Regulatory frameworks for distributor-led stand-alone power systems

Response to Draft Rules

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Energy Networks Australia

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Key messages

- **The policy intent to enable more DNSP-led SAPS is unlikely to be delivered by this package.** This is due to onerous regulatory requirements delaying SAPS uptake, limiting demand-side development of the competitive market and stagnating competitive outcomes for customers.
- **Competitive markets are unlikely in the short to medium term.** The implicit assumption in the draft rules that effective competition will soon develop in the remote areas where SAPS will be installed is unrealistic, particularly for the provision of ongoing SAPS generation O&M services.
- **Streamlining is needed.** Developing a framework that principally relies on the existence and functional operation of competitive markets that are not yet developed is likely to result in detrimental outcomes for customers. Streamlining the ring-fencing waiver process is likely to catalyse the rollout of DNSP-led SAPS and increase the probability of functional competitive markets emerging.
- **Asset and cost recovery arrangements must be clear.** To deliver the best outcomes for customers there needs to be improved clarity and predictability around the regulatory treatment of assets:
  - these is a need for alignment between the length of waivers integral to delivery of the project and the life of the relevant SAPS assets.
  - an opportunity to adequately recover costs when DNSPs transition customers to a SAPS where a SAPS is the most efficient supply option is critical.

Overview

Energy Networks Australia appreciates the ongoing consultation that the Australian Energy Market Commission (AEMC) is undertaking on the regulatory arrangements governing distribution network service provider (DNSP)-led Stand-Alone Power Systems (SAPS) and welcomes the opportunity to make this submission on the recently released draft report.[1]

Energy Networks Australia is the national industry body representing Australia's electricity transmission and distribution and gas distribution networks. Our members provide more than 16 million electricity and gas connections to almost every home and business across Australia.

1 Proposed regulatory framework

Onerous regulatory processes will hinder competitive outcomes

In 2016, Western Power initiated a rule change proposal with the AEMC to allow DNSPs to supply customers via a SAPS as an alternative to the traditional grid connection. The intent of the rule change request was to allow DNSPs to supply customers with a SAPS where it is economically efficient to do so,

[1] AEMC, *Draft Report: Updating the regulatory frameworks for distributor-led stand-alone power systems*, 19 December 2019.

recognising that there are customer benefits, including improved reliability and lower costs, to SAPS supplied electricity.

The AEMC agreed with this policy intent[2], and is now considering a package of proposed rules to implement a new regulatory framework for SAPS provided by distributors in the National Electricity Market (NEM).

SAPS are currently subject to various jurisdictional arrangements in the NEM and are not generally captured under a consistent national regulatory framework. Energy Networks Australia is supportive of a change in the regulatory framework that allows DNSPs to supply their customers using SAPS where it is more cost efficient than maintaining a connection to the grid.

Energy Networks Australia, however, is concerned that the policy intent to enable more DNSP-led SAPS is unlikely to be delivered by this draft package of rules and the Australian Energy Regulator's (AER) proposed SAPS ring-fencing approach[3]. The principal reason identified is that the draft rules as they stand place onerous requirements on DNSPs that are not fit-for-purpose given the current absence of a mature, competitive market for SAPS generation services.

Under the draft rules, DNSPs are unable to provide an integrated SAPS solution, including both SAPS generation and distribution services, without first applying for a ring-fencing waiver to the AER. Only once a waiver is granted can the DNSP then begin the process to roll out an integrated SAPS to customer/s.

The risk is that the DNSP-led roll-out of SAPS will be slower and there will be fewer SAPS in the market than under a rules framework that poses fit-for-purpose requirements on DNSPs. Fewer SAPS in the market would mean that providers of competitive SAPS assets and services have less incentive to enter the market and competition could stagnate, delaying the possible benefits of competition to consumers.

Risk of inconsistent SAPS frameworks

In addition, it is possible that an overly prescriptive framework may be viewed as compromising the delivery of policy objectives of state governments to enable efficient rollout of DNSP-led SAPS where it is efficient. This introduces a risk that current or future jurisdictional governments could look to implement their own state-specific legislation rather than opt-in to the onerous national framework. The evolution of numerous inconsistent SAPS frameworks would not be beneficial for competition as SAPS asset and service providers may need to have different processes, technical specifications, customer requirements and ownership models for different states.

2 Ring-fencing Waivers

Energy Networks Australia considers that the framework needs to be robust to an outcome where competitive markets for the provision of SAPS generation services do not develop in the short to medium term. It is clear, however, that the proposed framework has been developed with the expectation that the majority of SAPS generation services *would be* obtained from competitive markets. If this assumption is not correct, the result could be customer detriment and a non-responsive regulatory framework.

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[2] AEMC, *Final Rule Determination, National Electricity Amendment (Alternatives to grid-supplied network services) Rule 2017* p. 20-25

[3] AER, *Ring-fencing interaction with distributor-led standalone power systems: Explanatory Note*, December 2019.

