

8 August 2019



Mr Andrew Truswell  
Director  
Australian Energy Market Commission  
PO Box A2449  
Sydney South NSW 1235

Dear Mr Truswell

**EMO0037 Review of the Regulatory Frameworks for Stand-alone Power Systems  
– Priority 2, Draft Report**

Energy Queensland Limited (Energy Queensland) welcomes the opportunity to provide comment to the Australian Energy Market Commission, on its draft report on the *Review of Stand-alone Power Systems – Priority 2*. This submission is provided by Energy Queensland, on behalf of its related entities Energex Limited (Energex), Ergon Energy Corporation Limited (Ergon Energy), Ergon Energy Queensland Limited (Ergon Energy Retail) and Yurika Pty Ltd (Yurika).

Energy Queensland's comments on the draft report are outlined in the attached submission.

Should you require additional information or wish to discuss any aspect of this submission, please do not hesitate to contact myself or Alena Christmas on (07) 3851 6784.

Yours Sincerely

A handwritten signature in black ink, appearing to read "Trudy Fraser", enclosed in a thin black rectangular border.

Trudy Fraser  
**Manager Policy and Regulatory Reform**

Telephone: (07) 3851 6787 / 0467 782 350  
Email: [Trudy.fraser@energyq.com.au](mailto:Trudy.fraser@energyq.com.au)

*Encl: Energy Queensland's submission*

# **Energy Queensland Submission on the Australian Energy Market Commission's**

## **Draft Report on the Review of the Regulatory Framework for Stand-alone Power Systems – Priority 2**

**Energy Queensland Limited**  
8 August 2019



## About Energy Queensland

Energy Queensland Limited (Energy Queensland) is a Queensland Government Owned Corporation that operates a group of businesses providing energy services across Queensland, including:

- Distribution Network Service Providers, Energex Limited (Energex) and Ergon Energy Corporation Limited (Ergon Energy);
- a regional service delivery retailer, Ergon Energy Queensland Pty Ltd (Ergon Energy Retail); and
- affiliated contestable business, Yurika Pty Ltd (Yurika), which includes Metering Dynamics Pty Ltd (Metering Dynamics).

Energy Queensland's purpose is to "safely deliver secure, affordable and sustainable energy solutions with our communities and customers" and is focussed on working across its portfolio of activities to deliver customers lower, more predictable power bills while maintaining a safe and reliable supply and a great customer service experience.

Our distribution businesses, Energex and Ergon Energy, cover 1.7 million km<sup>2</sup> and supply 37,208 GWh of energy to 2.1 million homes and businesses. Ergon Energy Retail sells electricity to 740,000 customers.

The Energy Queensland Group also includes Yurika, an energy services business creating innovative solutions to deliver customers greater choice and control over their energy needs and access to new solutions and technologies. Metering Dynamics, which is a part of Yurika, is a registered Metering Coordinator, Metering Provider, Metering Data Provider and Embedded Network Manager. Yurika is a key pillar to ensuring that Energy Queensland can meet and adapt to changes and developments in the rapidly evolving energy market.

## Contact details

Energy Queensland Limited  
Trudy Fraser  
Phone: +61 (7) 3851 6787  
Email: [trudy.fraser@energyq.com.au](mailto:trudy.fraser@energyq.com.au)

PO Box 1090, Townsville QLD 4810  
Level 6, 420 Flinders Street, Townsville QLD 4810  
[www.energyq.com.au](http://www.energyq.com.au)

Energy Queensland Limited ABN 96 612 535 583

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# 1 Introduction

Energy Queensland Limited (Energy Queensland) welcomes the opportunity to provide comment to the Australian Energy Market Commission (AEMC) on its *Draft Report on the Review of the Regulatory Frameworks for Stand-alone Power Systems – Priority 2* (the draft report). This submission is provided by Energy Queensland, on behalf of its related entities Energex Limited (Energex), Ergon Energy Corporation Limited (Ergon Energy), Ergon Energy Queensland Limited (Ergon Energy Retail) and Yurika Pty Ltd (Yurika).

