

5 February 2019

Sherine Al Shallah
Project Leader
Australian Energy Market Commission (AEMC)

Submission via AEMC website

Dear Ms Al Shallah,

Re: Review of the regulatory frameworks for stand-alone power systems

Thank you for the opportunity to respond to the AEMC's draft report on its review of the regulatory framework for stand-alone power systems. Our interest in this review is to ensure that:

- The network businesses in which we invest have the greatest opportunity to pursue lower cost options so that electricity delivery services can be provided at the lowest cost to customers; and
- The integrity of the regulatory framework is maintained, such that the framework provides incentives to undertake efficient investment and a return on efficient investment that together keep the cost of capital low.

We support the AEMC's key finding that in many cases it would be more efficient for a distribution network service provider (**DNSP**) to provide services to customers through a stand-alone power system (**SAPS**) than continued investment in the traditional network, and that the benefits of the DNSP doing so outweigh any potential dampening of competition for these services.

The AEMC's recommendations have the potential to remove unnecessary barriers to DNSPs for providing regulated services through the lowest cost means whilst ensuring customers remain covered by appropriate protections. This will facilitate an efficient transition to a low-cost, low emission energy supply system where appropriate customer protections apply regardless of technology, service provider or jurisdiction.

We agree with the AEMC that:

- The service and customer protections available to grid connected customers should apply to SAPS customers.
- It remains appropriate for customers of a DNSP to have access to a regulated price and for regulated price structures to encourage the efficient use of assets and energy; and
- DNSP's should continue to be compensated for efficient investment in assets that may no longer provide services as a result of a customer transitioning to a SAPS service.

We would, however, encourage the AEMC to re-consider proposals to:

- Impose additional process costs on a SAPS supply solution compared to network solution in the form of a bespoke evaluation process for projects that do not meet the threshold for a regulatory investment test for distribution (**RIT-D**) and customer engagement unless clear benefits of doing so are identified; and
- Impose additional costs on all customers to retain the potential for competition for retail services for SAPS customers where those services are not required or add little value.

Finally, we highlight the importance of ensuring DNSPs can earn a reasonable return on efficient investment where assets are transferred to a third party or are no longer required as a result of a SAPS supply solution. This will facilitate efficient investment at the lowest cost of capital. We support the AEMCs draft position that compensation be provided where assets are transferred and encourage the AEMC to ensure that any changes to the regulatory asset base (**RAB**) result in neither investors or remaining customers being worse off as a result of adopting a more efficient SAPS supply solution.

The Attachment to this letter responds directly to the draft positions outlined by the AEMC in the draft report.

Please do not hesitate to contact me on 0421057821 to discuss further.

Yours sincerely,



Sally McMahon
Head of Economic Regulation
Spark Infrastructure

Attachment: Response to the AEMC draft positions

Introduction

The draft report provides sensible recommendations that facilitate the provision (and regulation) of services under current regulatory frameworks rather than developing an additional specific regulatory framework for SAPS. This should enable lower cost service to all customers and simplify and clarify the regulatory requirements for new efficient and innovative investment.

The principles and recommendations set important precedent for the efficient use of storage or other technologies to support lower cost energy delivery services and avoid higher cost augmentation.

Section 3: Transition to DNSP-led SAPS

We support the AEMC's draft position to establish arrangements whereby a DNSP can provide a SAPS solution if it can demonstrate that a SAPS solution is the most efficient means of addressing a need to replace or upgrade parts of a distribution system because this will facilitate more efficient and innovative approaches to meeting obligations to provide services.

We agree with the AEMC that the existing AER oversight arrangements and RIT-D process are appropriate to be extended to SAPS supplied customers. However, we do not consider that it is necessary to apply an additional set of evaluation requirements to SAPS investments that fall below the RIT-D threshold as this would introduce an additional barrier to SAPS investments over traditional network solutions. It would also add costs that would be passed on to consumers. The existing governance arrangements and strong incentives for efficiency that exist in the regulatory arrangements are sufficient to ensure that only efficient investment occurs.

We also agree with the AEMC that a DNSP should not need to obtain explicit consent from customers to transition to a SAPS supply where customers are able to maintain the benefits of their existing retail offers as this would have no impact on the service provided to customers, and to require consent could prevent a more efficient solution from reducing the cost to all other customers. However, we encourage the AEMC to review the cost of the proposal to require a DNSP to develop and publish a SAPS customer information and engagement strategy where retail offers will be no longer available. The additional cost of this proposal may outweigh any benefit of access to retail offers, particularly where retail services are no longer required.

It is imperative that DNSPs should be able to connect new customers to SAPS to avoid negating the efficiency savings that can be passed on to all customers from a SAPS supply solution. We agree that this can be most effectively achieved by re-defining the DNSP's network to include SAPS. This will also avoid the costs imposed on all other customers that might be incurred if a customer retained a right to re-connect to the grid.

