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29 March 2019

Sherine Al Shallah
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear Ms Al Shallah

EMO0037 – Essential Energy submission on the consultation paper – Review of the regulatory frameworks for stand-alone power systems - Priority 2

Thank you for the opportunity to provide a submission to the Australian Energy Market Commission's (AEMC or Commission) consultation paper published on 1 March 2019 as part of the Review of the regulatory frameworks for stand-alone power systems priority 2 (the review).

Stand-alone power systems (SAPS) are set to become a more prominent feature of the energy market in Australia and will be provided by a number of different parties. Essential Energy supports the development of a competitive market for third-party SAPS provision, subject to robust regulatory requirements to ensure positive outcomes for energy consumers.

Essential Energy agrees with the Commission's position that there should be consistency between the regulatory arrangements in place across different supply models, namely SAPS provided by distribution networks, SAPS provided by third parties and embedded networks. We encourage the Commission to focus on achieving consistent outcomes across all three reviews.

Ensuring that SAPS systems are safe, reliable and to an appropriate standard should be the primary focus of this review. Another important element is that customers are aware of and understand their rights with respect to SAPS supply and that any risks or trade-offs associated with moving to off-grid supply provided by a third party are clearly articulated and understood by the customer.

Finally, we note that the Commission is considering whether regulatory arrangements for individual power systems may need to be different than for microgrids with larger customer numbers. We support the principle of having a regulatory regime that is proportionate to the costs and risks involved. We encourage the Commission to consider this principle of proportionate regulatory responses in the context of Priority 1 of this review.

Our response to the issues raised in the consultation paper is attached to this letter. If you have any questions in relation to this submission, please contact Therese Grace, Regulatory Strategy Manager on 02 9249 3121 or therese.grace@essentialenergy.com.au.

Yours sincerely

A handwritten signature in black ink that reads "Chantelle Bramley".

Chantelle Bramley
General Manager, Strategy Regulation and Transformation

Essential Energy submission to the consultation paper

General comments

Consistency across regulatory arrangements

Essential Energy agrees with the Commission's position that there should be consistency between the regulatory arrangements in place across different supply models, namely SAPS provided by distribution networks, SAPS provided by third parties and embedded networks.

We agree with the Commission's concerns regarding the risk of "forum shopping" if the arrangements for one type of supply arrangements are not as comprehensive as others. The Commission should seek to achieve consistent outcomes for customers regardless of how their energy is delivered and who supplies the energy services.

Principle of proportionate regulation

Essential Energy notes that two of the assessment criteria chosen by the AEMC for Priority 2 of the Review are:

- Are the regulatory arrangements proportional to the risks they seek to mitigate, such that the framework balances the costs of regulatory arrangements with their expected benefits?
- Do the regulatory arrangements promote efficient investment and allocation of risks and costs?

Throughout the consultation paper the AEMC makes the point that the arrangements that are put in place for individual power systems (IPS) may not need to be as onerous or as complex as those for microgrids.

Essential Energy agrees that the complexity of the SAPS system may have implications for the degree of regulatory oversight required. This is to ensure that the costs of regulation do not outweigh the benefits to consumers.

We also note the Commission's recognition that in some cases consumers should have the ability to make informed choices regarding their electricity supply arrangements. This may be the choice of what level of reliability they want or whether they want to own and operate their own system or have a SAPS provider and retailer involved in their energy supply arrangements on an ongoing basis.

Given that the principle of proportionate regulation should apply regardless of who the SAPS provider may be, Essential Energy considers that this should also be a factor in considering the service delivery model as part of Priority 1 of this review. Essential Energy recognises the importance of engaging with customers and recognises the trade-off to be made between having specific arrangements in place for simpler IPS installations and the need for customers to be informed and aware of the consequences of the changes in how their energy is supplied.

In our submission to the draft report we outlined an integrated service delivery model that is used in New Zealand.¹ This model is inherently simple and involves the DNSP providing the customer with a SAPS, charging an annual fee based on the cost of maintaining this system and the customer is responsible for the provision of diesel to fuel the back-up generator.² Further consideration should be given as to whether this model is an appropriate and proportionate solution for customers with an IPS in remote areas, provided the appropriate information provision and consumer consent requirements are in place.