In response to the AEMC’s invitation to provide comments on the draft report, Energy Queensland has focused on responding to specific matters raised in the report, including the categories proposed in the tiered regulatory framework, customer outcomes and the inconsistencies in the AEMC’s regulatory approaches in delivering outcomes on “related work” matters.

Energy Queensland is available to discuss this submission or provide further detail regarding the issues raised, should the AEMC require.

## 2 Key Messages

A significant focus of Energy Queensland is the customer’s experience. We believe that customers of stand-alone power systems (SAPS) should expect the same customer experience as if they were grid connected. For customers to have confidence in the third-party SAPS framework, they need some certainty that basic customer protections, such as reliability and quality, are adequate. Furthermore, customers need to understand, through the explicit informed consent provisions, the short- and long-term implications in agreeing to transition to a third-party SAPS. In particular, if they decide that they no longer want to be supplied by a third-party and instead reconnect back to a DNSP network solution.

We consider that flexibility and proportionality are key to delivering a positive outcome for customers. We agree with the AEMC that this is most likely to be effective through the support of jurisdictional regulation, with key features, such as price regulation, reliability, emergency response, Operator of Last Resort (OoLR), safety and metering, being determined at the jurisdictional level in the SAPS provider’s licence conditions. Similar to what Energy Queensland stated in our response to the AEMC’s Issues Paper on Regulatory Frameworks for Stand-alone Power Systems – Priority 1, non-grid supply affects a local community and jurisdictional energy policies, as such, jurisdictions are best

placed to determine the level of regulation given the diverse circumstances that may apply to different SAPS.

Although Energy Queensland welcomes the AEMC's draft report, we have some high-level concerns regarding the proposed regulatory framework and whether the assessment criteria being used to determine the framework has been met in this draft report. Good regulatory reform must ensure that the new regime is proportionate in terms of reducing the barriers to entry for new third-party SAPS providers while balancing the level of regulation to apply and ensuring customer protections and access. The approach to the development of the framework should promote regulatory certainty and transparency and align its principles expressed in the related work, including the DNSP-led SAPS – Priority 1 and the Final Report on Updating the Regulatory Frameworks for Embedded Networks, with the third-party SAPS framework.

Energy Queensland's key concerns regarding the AEMC's recommendations in the draft report are addressed separately below.

## 2.1 Transition to third-party SAPS

Despite Priority 1 of this review covering the decision-making framework to transition customers from DNSPs to SAPS provided by a third-party, Energy Queensland considers that this issue is interlinked to Priority 2 and should therefore be discussed. We believe that the AEMC should have provided more detail at this stage of the report highlighting the process around the transfer of assets and compensation for stranded assets. We note that in the final report for Priority 1, the AEMC stated they would *develop proposed changes to the NEL to allow rules to be made regarding compensation, in the course of Priority 2.*<sup>1</sup> Energy Queensland is yet to see these proposed changes, and these are critical to be able to understand the risks to the networks and customers of the networks. The application of the mechanism is required for all parties to understand the risk associated with stranding, duplication, under-utilisation and fair value of assets and the flow-on impacts to all customers.

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<sup>1</sup> AEMC, *Final Report – review of stand-alone power systems – Priority 1*, 30 May 2019.

## 2.2 Tiered regulatory framework

Taking a tiered approach to regulation for third-party SAPS makes sense in theory, especially given that the third-party market is in its infancy and it's important to design a framework that is proportionate and balanced. Similarly, it's important to ensure regulatory certainty and predictability so that regulatory arbitrage opportunities are not unintentionally created where parties are able to circumvent unfavourable regulations. Without creating too much of a barrier for new entrants, consistency between the DNSP-led SAPS framework and third-party SAPS framework is crucial to prevent regulatory arbitrage. As such, Energy Queensland recommends 2 categories instead of 3. Category 1 would retain full regulation similar to DNSPs. Category 2 would require less regulation, analogous to what is being proposed for category 3 in the draft report and could operate as a vertically integrated SAPS business under jurisdictional oversight in limited circumstances. In our opinion, by reducing the number of categories, there is less regulatory risk as third-party SAPS providers have less opportunities to move between categories. This will also promote more regulatory certainty and transparency.

