Government of South Australia
Department for Energy and Mining

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

***Review of the Regulatory Frameworks for Stand-alone Power Systems – Priority 1 Draft Report (EMO0037)***

Dear Mr Pierce

The Energy and Technical Regulation Division of the Department for Energy and Mining, South Australia (Division) welcomes the opportunity to comment on the Draft Report (Report) for the Review of the Regulatory Frameworks for Stand-Alone Power Systems (SAPS) – Priority 1 published by the Australian Energy Market Commission (AEMC).

The Division notes that the Report focuses on the first priority of the COAG Energy Council which is how part of the interconnected grid can transition to a standalone energy system where this is appropriate.

The Division is generally supportive of the AEMC's review and considers that with changes in technology and their associated costs, there is likely to be increased interest by consumers in the opportunities presented by SAPS. Additionally, and increasingly, as distribution network service providers (DNSP) face major replacement expenditure for remote network areas, consideration of SAPS and whether such a system would be more economic to service those areas on a standalone basis. As such, it is appropriate for the AEMC to consider the appropriateness of the frameworks that regulate these systems.

The Division agrees with the AEMC that the fundamental objectives of the review are to ensure SAPS can be used as an alternative to grid supply, whilst preserving consumer protections comparable to those afforded to grid connected supply.

The Division supports jurisdictional opt-in provisions for any national framework for the regulation of SAPS. This reflects the fact, as noted by the AEMC, that jurisdictions have a wide range of geographical and environmental factors to consider. In addition, there is considerable difference in the completeness of existing jurisdictional frameworks for SAPS. South Australia for example, has a well-developed framework administered by the Essential Services Commission of South Australia through

licencing arrangements. The licencing framework allows for flexibility depending on the characteristics, size and purpose of the SAPS.

As such, it is important that jurisdictions can evaluate any future national framework for SAPS and determine if opting in is the most appropriate action, after considering local factors.

The following more specific comments relate to the transition of network customers to a SASP. The Division does not necessary consider that the same framework principles apply for new customer SAPS.

*Decision to transition customers to a SAPS*

The Division supports the AEMC's view that any new measures in relation to distribution network planning and reporting should:

- Support DNSPs in the competitive testing of potential SAPS solutions which, once complete, will identify whether a SAPS solution provides the most efficient means of addressing a need to replace or upgrade existing parts of a DNSP's distribution system; and
- Promote the long-term interests of consumers by strengthening the engagement between DNSPs and parties (including customers) who may be affected by the decision to transition customers from grid supply to SAPS supply.

The Division considers existing network connected customers should only be transitioned to a SAPS solution if the DNSP identifies that a SAPS solution is the most efficient means of addressing a need to replace or upgrade parts of a distribution system.

As such, the Division agrees in principle the existing RIT-D and associated consultation process should be used to test the efficiency of non-network SAPS solutions proposed for projects which meet the RIT-D cost threshold (and are not otherwise exempt projects).

However, as noted by the AEMC it is likely that significant amendments to the National Electricity Rules (NER), the RIT-D and the RIT-D application guidelines developed and published by the Australian Energy Regulator (AER) will be required to recognise that SAPS are not connected to the interconnected grid and largely operate independent of the National Electricity Market. The Division looks forward to the AEMC's detailed consideration of such amendments.

For smaller projects where a SAPS is identified as the most efficient solution to address a need, but the project is not eligible for assessment under the RIT-D, the Division supports the AEMC's view that DNSPs should be required to ensure that the investment required to address the identified need is planned and developed at least cost over the life of the investment.

The Division supports the development of minimum SAPS project evaluation requirements to support such projects. These requirements should be developed to provide transparency around the assessment of smaller SAPS projects and ensure that the most efficient SAPS solution is provided.

Whilst supportive of the RIT-D and minimum evaluation requirements processes, the Division considers that further consideration should be given to the role of the AER in the decision process.

Assessment of a SAPS is likely to be complex:

- It will require consideration of technologies that are outside of a DNSP's normal business operation.
- There may be limited information about the performance of some technologies in Australian conditions (for example, the performance of batteries in extreme heat).
- Location will be a significant factor in determining the needs of a SAPS and has the potential to vary costs significantly (i.e. accessibility, security).
- It will require consideration of the counterfactual, which will include various assumptions and forecasts on further wholesale energy and retail costs.
- Community growth or reduction can also be a significant influencer of SAPS costs.

The AEMC may wish to consider whether the AER should provide guidance to DNSPs on some of these matters to ensure assessments are robust.

