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EPR0068 - Regulatory Sandbox Arrangements to Support Proof-of-Concept Trials

AGL Energy (**AGL**) welcomes the opportunity to make a submission to the Australian Energy Market Commission's (**AEMC**) Regulatory Sandbox Arrangements Consultation Paper (**Consultation Paper**).

AGL is one of Australia's largest integrated energy companies and the largest ASX listed owner, operator and developer of renewable generation. Our diverse power generation portfolio includes base, peaking and intermediate generation plants, spread across traditional thermal generation as well as renewable sources. AGL is also a significant retailer of energy, providing energy solutions to around 3.5 million customers throughout eastern Australia.

In addition, AGL is continually innovating our suite of distributed energy services and solutions for customers of all sizes. These behind-the-meter energy solutions involve new and emerging technologies such as energy storage, electric vehicles, solar PV systems, digital meters, and home energy management services delivered through digital applications.

Regulatory sandbox arrangements

Investigating the use of regulatory sandbox arrangements and facilitating the coordination of proof-of-concept trials will be useful in unlocking innovation across the energy supply chain. We consider that innovation in the energy sector will be best driven by increased opportunities for participation by competitive businesses. Reviewing the ways that regulatory hurdles create barriers to innovation for the competitive market is therefore very welcome as a part of this consultation.

We agree that the emergence of innovative technologies and business models in the NEM is likely to bring significant benefits to consumers. This was highlighted in the Independent Review into the Future Security of the National Electricity Market (**Finkel Review**), which noted that innovative technologies could help reduce the costs of providing secure and reliable electricity supply, and also contribute to reducing emissions. Regulatory frameworks and processes must therefore support the emergence of potentially beneficial emerging technologies and business models.

We are therefore generally supportive of developing a process to allow regulatory sandbox arrangements, but only for specific types of trials that meet defined criteria. For example, we note that networks should not seek to utilise the sandbox framework to overcome ring-fencing obligations or principles concerning the contestability of energy services. More generally, regulatory sandboxes should also not be used by businesses to gain a foothold in competitive markets; rather, they should be utilised to prove innovative concepts that are inhibited by regulatory failures or barriers in a transforming market.

Customer choice and preferences

Customer preferences are continuously evolving. The availability of distributed renewable generation and other digital technologies is enabling customers to exert greater control over their energy usage and demand improved services and a wider range of products from energy service providers.

These changing market dynamics require public policy reform to ensure fit-for-purpose consumer protection and robust participation in a competitive market. The existing rules framework should support innovation rather than stifle business development, and where genuine regulatory barriers exist, regulatory sandbox arrangements may in some cases be appropriate to prove that concepts can benefit customers.

Historically, there have been numerous examples of detailed regulatory obligations limiting the ability for retailers to engage in modern and innovative practices. For example, the use of SMS messages and e-mail as preferred modes of communication with customers has been hampered by restrictions on requirements to send notices by post and make telephone calls.

Customer consent requirements, pricing arrangements, and marketing obligations remain more stringent in energy markets than in comparable service industries, and there has been a limited desire by regulators to accept emerging technology and innovative approaches as useful replacements for traditional ways of meeting regulatory obligations.

The regulatory framework should therefore facilitate digital engagement and service providers in their efforts to expeditiously bring to market new products and services and through channels that consumers value. It should promote competitive neutrality and allow existing and emerging business models to compete on their merits, enabling consumers to choose products and services that suit their circumstances.

Grid modernisation and network reform

Innovative practices are not merely limited to arrangements between retailers and customers. AGL believes that the future of the grid will be as a gateway to multiple competitive platforms that enable a range of markets for customers. The distribution network will increasingly become the platform across which customers expect to be able to connect and transact. Competing energy service providers are beginning to trial and offer innovative products and services that leverage the grid to provide customers with access to other markets and value streams, and innovation in this area should be promoted.

Great care therefore needs to be taken in relaxing regulatory restrictions on network businesses that would impact the viability of emerging competitive markets. AGL and other stakeholders have previously raised concerns about the use of regulated funds to gain a foothold in competitive markets in relation to consultations regarding the contestability of energy services and the network demand management incentive scheme (**DMIS**).

Network businesses should be required to act in the most efficient manner by testing the competitive market for the provision of demand response and other non-network solutions before developing their own programs or directly investing in distributed energy technologies and including such expenditure in the regulated asset base. To facilitate the development of viable competitive products which address network needs, network businesses should also make available sufficient and useful data about the characteristics and location of those network needs and the costs of alternative network investments.

A regulatory sandbox should not be utilised to allow networks to participate in markets where competitive businesses could provide an equivalent service at a more efficient price.

There is a natural requirement on businesses operating in the competitive market to maintain a definite customer focus in the products and services they develop, and to innovate and extract efficiencies and additional values where possible, so that the product delivered to the end-customer addresses their needs and preferences while being price competitive. Without this competitive discipline and with a singular focus

on network benefits, programs delivered directly by distribution businesses are unlikely to result in the most efficient deployment of distributed energy technologies.

This creates a barrier to the development of well-functioning markets in products and services enabled by distributed energy technologies, including demand management programs. Without effective competition in the delivery of such services, the efficiency of network spending, customer choice and innovation will be diminished.