## 2.3 Category 2

Noting that the AEMC is still considering how to determine which category a given third-party SAPS will fall into, the AEMC's initial view is that category 2 microgrids will range from supplying smaller towns to those connecting more than a handful of customers. The AEMC further states that, "*.....effective retail competition is unrealistic in this category and...the costs associated with the AER determination to set network tariffs would be disproportionately burdensome*".<sup>2</sup> Accordingly, the AEMC considers that microgrids under this category should be vertically integrated, and therefore the level of regulation to apply should be undertaken at a jurisdictional level with alignment of nationally consistent principles.

Energy Queensland has concerns that the AEMC's initial views and justification for category 2 may be assuming efficiency gains are more beneficial than customer protections and choice. Any approach to regulation that promotes vertical integration needs careful consideration to ensure that customer protections are not compromised based on the proposed supply model. Furthermore, it is not clear whether parts or all of

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<sup>2</sup> Draft report, pg. vi.

the supply chain is vertically integrated. This structure will determine what consumer protections are required versus the likelihood of competition developing in this category. For example, vertically integrating the generation and distribution components but leaving retail contestable may provide suitable customer choice and protection.

Of concern is that allowing third-party SAPS providers to vertically integrate, essentially offering a monopolistic bundled service, will limit customers access to competition and relevant customer protections. This position is in contrast with the AEMC's key findings of the Embedded Network Review. In that review, the AEMC stated that an embedded network customer should be able to expect similar access to competition and consumer protections as a standard supply customer. Consistent with this, it is Energy Queensland's view that SAPS customers should be considered in light of the Embedded Network Final Report.

Furthermore, it is unknown what trade-offs customers can make between price, reliability, emergency response and other objectives against the SAPS service. Customers are receiving an essential service, and therefore must be fully informed on what customer protections they are forgoing from a grid-connection service to a third-party SAPS service. The AEMC also needs to be cognisant that when a customer elects to go off-grid and trade away customer protections, they bind all subsequent customers at that connection point with those same conditions in perpetuity. This could create perverse outcomes, where subsequent customers who don't have the same intent or needs as the original customer and therefore are forced into a scenario with less customer protections than a standard grid supply customer. Category 2 does not provide this detail as the AEMC's recommendation is that the jurisdiction would determine this under the relevant licence condition. Clarity should be provided by the AEMC on their intent in this regard.

The AEMC's finding in the Embedded Networks Review can equally apply to customers receiving supply from a third-party SAPS. Under the AEMC's proposed tiered framework, only category 1 is comparable with this finding. We therefore, strongly recommend that the AEMC reconsider the number of categories appropriate for tiered regulation and that only a handful of third-party SAPS fall under light-handed regulation as determined by their relevant jurisdiction.

Energy Queensland considers that category 2 is too uncertain and will create more ambiguity and regulatory arbitrage as SAPS providers could oscillate between categories.

## **2.4 Triggers**

It is critical to clearly articulate the triggers for movement from one category to another. Regardless of how many categories the AEMC opines in its final report, the definition surrounding each category and associated triggers for movement in and out of a category is critical. Any ambiguity could result in regulatory arbitrage. Furthermore, the triggers

should also consider the transition of embedded networks to SAPS. Energy Queensland considers that an embedded network that disconnected from the national grid would default to category 1 and therefore be subject to the same suite of regulatory obligations a DNSP has.

The AEMC might consider defining triggers but also make provision that allows a third-party SAPS provider the ability to submit reasons for remaining in a category and this could be overseen by a jurisdictional regulator.

