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Mr Rupert Doney
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Dear Mr Doney

Updating the regulatory frameworks for distributor-led stand-alone power systems – Draft rules

The Australian Energy Regulator (AER) welcomes the opportunity to comment on the AEMC's *Updating the Regulatory Frameworks for Distributor-Led Stand-Alone Power Systems* (SAPS) draft report and draft rules.

The AER supports the use of SAPS as an efficient alternative to traditional 'poles and wires' network investment. We agree with the position taken in the AEMC's September 2019 final report that customers should be no worse off for transitioning to a distributor-led SAPS, and should retain access to retail choice and the consumer protections of the National Energy Customer Framework. We consider that the AEMC has put forward a flexible framework that creates space for competitive forces to minimise costs to consumers, while allowing for ring-fencing waivers in special cases where the market is unable to provide SAPS generation services.

Service classification

We support the AEMC's proposed approach to service classification and associated draft rules. We consider that the proposed changes to clause 6.2.1A of the NER provide sufficient direction to the AER to classify a SAPS distribution service as a standard control service. This includes activities that a distributor undertakes in arranging for the provision of a SAPS, such as contracting with a service provider to provide an unregulated SAPS generation services.

Network pricing

We support the AEMC's proposed approach to network tariff assignment for customers of distributor-led SAPS. The draft proposed clause 6.18.4(4) maintains the principle that customers of distributor-led SAPS should be treated no less favourably than retail customers with a similar load profile connected to the interconnected system. We also consider that this principle is flexible enough to allow the distributor to assign a network tariff that reflects the operations of a particular SAPS generation system, while ensuring that SAPS customers pay equivalent network costs to customers on the interconnected system. This provides

opportunity for network tariff innovation, within the boundaries that a customer should be no worse off as a result of transitioning to a regulated SAPS.

Ring-fencing

We consider that competitive provision of SAPS generation services will provide long-term benefits to customers by facilitating price discovery and product innovation in SAPS generation services. However, in some cases a distributor may need to provide part or all of a SAPS generation service. In this case, ring-fencing waivers would be required.

We agree that the existing Rules provide sufficient flexibility for the AER to grant ring-fencing waivers to allow a distributor to provide SAPS generation services where needed. In December 2017 we provided waivers to distributors to allow them to provide services for existing stand-alone power systems.¹ We have also provided a number of waivers to various distributors that reflect the practicalities of reduced competition in markets for energy services in some regional and remote areas.² The *Electricity Distribution Ring-fencing Guideline* also contains a standing 'regional office' exemption from the requirement for a distributor to functionally separate provision of contestable electricity services from regulated distribution services.³

The AEMC's draft report notes that some SAPS generation support services (such as generation maintenance and support) may continue to exhibit natural monopoly characteristics in remote areas.⁴ We intend to engage with distributors to understand the likely need for future waivers. We may consider measures such as providing a standing exemption in the Ring-fencing Guideline in relation to some activities in some areas, or providing waivers covering several SAPS sites together. We will also consider the timeliness of waiver decisions, having regard to the steps a distributor has taken to engage with affected stakeholders and test the market for competitive provision of SAPS generation services prior to submitting a waiver application to the AER.

In December 2019, we published an *Explanatory Note* on the iteration between ring-fencing and the AEMC's proposed framework for distributor-led SAPS.⁵ The Explanatory Note was written to assist stakeholders in forming their submissions to the AEMC on the distributor-led SAPS draft rules. We may also provide updated guidance for distributors and stakeholders on seeking ring-fencing waivers in the future. We look forward to reading stakeholder submissions to the AEMC's draft report on this matter.

Distribution planning arrangements

We support the proposed amendments to the Distribution Annual Planning Report requirements under schedule 5.8 of the draft proposed rules. We consider that requiring a distributor to publish information on SAPS opportunities that have been considered in the past year, committed projects, and existing regulated SAPS on the network will provide transparency for the AER and stakeholders over the uptake of SAPS.

¹ AER, *Decision – DNSP applications for waivers from the Electricity Distribution Ring-fencing Guideline*, December 2017, pp. 47-57, pp. 51-52, pp. 66-76.

² AER, *Decision – DNSP applications for waivers from the Electricity Distribution Ring-fencing Guideline*, December 2017, pp. 47-57, pp. 66-89.

³ AER, *Ring-fencing Guideline Electricity Distribution – Version 2*, October 2017, cl. 4.2.1(b)(iii), cl. 4.2.2(b)(iii), cl. 4.2.3(b)(ii).

⁴ AEMC, *Draft report – Updating the regulatory framework for distributor-led stand-alone power systems*, 19 December 2019, p. 47.

⁵ AER, *Explanatory Note – Ring-fencing interaction with distributor-led stand-alone power systems*, 19 December 2019, available at: <https://www.aer.gov.au/networks-pipelines/compliance-reporting/explanatory-note-ring-fencing-interaction-with-distributor-led-stand-alone-power-systems>

We note that 'SAPS options' is defined distinctly and separately from 'non-network options' and 'demand management' under draft proposed definitions in chapter 10 of the NER. We understand that this means that SAPS options will not be subject to the DMIS and DMIA.

SAPS customer engagement

Engagement with and by customers of SAPS will be essential to the success of the framework overall. We agreed with the AEMC's proposed approach, to establish a SAPS Customer Engagement Guideline in the Rules that may be written by the AER. We will consult further with distributors and stakeholders to determine our approach to this Guideline.

Wholesale market settlement arrangements and SAPS settlement price

We support the AEMC's proposed approach to allow customers of regulated SAPS to be settled on the wholesale market, which is essential to ensuring those customers retain access to standard retail contracts, consumer protections, and retail choice. We consider that the administered pricing arrangements are appropriate, recognising that regulatory SAPS customer numbers are likely to remain low for quite some time. Therefore we agree that an administratively simple approach to wholesale market settlement and pricing is preferable.

We look forward to working with distributors and other stakeholders to implement arrangements for distributor-led SAPS, and realising the benefits of SAPS alternatives to traditional network investment for electricity consumers. To discuss any matters raised please contact Moston Neck on (07) 3835 4669.

Yours sincerely



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