Secondly, consumers that DNSP's engage with may have limited energy knowledge or expertise to effectively engage with the DNSP. The Division is also concerned that existing consumer representative organisations with energy experience may not have the capacity to engage on all SAPS assessment processes.

It is for these reasons that the Division considers there may be merit in requiring the AER to approve a RIT-D or minimum evaluation process outcome that recommends that a SAPS is the more efficient solution.

The Division agrees that there are significant challenges associated with any requirement for explicit consent from customers identified for transition from grid-supply to SAPS supply. However, if there is not going to be a requirement to obtain explicit consent then the Division considers that information provision and customer engagement is critical in the transition of customers from grid supply to a SAPS.

*DNSP implementation of a SAPS*

The Division supports DNSP-led SAPS for existing network connected customers where it is the most efficient solution.

The Division shares the AEMC's concerns regarding the use of SAPS by DNSPs to facilitate new connections as this could have negative impacts on the development of a competitive SAPS market, as DNSPs are able to leverage cross subsidies.

The Division considers that new connections should be able to be made to pre-existing DNSP-led SAPS, to allow DNSPs to meet their connection obligations, where it is efficient to do so.

Noting that the AEMC's proposed approach to achieve this is to redefine the DNSP's network to include pre-existing stand-alone systems, the AEMC must ensure that this

does not inadvertently impact on existing stand-alone systems that are operated by third parties and regulated by jurisdictional off-grid frameworks.

New SAPS, however, should be competitive. The Division does not consider there is any foreseeable circumstance in which a DNSP-led SAPS comprising of new customers is needed. For clarity, the Division has no concerns with a ringfenced business being involved in the competitive SAPS market. The concern of competition for new SAPS in remote areas is acknowledged, however, we consider there is evidence of existing companies implementing and operating SAPS in remote locations. The Division would therefore not support a role for the AER to approve a DNSP-led SAPS comprising of new customers.

*Review of DNSP implemented SAPS*

Given the current experience of DNSP's implementing SAPS and the complexities discussed above, the Division considers a formal process for the AER to review whether SAPS outcomes are consistent with DNSP assessments and decisions is necessary.

The Division considers that a formal review process is required until there is sufficient and strong evidence that the decision making process is resulting in the outcomes expected.

If the AEMC does not support a formal review process, the DNSP must at least be required to publish regular reporting on SAPS outcomes compared to the assessment and decision.

This information and visibility will be essential for consumers and stakeholders to make informed decisions on further SAPS proposals.

*SAPS service classification and delivery*

The Division supports DNSPs being able to recover expenditure on SAPS from regulated revenue. This is to ensure that outcomes for transitioning customers are not reduced by moving them to a SAPS.

It is noted that the current framework affords the AER discretion in how it classifies activities and services provided by DNSPs. The Division considers this discretion is appropriate in the current framework and should be consistent for SAPS also. The Division looks forward to the AEMC's further considerations on the benefits of providing the AER with additional guidance on how SAPS activities and services should be classified.

The Division is broadly comfortable with the positions outlined in the Report regarding the role of DNSPs and the associated ring-fencing provisions. It is appropriate that SAPS assets are considered as in-front of the meter, consistent with the services being provided by a DNSP to a connected customer.

In regard to non-network services, such as generation, the Division does not foresee any need for the DNSP to provide such a service. There is strong evidence of companies already providing generation and other non-network services in remote

areas. For clarity, the Division has no concerns with a ringfenced business being involved in providing non-network services. The Division therefore does not support the AER being provided with any powers to grant exemptions.

Service Delivery Model

Selection of the service delivery model will be the most important decision in relation to whether or not the framework achieves the goal that outcomes for consumers being transitioned to a SAPS should not be lessened.

In developing the most appropriate model, the Division considers the starting point should be retention of the existing arrangements with as little change as possible and at lowest cost.

The NEM consistency model appears more appropriate to deliver the goal. The Division considers, however, that there is a significant risk that the NEM consistency model will distort the wholesale electricity market. The SAPS load has no bearing on the wholesale electricity market and therefore if it in any way is accounted for, it will have an impact.

The purest model would be the integrated service delivery model. The Division agrees, however, that this may be a costly model with significant burden and costs associated with regulatory oversight and administration.

The Division therefore considers the delivery model most likely lies somewhere in the middle.