This model may represent one end of the spectrum of circumstances where SAPS may be deployed by the DNSP, for example for small numbers of customers in remote or hard-to-access areas. The service delivery model may need to be different in circumstances where there are larger numbers of customers involved. It could therefore complement other supply models that more closely align with

¹ See pages 5-6 of Essential Energy's submission to the Priority 1 draft report for more detail on the New Zealand integrated service delivery model.

² Although, as noted in our submission the DNSP could also provide the diesel and charge the customer for this service.

current NEM arrangements and where explicit customer consent may not be required. We encourage the Commission to undertake further stakeholder consultation on this issue.

Difficulties in defining a microgrid

The Commission makes numerous references to having different arrangements for IPS and microgrids. To have separate arrangements in place it will be necessary to define what constitutes a microgrid.

Having a clear definition in place is important as requirements to register as a third-party SAPS provider or to obtain a licence to operate will be an important enabler of other aspects of the regulatory framework, for example imposing reliability standards or obligations to connect new customers.

Defining a simple threshold for a microgrid (based on an arbitrary number of customers) would be problematic. A number of criteria should be assessed in defining a microgrid, these may include:

- the number of customers;
- the types of customers and size of the system;
- the generation assets involved;
- the complexity of the relationship between in the microgrid, for example if there is trading between customers in the microgrid or shared assets such as a community battery;
- the scale of network assets in the SAPS (if there is still significant “poles and wires” type infrastructure that requires maintenance and repairs);
- whether the SAPS system crosses a property boundary;

It may also be necessary to have more than one category of microgrid for the purposes of defining an appropriate and proportionate regulatory regime. For example, the arrangements that are required for a microgrid of 10 customers may be different than those required for a large microgrid of several thousand customers.

Comments on specific issues raised in the consultation paper

Continuity of supply and operator of last resort

As electricity is an essential service, ensuring that customers do not face supply interruptions as a result of the insolvency of their SAPS supplier will be an important consumer protection for third-party SAPS customers.

In designing any operator of last resort scheme for third party SAPS the costs and risks involved need to be carefully weighed up to ensure that the costs of the scheme are not too high but that there are protections in place for customers in the event that their provider becomes insolvent.

Essential Energy agrees that a formal operator of last resort scheme may not be appropriate in the case of IPS or smaller systems. In these cases, insolvency risk may be managed through contractual arrangements or insurance products.

If the local network service provider (LNSP) is the party that is designated as the operator of last resort for larger microgrids a number of factors would need to be considered:

- The LNSP should have information about the technical specifications of the microgrid if it is to be responsible for taking over operation in the event of insolvency of the third-party provider.
- The reliability standard that the LNSP would be required to meet would need to be considered. The LNSP should only be required to meet the reliability standard agreed between the third-party microgrid provider and the customers in that microgrid.
- Arrangements should be in place for the LNSP to recover any costs associated with being the operator of last resort. There are precedents for this in the current regulatory framework as any costs associated with the retailer of last resort (ROLR) arrangements are subject to pass-through provisions.

It is important that the third-party SAPS provider should bear some cost for an operator of last resort scheme. This is for two reasons. Firstly, if there is no cost to the SAPS provider there may be issues related to moral hazard because third-party SAPS providers would know that another party would step in in the event of their failure. This may incentivise operators to take risks that they would otherwise not take if they knew there would be consequences from becoming insolvent. The regulatory framework should not incentivise short-term business models that are not in the long-term interests of consumers.

Second, the LNSP's customers should not bear any cost associated with the third-party SAPS. This would be an unfair cross-subsidy between customers. The costs associated with establishing the operator of last resort scheme could be levied as part of the registration or licencing process for third-party SAPS providers.

Obligation to connect

To ensure consistency across supply models, third-party SAPS providers should be obliged to provide new customers with an offer to connect, that reflects the cost of that connection. If not, inefficient outcomes may result where a customer's connection costs are far higher than they need to be because they cannot access the third-party SAPS, even if this is the closest electricity infrastructure to the new connection. This may occur in areas where some parts of the network in remote areas has been transferred to a third-party SAPS and there is no longer any network infrastructure left in the area.

