

8 August 2019



Ms Alisa Toomey  
Australian Energy Market Commission (AEMC)  
PO Box A2449  
Sydney South NSW 1235

Dear Ms Toomey,

**DRAFT REPORT: REVIEW OF THE REGULATORY FRAMEWORKS FOR STAND-ALONE POWER SYSTEMS (SAPS) - PRIORITY 2, 27 JUNE 2019**

Endeavour Energy appreciates the opportunity to provide this response to the AEMC's draft report into the regulatory framework for third-party SAPS. With off-grid supply becoming an increasingly viable option for customers, a robust framework is essential to promote the competitive provision of SAPS services and to provide customers with a positive supply experience.

The draft report proposes to apply regulation in a proportionate manner through a tiered regulatory framework. We support this approach as it recognises the risk inherent in a SAPS will generally vary with the size of the system. It also provides flexibility to enable fit-for-purpose regulation that balances risk against the cost of compliance whilst maintaining appropriate consumer protections. We also agree that the framework should only apply where there is a sale of energy to a customer by a third-party. For a customer owned SAPS the general consumer protections provided through Australian Consumer Law are appropriate.

However, we believe there are opportunities to refine the SAPS frameworks proposed by the AEMC to better encourage efficient SAPS deployment. These opportunities are discussed in the Energy Networks Australia submission which we support. Below, we provide comments on more specific issues that warrant further consideration by the AEMC.

**Inconsistencies between frameworks incentivises forum shopping**

In determining the regulatory arrangements within each tier, the AEMC has had regard to the frameworks proposed for DNSP-led SAPS and embedded networks. We consider this is prudent as the similarities between frameworks require a holistic assessment to avoid creating unintended regulatory arbitrage opportunities which benefit service providers at the expense of consumer service outcomes.

However, inconsistencies between the frameworks have emerged where it is reasonable to expect greater alignment. In third-party led SAPS, a vertically integrated supply model without access requirements is permitted in the two lower tiers. In DNSP-led SAPS and embedded networks the same obligations apply irrespective of the system size, configuration and overall risk. In our view, these differences are driven by the focus on proportionality in the Priority 2 compared to the focus on preserving competition and consumer protection in Priority 1. We support these principles but consider they should be applied consistently across the alternative-to-grid supply frameworks.

These discrepancies mean that customer outcomes with respect to price, protections and service delivery arrangements will vary with how and by whom SAPS customers are supplied. We are concerned that differences in the compliance burden between frameworks will incentivise service providers to favour the less onerous framework and implement a supply model which may not be the most cost effective and in the long-term interest of customers. "Forum shopping" could lead to inefficient investments and higher than necessary prices for customers. These outcomes could be avoided if flexible regulatory arrangements were applied more equally between the related frameworks.

### **DNSPs should have the opportunity to provide SAPS at the lowest cost**

The “consistency model”, which applies to DNSPs, prohibits direct network involvement in the generation and retail functions of the SAPS. The rationale for this difference is that DNSP-led SAPS do not require customer consent. However, transferring a grid customer to a SAPS without their support would be problematic and in practice only likely to proceed with the implicit consent of the customer.

The objective is to reduce cross-subsidies between existing network connected customers, who could be supplied via a SAPS at a lower cost, and the remaining customer base. In doing so, the DNSP-led SAPS customer is no worse off than their grid-connected supply arrangement.

This contrasts to the flexibility afforded to third-party providers who are free to provide all services on a vertically integrated basis.

Although network customers would pay less following an efficient SAPS transfer, the cost of the protections afforded to SAPS customers by the DNSP-led framework limits these cost savings. Outside of minimising disruption in existing arrangements at the time of SAPS transition, the benefits of maintaining access to retail markets for transferred customers is of questionable value.

The prospect of multiple service providers competing to service a small number of customers in remote locations is limited in all but the largest microgrids. In the absence of workable and effective competition, the consistency model is unlikely to deliver SAPS for existing grid-connected customers at a cost below what could be achieved by a vertically integrated DNSP service. This pragmatism underscores the Priority 2 review which recognises that, for category 2 and 3 SAPS, the costs of preserving access to competitive markets will most likely outweigh the benefits.

We believe the long-term interests of customers would be better served if the DNSP-led SAPS framework focussed on optimising consumer outcomes without bias as to how this should be achieved. Allowing DNSPs to access the same flexible service delivery arrangements as third parties would allow networks to deploy the most efficient investment option and better satisfy the objective of the Western Power rule change request which initiated the AEMC’s SAPS review.

One way this could be achieved is by applying the “consistency model” as the default model for DNSP-led SAPS with the “integrated model” available to DNSPs on the condition that customer consent is obtained in accordance with requirements outlined in the priority 2 report.