## 2.5 Customer outcomes

The AEMC in their Final Report on Updating the Regulatory Frameworks for Embedded Networks stated, “..... throughout our discussions with stakeholders, the Commission has been informed of numerous examples where embedded network customers have faced significant challenges in relation to their electricity supply and related customer service. Many of these issues would either not arise for standard supply customers, or else other customers would have a clearer path for resolution”.<sup>3</sup>

Energy Queensland considers that these are valid concerns that would similarly apply in third-party SAPS categories 2 and potentially 3. SAPS are still providing an essential service under monopolistic conditions, and therefore, customers should be afforded the full suite of consumer protections. However, while Energy Queensland notes that there are benefits from vertical integration in a SAPS supply solution, for example when supplying a few customers on adjoining farms, in our view, vertically integrated SAPS solutions should only be available under limited circumstances to ensure that customers’ protections and competition opportunities are not limited. Limiting competition could result in excessive market power by third-party SAPS providers to the detriment of customers. It is therefore important that each jurisdiction approaches its third-party SAPS development to promote and conversely protect customer outcomes in markets where competition is emerging.

## 2.6 Operator of last resort

We note that the AEMC intends to give further consideration to the detailed design of an OoLR Scheme, including the process for appointing an OoLR and ensuring appropriate risk allocation.<sup>4</sup> However, the AEMC’s initial views are that an OoLR Scheme would only

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<sup>3</sup> Box 1 of the draft report, page iv.

<sup>4</sup> Draft report, pg. 56.

be relevant to categories 1 and 2 of the proposed tiered framework. Energy Queensland reiterates our concerns raised in response to the SAPS third-party Issues Paper where we highlighted the regulatory risk faced by DNSPs if they are appointed as an OoLR to a technical solution that does not meet a DNSPs required technical standard. Additionally, if DNSPs are potential OoLRs in a vertically integrated solution, this will create ring-fencing issues. DNSPs should be able to compete for the provision of OoLR services and, in circumstances where the solution is vertically integrated, with an automatic exemption from the Australian Energy Regulator's (AER) Ring-fencing Guidelines.

## 2.7 Related work

The AEMC discussed in all consultation papers related to the development of the SAPS framework for both Priority 1 and 2, and the Embedded Networks Review, the interrelationship between the reviews given they consider similar issues related to customer protections. However, Energy Queensland does not agree that the AEMC's philosophy and principles underpinning the Embedded Networks Review, for example, has been replicated in this draft report. We consider there are discrepancies in approaches which have resulted in more expensive frameworks under DNSP-led SAPS and the Embedded Networks Framework, while third-party led SAPS categories 2 and 3 offer the ability to achieve economies of scale by allowing vertical integration.

In Priority 1, the AEMC often discussed the benefits of customers being able to competitively source off-grid solutions from the market rather than seeking a connection from a DNSP. As such, DNSPs are restricted in the final report from offering SAPS solutions to new connections. Also, the AEMC said that *unlike the interconnected grid the provision of SAPS to new customers does not exhibit natural monopoly characteristics*.<sup>5</sup> In addition, the AEMC decided that one of the key benefits of the NEM consistency model is that customers will have access to the competitive retail market.

We understand that under the Embedded Networks Review, the AEMC found that the current network exemptions framework was no longer fit-for-purpose and that in developing this new regime, customer protections would improve, and embedded network customers would be able to access the retail market. We also understand that the

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<sup>5</sup> AEMC, *Final Report – Review of the Regulatory Frameworks for Stand-alone Power Systems*, 30 May 2019, pg. 53.

AEMC's view is that *consumer protections should be driven by the needs of customers and not the business model of supply.*<sup>6</sup>

In this draft report the AEMC does not appear to consider that SAPS customers have the same vulnerabilities as embedded network customers.

Regardless of the method of supply, that is grid-connected supply, embedded network supply, DNSP-led SAPS supply or third-party SAPS supply, customers are receiving the same essential service. Accordingly, the frameworks developed for delivery of the supply service should be consistent. We think that the AEMC has not given adequate attention to the ability for the same risks for embedded network customers to equally arise for third-party SAPS customers. As such, we recommend that the AEMC consider two categories rather than one and for a vertically integrated solution to be available in very limited circumstances with robust consumer protections. This would limit the ability for parties to shop between frameworks at the expense of customer outcomes.

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<sup>6</sup> AEMC, *Final Report – Updating the Regulatory Frameworks for Embedded Networks*, 20 June 2019, pg. i.