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8 August 2019

Mr John Pierce
Chair – Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear Mr Pierce,

Regulatory sandbox arrangements to support proof of concept trials

The Australian Energy Regulator (AER) thanks you for the opportunity to comment on the AEMC's *Regulatory sandbox arrangements to support proof-of-concept trials* Draft Report.

We support the AEMC's proposed sandbox toolkit. In particular, the development of a regulatory waiver power will allow the AER to provide exemptions for trials that have the potential to deliver long-term benefits to customers by providing evidence and experience necessary to support reform of the NEM. In establishing a regulatory waiver power and providing for development of a sandbox guideline in the energy laws and rules, we recommend that the AEMC should leave sufficient flexibility for the AER to design the sandbox waiver guideline collaboratively with stakeholders.

We see benefits in the AEMC's proposed innovation enquiry service. The AEMC's proposed approach will provide a more visible entry point for innovators to access the guidance. It will provide for closer coordination between other market bodies and ARENA. It may also help the AER to separate out innovation-focused enquiries so that we can identify trends in new services and business models more clearly. However, we see some risk that stakeholder expectations of the innovation enquiry service may exceed the AER's role and capabilities, particularly with respect to resourcing.

Both the proposed innovation enquiry service and waiver process (including the development of a waiver guideline) will require additional resourcing for the AER. With respect to the innovation enquiry service, the AEMC's proposal implies that there is pent-up demand from innovators for regulatory guidance, which a more visible innovation enquiry service would address. We are currently not sufficiently resourced to serve a marked increase in public

enquiries, and will likely need to seek additional resources to address this. Similarly, we would need additional resources to develop the sandbox guideline development process, assess waiver applications, and monitor/share insights from sandbox trials. We consider that appropriate resourcing for the AER will be important if the benefits of the sandbox toolkit are to be realised.

In Attachment A we comment in further detail on different aspects of a regulatory sandbox toolkit, and we provide information on how we have approached some of the specific trials raised in the consultation paper.

Yours sincerely,

A handwritten signature in blue ink, appearing to be 'M Feather', is written over a faint, light blue rectangular background.

Mark Feather
General Manager, Policy and Performance

Attachment A

The innovation enquiry service

We agree that it is important to set a common understanding of what the innovation enquiry service will provide. We support the AEMC's proposed scope of guidance that an innovator will receive, namely, an innovator that contacts the AER can expect to receive guidance on:

- what regulations and rules may apply to their specific project or business model;
- options available to progress a project or business model with respect to the regulations; and
- how to undertake any formal regulatory processes or applications and who they can contact to progress the process.

We also support the recommendation that the AER should not provide legal advice, binding rulings, regulatory decisions, endorsements, or business incubator services.

The AER currently provides staff level guidance to innovators as part of our business-as-usual activities (this is further detailed in our submission on the AEMC's Consultation Paper). We see a number of benefits from establishing separate entry point for innovators to seek guidance from the AER as outlined by the AEMC. These are:

- Innovators will be aware of the guidance we already provide, which will make it more accessible. From the submissions to the AEMC's consultation paper, many innovators seemed unaware that they could contact the AER through the email contact details on our website.
- Maintaining points of contact with AEMO and ARENA will enable us to more effectively provide the right entry point for innovators, where AEMO or ARENA are better positioned to address all or part of an innovator's enquiry.
- Creating a separate entry point through which innovators can contact us (e.g. a separate email address) may help us track and analyse innovation-focused enquiries.

However, we see a risk that stakeholder expectations of the innovation enquiry service may exceed the AER's role and capabilities. For example, we consider that it would be inappropriate for the AER to provide advice to innovators on behalf of other agencies or market bodies, such as AEMO or ARENA. The AER can help facilitate innovators in contacting the most appropriate staff in other market bodies or agencies, and we can arrange meetings between relevant staff from AEMO and the AER and innovators where appropriate. However, we cannot provide advice on behalf of AEMO or ARENA.

We note that the AEMC's Draft Report has set out how the innovation enquiry service would operate in some level of detail. This detail covers how innovators can expect to contact AER staff, and how AER staff should prioritise individual enquiries. We consider that this level of operational and mechanical detail is best left to the AER to determine, according to the resources we have available and our organisational systems and processes. We consider that setting out this level of detail in the final report risks raising unrealistic stakeholder expectations, given the AER's expanding general responsibilities and limited resources.

The AEMC's Draft Report does not say whether or not the innovation enquiry service will require a change to the energy rules. We suggest that the AEMC make this explicit in their Final Report.

Regulatory waiver power and sandbox guideline

We support the AEMC's proposal to expand the AER's heads of power under s.15 of the NEL to include a broad exemptions power, as well as establishing requirements in the energy laws and rules for the AER to develop a sandbox guideline to govern the operation of the waiver power. As noted in our submission to the AEMC's Consultation Paper, we support establishing a transparent mechanism to allow for regulatory experiments in the NEM. A mechanism that is explicitly focused on supporting innovation is preferable to using the AER's enforcement discretion to support innovative trials.