### **An Operator of Last Resort scheme should apply to all SAPS customers**

We support the AEMC’s intention to introduce an Operator of Last Resort Scheme (OoLR) and believe it is appropriate to require SAPS proponents to appoint the OoLR upfront to meet the framework’s licensing and registration obligations. However, we do not support intentions to limit the scheme to category 1 and 2 customers only.

Although some customers receiving supply through a category 3 SAPS would have the bargaining power to negotiate a tailored SAPS supply, we do not believe they should be prevented from the protections of the OoLR on this basis. For these customers, electricity remains a basic and essential service and therefore should be provided the same assurances around the continuity of their supply as other customers, especially as they would have no greater ability to avert the likelihood of operator failure than customers of larger SAPS.

As the provision of SAPS services would likely come from a broad range of smaller and less established providers to whom less stringent licensing requirements would apply, the risk of operator failure - and value for an OoLR scheme - is potentially the greatest for category 3 customers.

### **DNSPs are best placed to be the OoLR**

The draft report suggests parties other than the local network service provider should be allowed to compete to provide OoLR services as this would deliver efficient prices. However, for any benefits from competition to flow through to customers willing and capable providers are required to create competitive tension in the market.

We are not convinced that a competitive market for OoLR services would arise given these services will be required haphazardly, often in remote in rural areas for SAPS of varying size and state. Furthermore, if the AEMC consider competition for relatively straight-forward retail and generation services in category 2 and 3 SAPS are unfeasible it is even less likely that effective competition will emerge in the market for riskier and more complicated OoLR services.

In our view, the value of supply security and continuity should take precedence over the limited prospect of a competitive market for OoLR. Any competitively provided OoLR service would introduce a risk of subsequent operator failure which is a considerably less desirable outcome for customers and is contrary to the intent of any last resort scheme.

This risk would be avoided if DNSPs were appointed the OoLR for all third-party SAPS. Given the resources and expertise of network businesses and the comprehensive regulatory regime under which they operate, we expect customers would be more receptive to SAPS proposals if their supply was backed by the local network service provider (LNSP).

However, we are also mindful of the costs and risks borne by network connected customers. These customers should not be unduly burdened with the costs of inefficiency SAPS designs and practices by third party providers.

The design of an effective OoLR scheme should be cognisant of the issues impacting third party SAPS customers and network connected customers (where LNSPs are the default OoLR). Some of the issues that would need to be considered include:

- how to prevent the scheme from dampening the incentives of third-parties to prudently manage and operate the SAPS;
- the role of insurance and levies in ensuring the costs of the scheme are predominantly borne by SAPS providers and not existing network customers. Otherwise the pass-through mechanism may require expansion to include OoLR as a prescribed pass-through event (to which the materiality threshold would not apply);
- the extent to which the scheme requires providers to collaborate with OoLRs and meet disclosure requirements and technical standards as a condition of their licence or SAPS registration;
- whether DNSPs should be bound to the supply standards and conditions agreed between the SAPS provider and customers if they differ from those provided to network customers; and
- if the OoLR should have the discretion to provide supply through either the existing SAPS, a replacement SAPS or from the interconnected grid.

#### **More time is needed to consult on the framework design**

The responsibilities and processes that would follow a third-party SAPS failure is just one of several elements of the framework that was not covered in detail in the draft report. Among the issues which require further clarification prior to the release of the AEMC's final report in October are:

- determining the criteria and thresholds to which category a third-party SAPS will fall into;
- how to apply a "coverage test" that can determine the prospect of competition and value of allowing authorised parties to access to category 1 SAPS;
- the nationally consistent principles that will underpin jurisdictional regulations and how variations between jurisdictions would be minimised;
- the process of having services provided by a DNSP following an a OoLR event recognised as distribution service;
- how the separation of generation, network and retail functions into discrete categories in Priority 1 might impact the ability of DNSPs to be fulfil OoLR arrangements;
- the extent to which it might be appropriate to vary energy-specific consumer protections among SAPS and embedded network customers; and

- the regulatory requirements that would apply when a SAPS evolves and meets the criteria of another SAPS category or transitions to an embedded network.

Given the number and complexity of these issues, we encourage the AEMC to host further consultations ahead of the final report to allow stakeholders adequate opportunity to review and deliberate on these further and for the AEMC time to consider feedback ahead of any proposed changes to the Rules.

If you have any queries or wish to discuss our submission further please contact Joe Romiti, Regulatory Analyst at Endeavour Energy on (02) 9853 6232 or via email at [joseph.romiti@endeavourenergy.com.au](mailto:joseph.romiti@endeavourenergy.com.au).



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