further consideration. A regulatory framework for customers consent to transition from the DNSP's network to a third-party led SAPS has been addressed in the AEMC's *Review of the regulatory frameworks for stand-alone power systems – priority 1* draft report. However, we suggest that customer consent and information disclosure issues may be important in the context of a greenfield SAPS and customer entry into an existing SAPS. We provide further comment on this below.

As this review process progresses, we recommend that the AEMC consider whether an eventual regulatory framework for new SAPS could also apply to existing third-party led SAPS.

We suggest that the AEMC consider what regulations should apply to microgrids that retain a connection to the grid, but which are designed to operate in island mode for a significant proportion of the time. A number of project proponents have approached us seeking regulatory advice on microgrid projects of this sort, mostly in the context of retail and network exemptions. In considering these project proposals, we find that we have few practical mechanisms to allow such proposals to go ahead. For proponents, it is often not clear what regulations their projects would need to comply with, or how the AER might interpret and apply existing regulations to their proposal. We recognise that grid-connected microgrids are outside of the scope of the SAPS review. Nonetheless, the regulatory issues presented by grid-connected microgrids that are intended to operate in island mode on a frequent basis bear some similarities to the regulatory issues presented by disconnected SAPS.

Customer consent

We support the AEMC's approach to customer consent for a transition to third-party led SAPS, as outlined in the SAPS Priority 1 draft report, namely that:

- 100% of customers should consent to a transition
- explicit informed consent should be obtained, and it should be obtained in writing
- the SAPS provider should disclose information relating to: (1) the third party; (2) the SAPS system; (3) the SAPS supply model, setting out service and maintenance responsibilities, and; (4) expected consumer outcomes such as prices, service standards, and consumer protections.[1]

We look forward to providing further input on customer consent and information disclosure requirements through future rule making processes. At this stage, we would add that a SAPS provider should be required to provide information to customers about reversion to the grid as part of obtaining explicit informed consent. We expect that in most cases there would be limited opportunity for a customer to revert back to the grid once the customer's local distribution network has been replaced by a SAPS. Reconnection to the DNSP's network would likely come at a significant cost to the customer under the connection charging framework in Chapter 5A of the NER. If explicit informed consent requirements for third-party SAPS were to be required under the NERL, the AEMC might consider whether additional or SAPS-specific requirements are needed to ensure that the level of detail and the accessibility of information that a SAPS provider is required to be disclosed does indeed form a firm foundation for customer choice.

We also suggest that the AEMC consider whether there may be a role for information disclosure requirements and a customer consent process in establishing a greenfield SAPS (i.e. an entirely new SAPS with a newly built network component). We note that the incentives and preferences of parties that build new SAPS (for example, as part of a greenfield residential development) may not align with the incentives and preferences of the eventual occupants of a SAPS. As noted in the AEMC's *Updating the regulatory frameworks for embedded networks* draft report, recently we have seen cases where property developers have created new apartment buildings as embedded networks, and then required newly formed owners corporations to sign long-term fixed contracts with an embedded network service provider arranged by the developer.[2] The AEMC might consider whether customer consent and information disclosure requirements on a third-party SAPS provider may prevent similar 'lock in' of customers to unfavourable SAPS supply arrangements. Similarly, the AEMC could consider whether information disclosure requirements for customers entering new SAPS as tenants or property owners would support informed choice by those customers.

Registration and licensing

We see merit in applying a licensing, registration, or authorisation/ exemption regime for third-party SAPS providers. We think that the current retail authorisation and exemption framework under the NERL could be tailored to accommodate SAPS, where jurisdictions choose to apply the NERL to off-grid areas (as Queensland does currently). Broadly speaking, we think that the framework for embedded networks outlined in the AEMC's

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1 AEMC, *Draft report: Review of the regulatory frameworks for stand-alone power systems – priority 1*, 18 December 2018, pp. 131-132.

2 AEMC, *Draft report: Updating the regulatory frameworks for embedded networks*, 31 January 2019, p. 25.

Updating the regulatory frameworks for embedded networks draft report could form a reasonable starting point for market entry regime for third party SAPS.

