

Energy Consumers Australia

Local Generation Credit Rule Change

Submission on the Consultation Paper

February 2016

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Background

On 14 July 2015 City of Sydney, the Total Environment Centre and the Property Council of Australia (the proponents) submitted a rule change request (the Rule Change) to the Australian Energy Market Commission (AEMC) that would alter the payment arrangements for embedded generators in the National Electricity Market (NEM).

On 10 December 2015 the AEMC published the National Electricity Amendment (Local Generation Network Credits) Rule 2015 Consultation Paper (the Paper).

As outlined in the Paper there are already a number of mechanisms in the NER to incentivise market participants to support the use of embedded generation. The rule proponents contend that there remains a gap in the NER with regard to **small-scale** embedded generation.

Given the complexity of the rule change and the number of different stakeholder views that will need to be addressed the AEMC has indicated that a series of workshops will be held from February to April.

The intention to conduct workshops is welcomed, however the effectiveness of these workshops will depend on their design. To be effective they need to elicit the principles that parties think need to be achieved by market outcomes and a consideration of the extent to which rules or other mechanisms can achieve these outcomes.

The Paper also states that “Depending on the content of submissions and the feedback received at the workshops we may choose to release an Options Paper in June or July 2016 that seeks views on a number of alternative approaches.” ECA encourages the AEMC to publish a further consultation paper after the workshops that summarises the outcomes from the workshops and invites further submissions irrespective of whether there are any alternative approaches being considered.

The Long Term Interests of Consumers

Australia’s national energy markets have been established by the agreement reached between participating jurisdictions with the objective of promoting the long term interest of consumers. The three laws that govern the regulatory arrangements also have the promotion of the long term interests of consumers (through efficient investment in, operation and use of, services) as their objective.

The long term interests of consumers with respect to price, reliability, quality, safety and security of supply depends on the economically efficient operation of the electricity markets. The policy framework employed for the Australian market is based on the strict separation of potentially competitive markets from services that have natural monopoly characteristics. The LTIC is promoted by “best practice” regulation of (transmission and distribution) networks and promoting competition in the generation and retail markets.

Embedded generation is a potentially contestable market. Policy and rules should support the development of competition in these markets while at the same time restricting networks from utilising their monopoly power in those markets.¹

The outcome of these arrangements should be that prices for consumers are no more than necessary to provide the quality, reliability, safety and security of supply required by consumers.

At its simplest the proposition advanced by the rule change proponents is based on the assumption that embedded generation can provide services that can reduce the need for investment by networks. However, the proposition that the entire cost saving (if any) to networks should be passed through to the embedded generator does not promote the long term interests of consumers because the aggregate network cost does not decline (because the avoided cost is converted to an operating expense).

Where the issue becomes particularly significant is where a Distribution Network Service Provider (DNSP) is confronted by an actual choice between making an investment in their network and making ongoing payments to a third party to obtain the equivalent outcome. Where the cost of the series of payments is less than the required rate of return on the investment the LTIC is best served by the DNSP acquiring the network outcome through an embedded generation credit.

The conditions under which the LTIC is promoted by an embedded generation credit are therefore location context specific and as the Paper demonstrates, the LTIC of consumers is unlikely to be well accommodated by a rule change requiring the payment of such credits. Ultimately the trade-off between accuracy and simplicity, as the Paper describes it, will have implications for increases in average electricity prices faced by consumers.

The more relevant issue than requiring the payment of credits to embedded generators is the proposed consideration of network incentives to substitute opex for capex (recommendation 3 from the AEMC's final report *Integration of Energy Storage: Regulatory Implications*).

The AEMC recommends that the incentives on network businesses to substitute opex for capex would benefit from review. The AER is the appropriate body to do this. The review could encompass:

- *the strength of the EBSS and CESS;*
- *whether expenditure on storage services through opex would qualify for the EBSS; and*
- *whether further incentives are needed on network businesses to consider opportunities to substitute opex for capex, noting the ineligibility of TNSPs for the DMIA and DMIS.*

Conclusion

Within the overarching framework of the LTIC ECA supports the AEMC's proposed assessment framework for the rule change. Within this framework the rule change should assess whether existing incentives are adequate for both customer investment in, and operation of, embedded generation and for DNSPs to procure embedded generation services through opex when it is the least cost solution. However, a more complete understanding of the incentives for DNSPs to substitute opex for capex more generally is needed, and this requires the AER to undertake the review proposed by the AEMC.

¹ See the ECA Paper *The future of electricity distribution network regulation* January 2016.