For those circumstances where contestable service providers are unable or unwilling to provide a SAPS generation service, under the draft rules a DNSP would require a ring-fencing waiver to provide both SAPS distribution and generation services to its customers. This process, undertaken on a case by case basis, is likely to cause delays in the rollout of DNSP-led SAPS, and therefore in customers being able to take advantage of their implementation.

AER waiver process should respond to actual market circumstances

Energy Networks Australia believes it is important that a pragmatic assessment of SAPS waiver applications is made. Undertaking the full waiver application process on a case-by-case basis will be a labour and time-intensive exercise which may not be the most efficient use of DNSP or AER resources. Energy Networks Australia also understands that there will be many similar situations where a DNSP will need to apply for a ring-fencing waiver given the current limited competitive market for SAPS generation services. The customer experience should not be compromised due to a drawn-out bureaucratic process.

Energy Networks Australia therefore recommends a review of the proposed waiver process for SAPS, with consideration given to the following approach:

1. **Introduction of standing ring-fencing waivers**. If a DNSP receives no bids for SAPS generation services from the competitive market, a DNSP should be automatically granted a 'standing' waiver subject to the DNSP's tender satisfying certain pre-conditions. The 'standing' waiver should also be applied in situations where the customer or customers have given their explicit informed consent to be transitioned from the interconnected grid to an integrated DNSP-led SAPS.

2. **Introduction of an expediated ring-fencing waiver process in situations for which a DNSP has previously received no bids**. Where the DNSP can show that customer circumstances such as their energy usage and location or relative remoteness are similar to a number of previously granted waiver applications, the AER should be able to reasonably assume that customer outcomes from the competitive market will be similar to those evaluated during previous waiver applications. This approach is practical and will reduce the administrative burden on both DNSPs and the AER.

3. **Recognition of edge of grid environment**. The implicit assumption in the draft rules that effective competition will develop for the provision of SAPS generation operating and maintenance (O&M) services (as distinct from the initial construction) in the areas where SAPS will be installed is highly unrealistic. By definition, these edge-of-grid locations are in remote areas that are difficult to serve, yet DNSPs have established large, trained workforces that would be able to respond better to edge-of-grid SAPS O&M requests than any other SAPS provider. In Energy Networks Australia's opinion, DNSP operational workforces are best placed to perform O&M services for generation assets of DNSP-led SAPS.

   Electricity is classified as an essential service and ensuring customers are safely back on supply as soon as possible should be the primary goal of SAPS generation O&M services. Customer reliability is a normal DNSP responsibility and DNSPs are best placed to get the customer's lights back on in these circumstances. The design of the DNSP-led SAPS framework must take this into consideration as the proposed rules would require DNSPs to apply for numerous waivers, increasing the regulatory burden and delaying the SAPS roll out.

In addition, if a DNSP receives one or multiple bids for the provision of SAPS generation services, the AER should have regard to the competitiveness (in terms of both cost and quality considerations) of bids

rather than the simple existence of bids when assessing waiver applications. In the absence of competitive bids, the DNSP should be granted a waiver to provide relevant SAPS generation services. A potential assessment of whether a bid is competitive or not could be whether the competitive market bids to provide relevant SAPS generation services are in excess of the cost to the DNSP to provide the required service.

Noted rules exclusion for emergency situations

At a minimum, there should be a noted exclusion in the rules drafting that allows DNSPs to service customers in situations where customers require immediate assistance such as during an emergency or where a third-party maintenance provider becomes insolvent.

Under the current rules framework, it is Energy Networks Australia's understanding that when SAPS generation O&M services are contracted out, the DNSP may lose the ability to provide emergency relief. In most cases it is likely that DNSPs will be best placed to provide emergency relief services due to the size and reach of their operational workforce. The DNSP should be able to provide a minimum customer service guarantee to SAPS customers whose generation O&M services are contracted and serviced by a third-party.

Revoked or extended

It is Energy Networks Australia's understanding that ring-fencing waivers provided in all instances, including for the DNSP-provision of SAPS generation assets or services, will only be valid for an initial maximum period of five years.

Energy Networks Australia believes that the current length of ring-fencing waivers is not fit for purpose and should instead be valid until:

1. the SAPS generating assets reach their end of life and require replacement, or
2. the SAPS generating assets or contract for maintenance are sold to a third party, or
3. the AER commences an enforcement process to revoke the SAPS waiver.

DNSPs should be able to have confidence that SAPS ring-fencing waivers will last until one of these three conditions are met to limit unnecessary investment risk and regulatory burden.

If the AEMC instead decides that the waiver process should progress unchanged as stipulated in the draft rules and the AER's SAPS ring-fencing waiver explanatory note, some guidance would need to be provided to give DNSPs clarity around when and in what circumstances a waiver would be revoked. Energy Networks Australia believes that this could be achieved by the AER producing a further guidance note giving some examples of the circumstances where a waiver would be revoked and clarity that waivers would be rolled over between regulatory periods in the majority of circumstances.