As noted in the AEMC's consultation paper, the AER already regulates market entry for third-party SAPS providers in Queensland, under the *AER (Retail) Exempt Selling Guideline*. For example, we have granted exemptions to RTA Weipa, Stradbroke Island Beach Hotel, and we are currently assessing an exemption application from Tangalooma Island Resort Pty Ltd. Through individual retail exemptions, we have had the flexibility to tailor the terms of a retail exemption to a particular SAPS. As the AEMC notes in its consultation paper, when we granted an individual exemption to RTA Weipa we tailored some NERL obligations that would have otherwise applied to account for the applicant's unique circumstances, such as the fact that RTA Weipa does not have the legal right to enter a customer premises to perform meter reads.[3] For jurisdictions that adopt the NERL for off-grid areas in the future, having a flexible mechanism to tailor the terms of an exemption or authorisation within a future regulatory framework would allow the AER to respond to emerging business models with proportionate regulation.

We expect that independent power systems (IPS) would not meet the definition of 'sale of energy' under the NERL in cases where a customer purchases an IPS from a provider (including through a long-term financing or repayment program). We agree with the AEMC that provision of an IPS is unlikely to require a sophisticated market entry and exit regime. Should providers structure an IPS product offering in a way that meets the definition of 'sale of energy' under the NERL, a potential model for regulation of this sale arrangement could be exemption class R8 in the Retail Exemption Guideline, which applies to PPA arrangements in embedded networks.

Third party access and connections

We support regulations that give SAPS customers access to generation and retail competition to the greatest extent possible. It will be important for customers to have the option of obtaining supply from another provider if they become dissatisfied with the incumbent SAPS provider. Equally, we would support regulations that minimise the barriers to exit for SAPS customers, so that they can choose from a range of alternatives to the incumbent SAPS provider, including installing an IPS, reconnecting to the grid (where possible), or seeking supply from a third-party.

We think that third-party access can reasonably be scaled to suit the needs of different SAPS arrangements. We agree that a third-party access regime modelled on Part IIIA of the CCA may be a good starting point for a third-party access regime that is a scaled down version of on-grid network access arrangements. This could involve establishing benchmark pricing or model terms and conditions, which could then be negotiated by an access seeker. A third party access regime would need to be structured with the understanding that the incumbent SAPS provider will likely provide a vertically integrated solution for customers in most cases.

We would prefer to allow third-party access to apply as widely as possibly to all microgrid SAPS. But we acknowledge that there are a number of risks that could limit the effectiveness of a third party access regime in stimulating competition within a SAPS. For example, it is

[3] Further detail is provided in the RTA Weipa case study in our submission to the EMTPT consultation on regulatory implications of stand-alone energy systems in the electricity market, 4 October 2016.

possible that administrative costs of a third-party access regime could be considerable, particularly for smaller SAPS of (for example) a handful of customers. A more 'light-handed' third-party access regime may not offer customers the same ease of switching between service providers compared to on-grid retail competition. As such, third-party access regime may not be sufficient to protect customers from poor customer service or excessive pricing by an incumbent SAPS provider, even with the availability of a dispute resolution mechanism. While a third party access regime could provide some recourse to alternative supply options for customers, the overall effectiveness of a third-party access regime would need to be monitored over time.

We support establishing supply obligations for SAPS providers, as well as regulations to govern connection charging. In most cases, we expect that a SAPS will replace a DNSP's local network that would have otherwise existed close to a customer's premises. This means that many SAPS customers will have little practical choice between connecting to the DNSP's network or connecting to a SAPS. We therefore consider that a requirement for a SAPS provider to supply customers within a defined geographic SAPS boundary is appropriate.

On the same basis, we also consider that there is a case to establish regulatory obligations to govern a SAPS provider's connection charging practices. Absent such restrictions, a SAPS provider may be incentivised to charge customers up to the cost of alternatives to connection (such as the cost of an IPS or the cost of connecting to the DNSP's network), rather than a connection charge that reflects the true cost (or benefit) that an additional customer has for a microgrid.

We note that the AEMC's *Updating the regulatory frameworks for embedded networks* draft report proposes a supply obligation and connection charging process for embedded networks that could also be appropriate for SAPS.[4]

Economic regulation

The AEMC's consultation paper outlines a spectrum of options for economic regulation of third-party SAPS. We think that market power risks inherent in third-party led SAPS can likely be mitigated with 'light handed' economic regulation in many cases. Given that most third-party led SAPS are likely to be relatively small, we see few occasions where 'full regulation' (for example, involving vertical separation and a regulated network component) would be warranted.