The AEMC should consider whether the following arrangements are workable:

- Transitioned customers continue their existing retail arrangements and full access to generally available offers in the same manner they do today.
- For transitioned customers, retailers would transfer to the DNSP the usual network tariff costs as well as a wholesale electricity cost component.
- The wholesale electricity cost component would be calculated as the SAPS customer load at the average spot price for the particular month (this is to reduce the requirement for retailers to hedge for SAPS customer load).
- The DNSP would be responsible for contracting the SAPS generation from the competitive market and transferring the required generation costs as set out in the contract.
- Generation cost overs and unders would be accounted for and shared through the DNSP economic regulation process (this should inventive the DNSP to negotiate efficient generation outcomes), limiting cross subsidies on other customers.

*Application of consumer protections*

The Division acknowledges that retail price protection may be warranted for transitioned customers if the AEMC cannot find a workable model which allows transitioned customers to access generally available retail offers.

It is unlikely that any form of price regulation will ensure that the outcomes for every transitioned customer are not lessened.

In the past Standing Contract rates have been used for price protection of embedded network customers. In this circumstance, Standing Contract rates would not be an appropriate form of protection, as they are likely to result in most SAPS customers paying a greater amount than they currently do.

The COAG Energy Council agreed to task the AER with development of a reference price for retailers to use when making offers to consumers. This is similarly unlikely to be suitable, as South Australia expects the AER to develop this reference price using a top down approach based on standing contract rates.

When South Australia had retail price regulation, a bottom up approach was used to determine a regulated price. As each SAPS is likely to have substantially different costs, this approach would be administratively burdensome.

The Division considers that consideration should be given to a median market offer rate. This would ensure a fair price for transitioning customers.

In regard to other consumer protections, the Division supports the AEMC view that consumers who move to off-grid supply in DNSP-led SAPS should receive equivalent levels of consumer protections that they previously received as a grid-connected customer.

However, the Division agrees that the full suite of protections in the National Energy Retail Law and the National Energy Retail Rules may not be appropriate for all types of SAPS, depending on the supply model chosen and if retail competition is possible or not.

The Division also notes that it is important that under any model proposed by the AEMC, sufficient consideration must be given to arrangements for customers suffering hardship and those most at risk, such as customers dependant on life support systems.

We also support current jurisdictional consumer protections (such as access to concessions and rebates, access to energy ombudsman schemes etc.) extending to DNSP-led SAPS arrangements.

There may also be some protections specific to SAPS customers, over and above those that currently exist. The Division considers that information should be provided to consumers in regions where the DNSP is considering a transition to a SAPS. In addition to the requirements provided in the AEMC's draft report, this information should include discussion on the DNSP's ability to transition the customer with or without consent. The AEMC should also consider whether similar information provision requirements are necessary for new customers or connections to a SAPS, and how these could apply.

It is also critical that any framework provides for information to be provided to customers once a transition to a SAPS has been determined. This should contain

further information on the nature of the SAPS the customer will be connected to and their rights as customers connected to the SAPS. It may also contain the specific tariffs that will apply, as well as the methodology used to determine these rates.

Finally, the Division supports the AEMC's view that customers of DNSP-led SAPS should receive reliability protections equivalent to grid-connected customers. We consider this an important feature of the transition to any SAPS framework as this would ensure a degree of confidence amongst those consumers potentially transitioning to a new method of supply.

While the exact standards will not be appropriate for SAPS customers, the Division supports consideration by each jurisdiction on their reliability requirements and how these may apply in a SAPS framework, including a potential SAIDI and SAIFI target for a SAPS feeder, and a review of appropriate GSL payments.

The Division does not however support the ability to negotiate lower levels of reliability in return for lower prices. We consider the transition to a SAPS framework to be sufficiently complex for consumers without the introduction of bespoke reliability standards.

*Transition to Third Party SAPS*

The Division is generally supportive of the AEMC's draft position in relation to the decision-making framework for customer transition to a third-party SAPS. That is, the third party should obtain the Explicit Informed Consent of all relevant customers in written form, and the requirements of that consent should include detailed information about the third party, SAPS solution, and additional conditions related to service delivery and outcomes under a third-party SAPS supply model.

In relation to asset transfer and stranded assets the Division supports the AEMC's view that the third party should compensate the DSNP for costs related to stranded assets as a result of the transition under AER guidance and that the national framework should also set out provisions for the AER to account for any asset transfer, re-allocation and stranding in the DNSP's regulatory accounts.

The Division looks forward to the AEMC's further consideration of these important matters over the remainder of the review.

Should you wish to discuss the submission in further detail, please contact Mr Mark Pedler, Principal Policy Officer, on (08) 8429 3361.

Yours sincerely

**Vince Duffy**
Executive Director
Energy and Technical Regulation
Department for Energy and Mining