Section 4: SAPS Service classification and delivery

We support the AEMC's findings that DNSPs should be allowed to provide services to customers through SAPS where it is more efficient and that these services should be able to be classified as a regulated service. This approach is likely to be the most effective way to encourage innovation and facilitate the lowest cost approach to providing services and meeting obligations, including maintaining a lower cost of capital. We also recommend that the NER provide clear direction to the AER to ensure the desired outcomes can be achieved.

Spark Infrastructure contributed to the AER's review of the DNSP ring-fencing guideline process in 2016 and outlined the need to enable DNSPs to utilise non-traditional and innovative means of providing services to reduce the cost of supply to customers.¹ We understand that the ring-fencing guideline aims

¹ Spark Infrastructure, Submission to the AER's Draft Ring-Fencing Guideline for Distribution Network Service Providers, 28 September 2016.

to avoid subsidisation between regulated and unregulated services and crowding out of competition in potential new services and markets. However, the requirements should not inadvertently stifle competition, innovation or efficiency in the absence of an assessment of the costs and benefits of prohibiting the method of supply, particularly where there are benefits of enabling supply approaches to evolve dynamically with new technology and customer service expectations and requirements.

The benefits to customers of enabling and incentivising lower cost supply through non-traditional and innovative means occur in two ways. Firstly, to the customer directly by avoiding higher cost individual solutions to achieve the desired service level and secondly, by reducing the cost to all customers over time where a lower cost solution can be employed to deliver on an NSP's obligations to supply.

We consider that the proposed changes and guidance will facilitate evolution of energy delivery services provided by NSPs and extend the strong incentives for efficiency to non-traditional and innovative supply solutions regardless of the technology, asset or approach. This enables each DNSP to identify the lowest cost means of meeting its obligations taking in to account the individual circumstances of the NSP, the community and the potential for third party service providers.

We support the changes to the NEL and NER that remove barriers to DNSPs to provide SAPs as a regulated service and provide the AER with direction to include alternative supply methods as a regulated service.

Delivery models

The AEMC has outlined two delivery models for DNSP-led SAPS supply; the NEM consistency model and the integrated service delivery model.

The NEM consistency model seeks to make the customer transition from grid connected supply to SAPS supply seamless. However, this model imposes additional and unnecessary costs on all other customers to retain the opportunity for a SAPS connected customer to benefit from retail competition. The provision of energy supply service by a DNSP through a SAPS is likely to supplant the need for retail services. Therefore, if there are any benefits forgone by SAPS supplied customers from the loss of retail competition for those services, they are likely to be immaterial.

The integrated service delivery model is more reflective of the supply (and cost) arrangements for the SAPS customer. However, this model would require an appropriate regulated price to be developed. Although complex, it is possible and appropriate for an efficient regulated tariff to be available to SAPS customers. We outline a proposal for this in the next section.

Section 5: Application of consumer protections

We support the AEMC's draft position that a regulated tariff should apply to DNSP-led SAPS customers and customer protections and service standards should be equivalent to those under standard supply arrangements. However, we do not support any SAPS specific customer protections unless there is a requirement for a customer to behave differently in certain circumstances to minimise impacts compared to a grid connection. Otherwise, these may become unnecessary barriers to an efficient SAPS supply solution.

The regulated tariff could reflect the regulated retail price in jurisdictions where one is available or the default market offer (**DMO**) being developed by the AER where a regulated retail price is not available. However, we consider that it may be appropriate for a DNSP SAPS specific tariff to be developed.

The regulated tariff should ensure that a SAPS customer continues to make a contribution to the cost of bundled supply service of at least an amount that is equal to the lowest market retail offer available at the grid connection point at the time the customer was transitioned to the SAPS. This will ensure that the SAPS customer pays the maximum contribution to the ongoing cost of providing services, whilst capturing any forgone benefit of competition for retail services. It also ensures that the subsidy paid by other

customers on the network towards supply of the SAPS customer is minimised and that they receive the benefits of transitioning customers to a SAPS supply solution.

Section 6: Transition to third party SAPS

We support and emphasise the importance of the AEMC's draft position on the treatment of transferred and stranded assets to ensure appropriate incentives for investment and the lowest cost of capital.

It is appropriate for the cost of stranded assets to be included in cost benefit analysis and to compensate the DNSP for costs related to stranded or transferred assets as a result of the transition of a customer to a SAPS supply. If the SAPS supply is provided by a third party, the third party should provide the compensation to ensure all other customers are not negatively impacted (now or in the future). Introducing risk that these costs will not be recovered will reduce the likelihood of investment in innovation, and increase the cost of capital, so that future services are at higher risk of disruption and provided at an increased price.

The treatment of (and compensation for) transferred and stranded assets should ensure that remaining customers and investors are no worse off as a result of the transfer or stranding. For example, the compensation provided to the DNSP by the third party should also take in to account the potential impact on remaining grid connected customers under the revenue cap regime so that forgone revenue is not simply recovered from remaining customers.

Given the critical nature of this issue to future investment, we support guidance in the NER to provide clarity about the treatment of assets and ensure any consequences of the treatment of assets are properly reflected in future AER reviews of regulatory proposals and the regulated rate of return.