Price and billing transparency would be an important form of 'light handed' regulation, to allow customers to negotiate with their SAPS provider over pricing. We consider that NERL retail obligations with respect to billing format and accuracy, information that must appear on a bill, and price information disclosure would support this transparency (for jurisdictions that adopt the NERL for off-grid areas).

The AEMC suggested a range of additional pricing-related regulations that could apply to a SAPS, such as requirements for SAPS provider to publish reasons for changes in prices, limitations on the allowed reasons for which a SAPS provider can increase prices, and/or limitations on the allowed rate of price increase over a given period. Given that a light-handed third-party access regime may not offer customers the same competitive pressure as

[4] AEMC, *Draft report: Updating the regulatory frameworks for embedded networks*, 31 January 2019, pp. 91-103.

full retail competition after a SAPS is established, some additional controls on pricing may be justified. These sorts of light-handed pricing-related regulations could also smooth out the impact on customers of the lumpy investment cycle that will likely characterise many smaller SAPS (for example when an important SAPS component needs to be replaced). However, any such framework would need to be flexible enough to allow for exceptions, possibly subject to a customer consent process.

Setting regulated retail prices for SAPS customers (a form of 'full regulation') would likely be resource-intensive and costly for the relevant regulator. Regulated retail prices would also be unlikely to give customers the flexibility to make their own trade-offs between price, reliability, and other objectives that might motivate the creation of a SAPS in the first place.

Consumer protections

We consider that SAPS customers should have the same level of protection that they would have if there were on the grid, where possible. Maintaining these protections will be important, as a customer's power to negotiate appropriate consumer protections on an individual basis may be reduced once long-term supply arrangements have been established and implemented for a given SAPS.

For jurisdictions that have adopted the NERL for off-grid areas (such as Queensland), an appropriate subset of NERL consumer protections could be extended to SAPS customers as part of a broader SAPS regulatory framework. For example, the core conditions for retail exemptions (which are based on NERL protections) could serve as a starting point to consider what protections could apply to SAPS customers. Nonetheless, our view is that the framework should be flexible enough to adapt consumer protections where necessary. Where a lesser degree of protections is proposed as part of the conditions of entry into a SAPS, this should be subject to customer consent.

Microgrids that involve control of a customer's behind-the-meter distributed energy resources (DER) or smart appliances by a SAPS provider could pose new kinds of customer protection issues. For example, a SAPS provider may seek to limit its customers to buying certain brands of appliances or DER in order to integrate them into the SAPS control system. Similarly, SAPS customers may enter into agreements with a SAPS provider that gives them less control over how and when they use individual appliances within their premises. While some of these issues may already be covered under existing law (e.g. exclusive dealing provisions in s. 47 of the CCA), we note that potential consumer protection issues arising from the integration of consumer appliances with the operations of a SAPS may need to be monitored over time.

Reliability of supply

We support a regulatory framework that gives SAPS customers certainty over reliability of supply, and that requires SAPS providers to meet minimum reliability standards. Where an integrated SAPS relies on control and coordination of behind-the-meter customers assets, it is possible that a SAPS operator may restrict customers' use of their appliances in an effort to reduce electricity demand. In some cases, where demand must be significantly altered to meet available generation in the SAPS, this may restrict the value that a customer derives from those appliances. A definition of reliability may need to take this into account.

We note that reliability is usually a matter for jurisdictional regulation. Nonetheless, consistency between jurisdictional standards for SAPS reliability may lower the barriers to entry for SAPS providers, as they are likely to be smaller firms with less capacity to comply with differing state regulations.

Network operations and system security

Metering accuracy standards provide an important mechanism for customers to have confidence in their billing data. We consider that standards for metering accuracy that apply to on-grid customers under the NEL should also apply to SAPS.

We consider that SAPS customers should have the flexibility to determine their own settlement processes. For example, some SAPS customers may wish to adopt specific types of settlement processes (such as distributed ledgers or blockchain) as part of going off the grid. The AEMC could consider whether there should be a requirement for settlement processes to allow for third-party access, so that settlement does not become a barrier to competition if and when SAPS customers seek supply from another party.

Safety

We support appropriate safety regulations for SAPS. Safety requirements in the AER's *Electricity NSP Registration Exemption Guideline* are adapted from jurisdictional safety regulation, and our view is that jurisdictional regulators are best placed to administer safety regulation where possible. As with other areas of jurisdictional regulation, we expect harmonising state-based regulation as much as is practicable would allow access to a more competitive market for SAPS services.