

Australian Energy Market Commission
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Lodged online: www.aemc.gov.au

25 January 2019

Regulatory sandbox arrangements

The Australian Energy Council welcomes the opportunity to make a submission to the AEMC consultation on regulatory sandbox arrangements to support proof of concept trials.

The Australian Energy Council (AEC) is the industry body representing 21 electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. These businesses collectively generate the overwhelming majority of electricity in Australia and sell gas and electricity to over 10 million homes and businesses.

The AEMC has been asked by COAG to consider whether the economic regulatory framework for electricity networks is sufficiently robust and flexible to continue to support the long term interest of consumers in a future environment of increased decentralised energy supply as part of its annual framework review to monitor market developments.

The Finkel review recommended updating the proof-of-concept testing framework, to facilitate innovation in the NEM¹. In the AEC's view, proof of concept centres around novel, early stage research that would not be facilitated from any other conventional source. Further, proof-of-concept testing is to create evidence about the feasibility of a good and/or service to meet a business need under realistic operating conditions². This is a sensible contextual requirement, as the question needs to be considered as to what happens when the relaxed regulatory requirements lapse and the real regulatory environment applies.

Barriers to proof of concept trials

OFGEM's insights from running the regulatory sandbox indicate that innovators commonly needed advice, and not a sandbox.³ They observed that most innovators wanted to launch enduring businesses and are less focused on trials.⁴ In the AEC view the regulatory sandbox should focus on the business innovation at a stage when it is characterised by a lot of unknowns, uncertainties,

¹ AEMC, Regulatory sandbox arrangements, Consultation paper, 20 December 2018

² NSW Procurement Board Direction on Innovation. Available at <https://arp.nsw.gov.au/pbd-2014-05-procurement-innovation-stream>

³ AEMC, Regulatory sandbox arrangements, Consultation paper, 20 December 2018, p.7

⁴ Ibid

and inherently unknowable risks, ie the trial stage. If innovators want to launch an enduring business then they are presumably ready for a hard launch and have already contemplated the unknown, uncertain, and unknowable. The AEMC consultation paper notes that the Financial Control Authority report on *Regulatory sandbox lessons learned* identified improved access to finance for projects through increased regulatory certainty.⁵ Whilst perhaps welcome, the AEC would caution that the sandbox process should not be used by innovators to signal lower regulatory risk to investors. The sandbox is an innovation tool, not a risk reduction strategy. Nor should it comprise a free kick to market entry. Above all, the sandbox is not a specific condition to support integration into the existing market that endures beyond the trial stage.

OFGEM also reiterated that it was important to differentiate the sandbox from a permanent rule change. The regulatory sandbox has covered rules controlled by OFGEM, and OFGEM are not able to offer relief from the detailed codes which underpin the operation of the gas and electricity markets. Sandbox trials can provide evidence to OFGEM as to whether regulation should change permanently⁶. As proof-of-concept testing is to create evidence about the feasibility of a good and/or service to meet a business need *under realistic operating conditions*, presumably there would be many cases where the case for change could be made without specific sandbox trialing, as it is now.

The Australian retail energy market context

Energy retailers see value in greater engagement between participants and AEMO or the AEMC to inform policy development. They also see value in the AEMC being able to test rules changes before any reforms are implemented, where possible.

In general, retailers don't see the need for a rules relaxation sandbox. They have worked with dozens of innovators and new businesses and haven't to date identified any specific need for such a capability. Much can be done with the existing framework⁷. It would be helpful to the consultation if the AEMC (or the SCO or ARENA)⁸ could provide more examples of the types of things that could be done, as opposed to the range of areas that could utilise a sandbox. These examples could also include the current regulatory issues related to these examples, or the types of rules that would need to be changed.

We also seek clear and strong guidelines and application criteria on any actual relaxation of rules. As a minimum we contend these must consider:

- Material social benefit. This, as opposed to minor unique business models;
- Physical and financial impacts on others. "In-market" tests should be ring-fenced from the rest of the market. To test an idea with impacts on others, the tests could be conducted in a non-live simulated environment.