3 Clarification of service classification is required

The AEMC's draft rules and report posit that a DNSP-led SAPS will comprise both a SAPS generation system and a distribution system.

The distribution system provides customers with a distribution service, which must be given the same classification that it would have been given if the distribution service were not provided by means of a

regulated SAPS. The generation system provides a generation service and an input into the distribution service, both of which are not subject to AER classification.

It is not clear in practice how different assets of the SAPS system, for example the battery component, would be classified as either part of the generating system or distribution system.

ENA recommends that the AEMC provide further clarification of how different physical SAPS assets would be classified as either part of the SAPS generating system or SAPS distribution system. Without this clarity, it will be difficult to accurately assess the cost implications for DNSPs.

Clarity of cost recovery arrangements

To sustainably provide SAPS generation services to customer/s, DNSPs need to be in a position to appropriately recover their costs. Further clarity is required on how the financial arrangements of DNSPs will operate for SAPS generation services provided under a ring-fencing waiver. This lack of clarity makes it harder for DNSPs to determine the cost of providing customers with a SAPS under a waiver and exposes DNSPs to unnecessary risk through uncertainty.

The proposed pricing arrangements also expose networks to wholesale price risk. This is because the DNSP would be required to pay the SAPS generation service provider an amount equal to the agreed contract price minus the wholesale revenue received. This adds uncertainty to the cost DNSPs will pay for the SAPS over the asset's life and will make contract negotiations with SAPS generation service providers more difficult.

4 Other items

Market benefits testing

Under the proposed framework, if a DNSP has identified a SAPS as the most cost-efficient solution, then the DNSP would be required to transition customer/s to a SAPS for the AER to approve the expenditure. It is Energy Networks Australia's understanding that the market benefits test does not take individual customer benefits into account when determining efficient outcomes. However, it is important to recognise the value of exported distributed energy resources, and the value that a customer may place on them within the benefits testing for SAPS evaluation.

Bushfire-affected customers

DNSPs have implemented interim supply solutions for many bushfire-affected customers in areas where grid infrastructure has been damaged or destroyed.

Optimal long-term supply solutions for these customers will be considered in due course but are currently yet to be determined. If the optimal supply arrangement for these customers in the long-term is determined to be a permanent SAPS, appropriate arrangements should be made to transition temporary bushfire supply solutions to more permanent SAPS. The SAPS market benefits test should be sufficiently broad to incorporate benefits such as SAPS reducing the risk of power lines igniting bushfires.

DNSP SAPS capacity management

Energy Networks Australia understands that it will be the role of DNSPs to manage the capacity of SAPS. Although appropriate measures would be taken to ensure each SAPS would be sized for the customer's

usage, further consideration should be given to the appropriate mechanism to facilitate capacity augmentation of existing DNSP-led SAPS and provide clarity to the relevant financial arrangements.

DER enablement

Energy Networks Australia believes that in principle customers should be able to install their own solar or batteries, at their own cost, in addition to those that are already provided as part of the DNSP-led SAPS.

This would give SAPS customers the same ability to connect their own distributed energy resources as other NEM customers. However, this system's inverter would need to be DNSP controlled or set up to not conflict with the SAPS inverters to ensure safe operation of the SAPS within technical limits.

Network pricing

Energy Networks Australia believes that there is benefit in giving customers the choice of an opt-in network tariff which is more cost-reflective than a flat network tariff. If the customer was to give their consent and appropriate tariffs could be approved for that customer, a more cost-reflective tariff has the potential to reduce diesel usage, increase reliability, and reduce the required battery capacity.

The SAPS framework should not foreclose the possibility of cost-reflective pricing where there are potential benefits to customers. Additionally, DNSPs should not be precluded from providing customer services such as behavioural incentives which could deliver customer benefits.

Need for post-implementation review

Energy Networks Australia believes that there is benefit in reviewing the outcomes of the SAPS framework in three years' time.

The AEMC would undertake this review for the purpose of determining whether outcomes arising from the application of the SAPS framework have met the expectations of the AEMC and other stakeholders. Where they had not been met, or arrangements have provided to be not effective given actual market and cost conditions faced by SAPS projects, changes to the framework would be recommended for legislative approval.

Ensuring the regulatory framework is and remains fit-for purpose relative to the state of competitive development and the pace of innovation is important for delivering optimal customer outcomes.

Planning and engagement

Energy Networks Australia generally supports the AEMC's approach to planning and engagement, including:

- providing additional information in Distribution Annual Planning Report related to SAPS projects,
- revising industry engagement to include consideration of SAPS,
- developing a SAPS customer engagement strategy, and
- quantifying all classes of market benefits.