Essential Energy would also note that in the embedded network review draft report the Commission has proposed that embedded network service providers (ENSPs) will now have an obligation to offer to connect new customers within their defined geographical boundary. To not impose the same requirements on third-party SAPS would be inconsistent and would not conform to the Commission's stated aim to avoid the risk of "forum shopping" between regulatory arrangements for different supply models.

We further note the Commission's discussion that electricity is an essential service which requires special consideration, even if it is supplied by a third-party operating in the competitive market. To ensure that all customers have access to the essential service of electricity, an obligation on third-party SAPS providers to provide an offer to connect is appropriate.

Placing an obligation on third-party SAPS providers to provide an offer to connect would enhance consumer choice as a connecting customer would have the choice between:

- Connecting to the local DNSP's network (either the main grid or existing DNSP SAPS).
- Connecting to the third-party SAPS.
- Procuring their own SAPS.

Economic Regulation

In Priority 1 of this review, the Commission has taken the position that customers should not be disadvantaged by a move to off-grid supply via a SAPS. This includes the notion that customers that are transitioned to a third-party SAPS should not pay more relative to grid-supplied customers. There is no reason why this principle should not also apply to customers who transition to a third-party SAPS supply arrangement.

For larger microgrids that are subject to licencing and registration requirements some form of economic regulation, in the form of price regulation, may be appropriate. This would also be consistent with the position taken in the embedded network review where ENSPs are prohibited in charging network charges that are higher than those of the LNSP.

For these larger microgrids, requirements around price disclosure as well as a form of price monitoring could be developed. The AER's default market offer could be used as a price cap or jurisdictional regulators could set a reference rate for microgrid customers.

This approach would strike the right balance between transparency of the price a SAPS customer would pay as well as making sure that this price does not increase disproportionately over time while

not being overly onerous or complex to administer. Further consideration would be required as to who is the appropriate party to administer the price controls as this would depend on other aspects of the regulatory regime, for example if licencing was done at the jurisdictional or national level.

Reliability of supply

Essential Energy agrees that SAIDI and SAIFI measures are not appropriate for smaller SAPS as customer numbers are likely to be too small for the calculation of these metrics. Consideration may be needed as to a threshold number of customers over which these measures may apply, for example if a large town with thousands of customers was taken off-grid by a third party. Further, SAIDI and SAIFI measures may also be appropriate in large microgrids with significant network assets that mean that supply is a system and failures can result in small segmented outages.

For smaller SAPS, availability and repair time measures may be more appropriate measures of reliability. It will be important that customers are aware of the reliability outcomes that they should expect from their third-party provider and have recourse to a process to rectify poor performance if these standards are not being met.

Essential Energy notes that approach adopted by the Essential Services Commission of South Australia mentioned in the consultation paper. Under this framework the SAPS provider would have to “use best endeavours to minimise the frequency and duration of supply interruptions”. There is an obligation to report on reliability outcomes and if there are continued issues with reliable supply the SAPS provider is required to prepare a plan to resolve the reliability concerns. This approach appears to be reasonable and over time a benchmark level of SAPS reliability should emerge to use as a benchmark for what constitutes best endeavours.

Consumer protections

To ensure consistency across supply models the same level of consumer protections should apply to customers regardless of how their energy is supplied or who supplies it. In the Embedded Networks Review and Priority 1 of the SAPS review the Commission has followed the principle of providing customers with the same (or similar) consumer protections as grid-supplied customers. The AEMC would need to clearly outline the reasons why this principle would not be appropriate in the context of third-party SAPS.

Third-party SAPS customers should have access to government rebates and concessions as well as recourse to jurisdictional ombudsman schemes.

Safety

Ensuring safety should be the primary objective of any framework for the provision of electricity services. There can be no compromise on safety outcomes regardless of how energy is delivered and who is providing the services.

Essential Energy considers that arrangements around safety are likely to be the major risk management area in third-party SAPS provision. The Commission should consider how any proposed models would effectively operate under jurisdictional safety regulation, in terms of assurance, inspection, standards and penalties. The Commission could look to determine what ‘best practice’ would look like nationally to assist in developing consistency across the NEM.