

13 February 2020

Rupert Doney
Project Leader
Australian Energy Market Commission (AEMC)

Submission via AEMC website

Dear Mr Doney,

Re: Updating the regulatory frameworks for distributor-led stand-alone power systems draft report

Thank you for the opportunity to respond to the AEMC's draft report on the package of rule changes to give effect to the AEMC's recommendations for the regulatory framework to support distributor-led stand-alone power systems (**SAPS**). Spark Infrastructure provided a submission to the draft report on the AEMC's recommendations.¹ 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 findings that the benefits to customers of enabling distribution network service providers (**DNSPs**) to provide regulated services through SAPS where it is more efficient outweigh any potential dampening of competition for these services. We consider this will also encourage innovation and greater advancements in lowering the cost of providing services whilst meeting obligations and service commitments.

However, we consider that the proposed rules, and reliance on waivers to the AER's distribution Ring-fencing Guideline, will not remove barriers to DNSPs from utilising SAPS to provide lower cost regulated services and therefore, the benefits to customers will not be fully realised.

Limiting the scope of regulated SAPS services will not remove barriers to lower cost services

The AEMC's recommendation was to enable a SAPS distribution service to be provided as a regulated service on the basis that a SAPS distribution service could be distinguished from a SAPS generation service. The AEMC also recognised that it would be beneficial to provide guidance about the classification of distribution services and generating systems where the assets utilised in providing each of these SAPS services are difficult to discern as in the case of individual power systems.

We consider that this guidance is critical to the effective application of the framework but has not been achieved in the package of rule changes. However, we also consider that limiting the scope of regulated services to SAPS distribution services, even if clarified, will not remove barriers to DNSPs providing regulated distribution services through a SAPS, and relying on waivers under the AER's distribution Ring-fencing Guideline will be ineffective in overcoming those barriers. These barriers include:

1. **Legal** – a DNSP will remain prohibited from providing a SAPS solution. It must contract with a third party service provider to provide the generation service. The DNSP remains liable for the performance of the system.

¹Spark Infrastructure, Review of the regulatory frameworks for stand-alone power systems, 5 February 2019.

2. **Practical** – the assets used to provide the SAPS distribution service and the SAPS generation service are not always distinguishable.
3. **Administrative** – where a SAPS solution is identified, the DNSP is required to provide additional information and undertake additional engagement, tender and waiver processes to implement the solution which give rise to higher costs and delays.
4. **Economic** – where a SAPS solution is identified and implemented, the DNSP will incur additional unrecoverable operating costs (administrative and service related) and be penalised under the incentive schemes for doing so.

The proposed approach to waivers will not remove barriers to lower cost services

Relying on waivers to enable DNSPs to provide SAPS generating services will not be effective in overcoming the barriers to providing a lower cost service. The AER has indicated² that a waiver will only be available if the DNSP can demonstrate that there are no third party providers of generating services even if the DNSP can provide the service at lower cost. Further, any assets transferred after construction will be ascribed no value. However, this will not avoid the tax liability that will be paid by customers. The need for a waiver not only reduces the incentive for a DNSP to identify and pursue a more efficient distributor-led SAPS solution but means it cannot be expected to do so.

In addition, the DNSP has no guarantee that the waiver will continue for the economic life of the SAPS generating system. This will increase the risk of meeting service requirements compared to the network solution and the risk to both the DNSP and third party service providers that costs will not be recovered. This will further reduce the incentive to pursue a lower cost SAPS solution and increase the cost of capital.

We recommend that if waivers remain in some form, they should allow a DNSP to provide a generating service where it can do so at lower cost and be granted for the economic life of the SAPS system. This will improve incentives to pursue efficiencies and provide certainty about service and cost recovery.

A proposed solution

A simpler approach would be to enable the generating system to be included as a regulated distribution service where the DNSP can demonstrate that this is the lowest cost solution. This would also increase the benefits to customers in the following ways:

- DNSPs would have strong incentives to identify and implement SAPS solutions where they are lower cost which would benefit customers over time.
- The market for SAPS would develop more rapidly as the demand for SAPS increases driving improvements in technology, reductions in costs and opportunities for third party providers.
- The revenue received by the DNSP at the SAPS settlement price could off-set distribution charges to all other customers.
- Customers will continue to receive the benefits of the strong incentives to provide regulated services at the lowest cost (with no more or less say in the type of assets used) and a DNSP would only provide a new connection through a regulated SAPS where the cost of doing so is lower than a network solution or third party provided SAPS.
- Individual customers will not be able to choose an option that would impose higher costs on other customers.
- A DNSP will remain accountable for service performance and capacity requirements of customers.

² AER, Ring-fencing interaction with distributor-led stand-alone power systems, Explanatory Note, December 2019.

- Customers can continue to choose their retailer where the practical and operational features of the SAPS support this. However, if a customer is unable to choose a retailer, the same customer protection, billing and SAPS settlement price could be provided by the DNSP. Given all SAPS services will be subject to the SAPS settlement price and the options to reduce localised generating costs are limited, lost price discovery and service differentiation benefits are negligible.
- Avoids additional process and compliance costs (including those of the AER).
- Provides flexibility to enable new approaches to evolve dynamically with new technologies that reduce the costs of providing services to be covered under the SAPS framework.

This approach will:

- Extend and strengthen incentives for efficiency in supply solutions regardless of the technology, asset or approach;
- Enable DNSPs to identify the lowest cost means of providing services taking in to account the individual circumstances of the NSP, the community and third party service provider options; and
- Maintain important customer protections, technical requirements and market operation functions.

We urge the AEMC to re-assess the costs and benefits of the limiting the classification of regulated services and the effectiveness of relying on waivers to deliver lower costs.

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

Yours sincerely,



Sally McMahon
Head of Economic Regulation and Energy Policy
Spark Infrastructure