Scope of the waiver power

The AEMC states that the waiver power will apply only to the energy rules and not the energy laws. We agree that this is appropriate. Based on our experience in providing advice to proponents of innovative projects (as outlined in the case studies section of our submission on the Consultation Paper), we expect that an ability to waive the requirements of the rules will provide the AER with sufficient latitude to support meritorious trials.

The AEMC has stated that the waiver power will cover Chapters 6 and 6A of the NER. We support this approach, as it will be an important precondition for NSP participation in sandbox trials in some cases. We also note that the AEMC's draft recommendations include that the AER will be unable to 'exempt themselves' via a regulatory waiver. We agree that the AER should not be able to exempt itself from some provisions in the energy rules (for example, timeframes or consultation procedures). However, we note that many of the clauses in the Chapters 6 and 6A impose obligations on the AER in relation to the economic regulation of network businesses. For example, in order for the AER to allow NSPs to recover the cost of sandbox trials from regulated revenues (where this would otherwise not be permitted), the AER may need to waive provisions in the Chapters 6 and 6A that require us to have regard to specific factors in making an NSP revenue determination. We recommend that the AEMC further consider any potential unintended interactions between preventing the AER from exempting itself under the regulatory waiver power and its ability to waive NER requirements in Chapters 6 and 6A.

Waiver test and entry and eligibility criteria

In the Draft Report, the AEMC outlined a set of factors and criteria that will govern the development of a sandbox guideline, and the operation of regulatory waivers granted by the AER. We support the AEMC's proposed 'regulatory waiver test' that will be in the NEL and other energy laws. We note that the requirement in the regulatory waiver test for a project to be 'genuinely innovative' is quite broad in scope. We suggest that a clearer definition of 'innovative' would be appropriate, while allowing sufficient scope for the AER to further determine what is innovative in consultation with stakeholders. We suggest that a suitable definition of 'innovative' could be that: 'The AER must be satisfied that the trial will have a reasonable prospect of delivering material benefits to customers, where consideration of a rule change would otherwise be hampered through inadequate information or experience.' We base this recommended definition on the principles outlined in the AEMC's discussion of

the trial rule change, and consider that this is also appropriate for the waiver power.¹ We consider that a broad definition that is aligned with the purpose of the sandbox mechanism could provide additional clarity for the AER in assessing waiver applications.

We agree with the minimum eligibility criteria set out in the AEMC's Draft Report, which would be in the NER and other energy rules. In particular, we see merit in the consumer protections that the AEMC has proposed. Noting our comments above regarding the definition of 'genuinely innovative', we consider that the eligibility criteria set out in the Draft Report are sufficient to provide the AER with the flexibility to further define appropriate eligibility criteria in greater detail in the guideline, to assist us in transparent decision making with respect to waiver applications. Should the AEMC further develop these criteria in the final report, we recommend that the AEMC consider whether any additional criteria should be optional on the AER, rather than mandatory.

We consider that the minimum entry requirements outlined in the AEMC's Draft Report are broadly appropriate. However, we recommend that these requirements should be optional on the AER, rather than mandatory. As the entry requirements relate to the operational mechanics of how a waiver application should be submitted, rather than the principles on which a waiver application should be assessed and granted, we consider that these can appropriately sit in a guideline rather than the Rules.

We also recommend that the energy rules specifically require an applicant to comply with the entry requirements set out in the sandbox guideline to give the guideline entry requirements sufficient enforcement power.

The waiver process

The AEMC's Draft Report states that the AER will have the ability to prioritise trials that it will consider first. We recommend that the AER should be able to decide not grant a waiver applications if the application does not fit with an established set of priorities for sandbox experiments and trials. We see merits in adopting a more strategic approach to some areas of innovation by establishing priority areas for sandboxing. It is possible that an industry-wide approach to identifying areas of reform that require evidence from sandbox trials may yield better long-term outcomes from the sandbox mechanism than a random or reactive approach based on who comes 'through the door' first. While we expect that some areas of innovation in the NEM may lend themselves to a more reactive or 'bottom-up' approach (i.e. where the AER considers waiver applications on a case-by-case basis), we recommend that the rules should also enable the AER to prioritise trials based on future areas of reform in the NEM.

Subject to consultation with stakeholders, we may explore options to target sandbox waiver applications. For example, we may call for waiver applications that address particular innovation challenges identified collaboratively by stakeholders. We may adopt processes that enable us to compare waiver applications, and choose the best waiver applications out of a similar set of projects. For example, we understand that Ofgem and other regulators sometimes issue competitive calls for applications on specific kinds of projects as part of their sandbox processes. We may also adopt processes to limit waiver applications to specific types of participants.

¹ p. 32 of the Draft Report.

We may adopt these sorts of waiver application processes based on whether they would help us:

- improve our ability to discover trials that are most likely to contribute to the long-term interests of customers;
- target trials that are likely to provide evidence and experience that can be used to support rule changes; or
- mitigate various kinds of project risks (e.g. risks to customers, other market participants, or project failure risk).

We recommend that a number of elements of the AER's waiver power should be established in the energy rules. These include the ability to: impose time limits on waivers, extend waivers, impose conditions on waivers, revoke waivers, and require recipients of waivers to comply with any waiver conditions set out by the AER. This reflects the fact that the requirements that the AER will be waiving under the waiver mechanism will be those set out in the rules themselves, rather than in an AER guideline.