Insights from other regulatory sandbox arrangements

Insights from OFGEM trials cited in the AEMC's consultation paper provide a useful basis for discussing the rationale for sandbox trials. OFGEM's observations that prospective users of the regulatory sandbox needed advice rather than a relaxation of regulatory restrictions are insightful for the purposes of the AEMC's review.

It may not always be clear to innovators if a prospective practice or business model is in conflict with existing regulation. Energy market regulation is complicated and consists of a complex mix of requirements including industry norms, systems, financial arrangements, codes, and licenses. In our view, prospective innovators should be aware of these structures prior to requesting exemptions from regulatory conditions.

Although innovation may often be considered the domain of smaller agile companies that are willing to take on greater risk, developing innovative business models applies equally to more advanced businesses (either within the energy sector or adjacent industries) looking for ways to better serve their customers. These businesses often have a clear understanding of barriers to participation that could enable new approaches to reducing costs and improving services for customers.

The focus of sandbox arrangements should not therefore be simply to provide advice to prospective innovators, but rather to facilitate arrangements for informed businesses to test the structure of existing regulatory frameworks by proving a concept is beneficial for customers in the long-term.

In this regard, we support OFGEM's guidelines for projects that may be eligible for a regulatory sandbox, being that: the proposal is genuinely innovative, the innovation will deliver consumer benefits and consumers will be protected during the trial, a regulatory barrier inhibits innovation, and that the proposal can be trialled.

To these conditions we would add a recommendation as to the appropriate credentials of the business to undertake the trial, which should be assessed on a case by case basis. For example, it may not be appropriate for a network business to undertake trials that are more suited to a competitive landscape.

Businesses with established frameworks to manage energy market risks and impacts on customers may pose less of a risk to sandbox utilisation than emerging companies who may not be able to adequately manage risks or obligations. Without limiting competition, the ability to participate in a trial should be commensurate to the ability of the business to establish that they can adequately manage any adverse risks that may emerge during the process.

Current arrangements in the NEM

Under the current regulatory framework, trials and other forms of innovation can be facilitated by the AER exercising its enforcement discretion, including its powers to issue no action letters or simply to provide informal advice to participants in response to questions.

We consider that these existing powers are useful, and that innovation will be driven by flexible compliance frameworks and holistic approaches to regulation that take account of attempts to drive innovative solutions that are for the long terms benefit of customers.

The disadvantage of letters of no action or informal guidance, however, is that such advices are often not made public for the benefit of other participants. While we do not consider that all interactions with market

bodies and regulators need to be made public, there would be some advantages to formalising trials and sandbox arrangements where these can provide significant benefits for the market where these trials address material regulatory barriers.

To the extent that disclosures regarding commercially sensitive data and customer data must be protected, we therefore consider that there are good arguments for providing broader information about the outcome of innovative trials in the NEM. The focus on any disclosure arrangements should be that innovation is for the benefit of all customers and not just for certain businesses to gain a foothold in the market.

Reporting conditions may be considered as a part of the process to participate in a sandbox and should be commensurate with the scope of the exclusion sought by a participant. Information that must be reported on could include a brief statement of the concept that is being tested and next steps; for example, in relation to recommendations for a rule change.

Existing exemptions frameworks

Where existing exemptions are available, or where other process allow market participants to innovate, these should be utilised, or further developed in a way that drives innovation.

An example is the DMIS, which should be used as a regulatory basis for demand management innovation by networks rather than sandbox arrangements. Similarly, there is an established process for providing exemptions for alternative energy sellers, which should be utilised where appropriate instead of bespoke sandbox arrangements.

Exemptions for the retail sector must also consider the maintenance of consumer protections, in particular in multi-party relationships. In an increasingly connected market, customers may have an existing relationship with their retailer, solar or battery provider, appliance installer, or other parties, each of whom have their own responsibilities to the customer. In allowing a sandbox trial, care should be taken that existing relationships and obligations are not impacted. As a general rule, regularly sandbox arrangements should not oblige other participants to amend their business practices unwillingly.

Exclusions to consumer protections to undertake trials should also be available on an open basis where possible; for example, if one party is able to obtain information on a certain technology, then others must equally be afforded this opportunity. Businesses should not necessarily be able to gain a foothold in a desirable market simply by virtue of a regulatory sandbox. Proof of concept should not equate to first-to-market, and it may be appropriate that limitations are placed on trials to preserve competition in the market.

Regulatory guidance

Prior to requesting letters of no action or exemptions on a formal basis, guidance is often sought from market bodies on their interpretations of rules where there is a lack of objective clarity on how those rules may apply to innovative business models or practices.

We would expect that some guidance generally should be provided by regulators and relevant market bodies as a part of their everyday business. Information that is regularly sought by existing and prospective market participants should be publically available, and explanatory information for new entrants should be developed to avoid regular similar enquiries.

Provision of guidance, in our view, is unlikely to be a significant overhead for organisations with the size and expertise of the AER, AEMO, and AEMC. We recognise, however, that such guidance would not replace legal advice, and we acknowledge that regulators may reserve the right to not provide a definitive ruling on an interpretation of the regulatory framework.

Particularly in relation to innovative practices, proposed business practices may be at the edge of established rules and regulations. It is precisely in these instances that opportunities for sandbox trials may arise to assess impact and resulting compliance with the energy regulations.

Should you have any questions in relation to this submission, please contact Aleks Smits, Manager Policy & Research on 03 8633 7146, or myself on 03 8633 7252.

Yours sincerely,

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