⁵ Financial Control Authority, Regulatory sandbox lessons learned report, October 2017, pp.5-6.

⁶ OFGEM, What is a regulatory sandbox? September 2018

https://www.ofgem.gov.uk/system/files/docs/2018/09/what_is_a_regulatory_sandbox.pdf

⁷ AEMC, Regulatory sandbox arrangements, Consultation paper, 20 December 2018, p.10 – No Action letters

⁸ AEMC, Regulatory sandbox arrangements, Consultation paper, 20 December 2018, p.10 – reference to letter from SCO

- Risks to customers. This requires that strong protections are retained, without creating duplicate regulation to specifically protect sandbox environments.
- Free rider situations. Ensuring that customers aren't funding substantial infrastructure, or extensive free legal advice, for businesses. Guidance should be co-funded by applicants, and consumers shouldn't be funding substantial advice requirements to test business models or ideas.

Retailers are supportive of creating a co-ordination framework that aggregates information and streamlines businesses ability to navigate and to request support. Any guidance or application criteria would in our view preferably be co-ordinated by the AEMC in their role of assessing possible rule changes.

Trials under AER enforcement discretion

OFGEM requires that the innovator report on what it has learnt.⁹ The AEC would like to see this reporting criteria expanded here, especially where regulated businesses are involved in sandbox trials, to avoid duplication of effort and ultimately costs. This reporting should have a reasonable time limit. Though we agree that commercially-sensitive information may be withheld from public reporting, including the innovator's intellectual property, unless otherwise agreed.

The AEC view is that no action letters issued by the AER that facilitate innovation or proof-of-concept trials should be made public, along with an explanatory memorandum. The memorandum need not be complex. The NSW Procurement Board Direction on Innovation set out the minimum requirements for public information about sandbox trials. These are:¹⁰

- a statement by the agency as to why the test or trial was undertaken
- the identity of the supplier(s) involved in the test or trial, and whether the agency or the supplier initiated negotiations leading to the test or trial¹¹
- the value and duration of the test or trial
- all data and findings associated with the trial
- the treatment of intellectual property created during the course of the trial
- whether the agency has any further procurements planned arising from the test or trial.

The NSW Procurement Board Direction allows for commercially sensitive information to be withheld from publication, including the supplier's intellectual property.¹² The AEC supports a comparable, though not verbatim approach. In particular, explanation of what will happen with data and findings associated with the trial is useful as opposed to their specific publication or release.

⁹ Ibid

¹⁰ NSW Procurement Board Direction on Innovation. Available at <https://arp.nsw.gov.au/pbd-2014-05-procurement-innovation-stream>

¹¹ This latter point is probably not required.

¹² NSW Procurement Board Direction on Innovation. Available at <https://arp.nsw.gov.au/pbd-2014-05-procurement-innovation-stream>

The need for a formal regulatory sandbox

OFGEM reiterated that it was important to differentiate the sandbox from a permanent rule change. The regulatory sandbox has covered rules controlled by OFGEM, and that OFGEM are not able to offer relief from the detailed codes which underpin the operation of the gas and electricity markets. This seems to conflict with a view of regulatory sandbox arrangements in the consultation paper where some regulatory requirements are relaxed on a time-limited basis whilst appropriate safeguards remain in place.¹³ The need for proof-of-concept testing to create evidence about the feasibility of a good and/or service to meet a business need requires that it be conducted *under realistic operating conditions*. Presumably there would be many cases where the case for change could be made without specific sandbox trialing, as it is now.

Any questions about our submission should be addressed to David Markham by email to david.markham@energycouncil.com.au or by telephone on (03) 9205 3107.

Yours sincerely,

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¹³ Consultation paper Regulatory sandbox arrangements 20 December 2018 p.19