We support the AEMC's draft recommendation that the AER should retain discretion as to whether it consults with other parties (whether publicly or otherwise) on waiver applications. In practice, we anticipate that any projects significant enough to require a regulatory waiver will, in almost all cases, be put to public consultation.

We also recognise that some waiver applications may involve confidential or proprietary information. In principle, we consider that applicants should be prepared to make their entire waiver application public, unless there are specific elements of the waiver application that are clearly confidential. Limiting confidential information in a waiver application will be important to ensure that the sandbox process is transparent and that knowledge is shared. The AER would welcome further discussion with the AEMC about how best to achieve this.

Trial rule-making process

We support the AEMC's proposal that the three different components of the sandbox toolkit should be sequential. That is, individual innovators would first seek guidance from the AER and/or AEMO before applying for a regulatory waiver. Innovators would then submit a trial rule change request to the AEMC only once it has been determined that a regulatory waiver provided by the AER would not be appropriate. We also support the AEMC's draft recommendation that trial rule change proponents should be required to demonstrate that a regulatory waiver is insufficient for their trial. We also recommend that trial rule change applicants should be required to describe any previous engagement with the AER and AEMO on the trial and the outcomes of this engagement. We consider that the AEMC should take previous engagement with other market bodies into account when considering a trial rule change request. We consider that this would be sufficient to avoid the risk of 'forum shopping'. We agree that it is not necessary to limit the ability to lodge trial rule change requests to the AER and AEMO only.

More broadly, the AER is conscious of the need to avoid forum shopping between all market bodies, including between the AER and AEMO. We would use the 'points of contact' outlined in the AEMC's draft recommendations on the innovation enquiry service to ensure that AEMO is appraised of any regulatory waiver applications that relate to AEMO's functions in a timely way.

We note that the AEMC raised the potential for trial rule change requests to be subject to a fee to ameliorate the impact of speculative trial rule change requests. With respect to the trial rule change process, we expect that the risk of speculative trial rule change requests could be mitigated by a requirement for a trial rule change applicant to: (1) demonstrate that they have engaged with the other market bodies on their trial before submitting a trial rule change request to the AEMC, and; (2) provide an accurate description of the outcomes of that engagement.

Resourcing the innovation enquiry service and the sandbox waiver

Adequate resourcing for the innovation enquiry service and the sandbox waiver will be an important part of the success of the sandbox mechanism. This resourcing need will cover both the innovation enquiry service and the regulatory waiver guideline development process, and the process of assessing and deciding on waiver applications.

From stakeholder submissions on the innovation enquiry component of the sandbox mechanism, we understand that the innovators are in many cases unaware of the guidance that the AER already regularly provides to members of the public, including innovators. This implies that there is a certain degree of pent up demand for this service, and that once the innovation enquiry service is established and promoted in the way outlined in the AEMC's Draft Report, the AER will likely experience a material increase in enquiries.

Similarly, development of the sandboxing guideline and implementation of a waiver process will represent an expansion the AER's remit to explicitly encompass innovation. This is distinct from our current organisational focus on economic regulation and compliance and enforcement (although we also support innovation where appropriate in the context of those two functions). We will aim to develop a sandbox guideline and waiver process that brings innovations to the fore that best contribute to the long-term interests of customers, in a way that is efficient for the AER and transparent for innovators. We expect that this will require an intensive process of collaboration and co-design with other market bodies, government organisations, and other stakeholders. Moreover, this collaborative approach will need to continue through the guideline implementation phase and into the operational phase, once the AER commences assessing regulatory waiver applications. This ongoing collaborative process, as well as the administrative process of assessing regulatory waiver applications, will require increased resourcing.

We note from Ofgem's lessons learnt report that many projects that received a sandbox exemption did not proceed due to non-regulatory project risk, such as the capacity and capability of the host organisation to successfully execute the project.² Access to financing was cited as one common reason for why projects did not proceed. In considering the resource efficiency of a sandbox mechanism, we would likely seek to collaborate with ARENA to mitigate the risk that sandbox projects do not succeed due to non-regulatory barriers. ARENA has teams of staff that manage end-to-end project execution risk, to ensure that ARENA funding of innovative renewable energy and energy efficient projects is put to its most efficient use. The AER would likely explore ways that we can leverage ARENA's skill set to detect and manage projects with high project failure risk. This would help to ensure that the resourcing for the sandbox initiative is targeted at projects that are more likely to deliver benefits for customers, as well as insights and experience that can inform rule

² Ofgem, *Insights from running the regulatory sandbox*, October 2018, p. 3.

changes. Should ARENA cease performing its current functions (ARENA's funding is due to expire in 2022 under the ARENA Act), the AER will need to consider whether there is a need for further resourcing to assess the capacity and capability of project proponents to execute their proposed trials.

Finally, we note that the AER will be required to monitor and enforce compliance with any conditions associated with a trial rule change. This will also need to be considered as part of the overall resourcing implications of the sandbox toolkit.