



EnergyAustralia

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Local Generation Network Credits Consultation Paper

1. Introduction

EnergyAustralia welcomes the opportunity to comment on the Australian Energy Market Commission's (AEMC) Consultation Paper on the Local Generation Network Credit rule change proposal. We are one of Australia's largest energy companies, with over 2.5 million household and business customer accounts in NSW, Victoria, Queensland, South Australia and the Australian Capital Territory. We also own and operate a multi-billion dollar portfolio of energy generation facilities across Australia, including coal, gas and wind assets with control of over 4,500MW of generation in the National Electricity Market.

We agree with the proponents of the rule change that embedded generation can potentially offer significant benefits to networks in the form of reduced operating costs and avoided investment. As the AEMC notes, however, this is highly dependent on factors such as location and reliability, rather than simply by virtue of being embedded generation.

EnergyAustralia believes our customers' interests are best served by a regulatory framework for electricity distribution that encourages efficient utilisation and investment. This means the National Electricity Rules should avoid encouraging a specific form of investment or single type of solution to network constraints. The Consultation Paper also clearly explains that the proposal represents a transfer rather than a certain mechanism for reducing the overall cost of providing network services.

We agree with this and view the proposal as a poorly targeted and unnecessary measure that will only serve to impose additional costs on distributors rather than driving efficiencies in the provision of network services. The inherent asymmetry in the proposal, namely, that the credit cannot become negative under any circumstances, means that costs may be imposed on non-participating to pay generation credits to customers who create no benefit or even impose costs on the system. Therefore, it is unlikely to contribute to the National Electricity Objective.

Network regulation should evolve and there is a need for the AEMC, Australia Energy Regulator and other key stakeholders to constantly review the National Electricity Rules to ensure they avoid any bias in favour of specific solutions, particularly further augmentation of existing networks. This is challenging as developments such as technological change means the distinction between network and non-network services becomes harder to draw. Within this context, we support regulatory arrangements that incentivise networks to operate efficiently and to consider all feasible solutions to existing and emerging constraints.

As such, we believe that current initiatives – most notably, the requirement for distribution networks to set tariffs with explicit reference to long run marginal cost – and the minimisation and removal of other distortions will deliver better outcomes for consumers than the proposed rule change.

2. Concerns with the proposed rule change

The AEMC's Consultation Paper offers comprehensive analysis of the rule change proposal and we broadly agree with its conclusions and concerns.

In particular, we agree that while embedded generation *may* be the most efficient solution to an emerging network constraint, this should be determined on a case-by-case basis as the optimal solution is highly dependent on location and reliability. Other solutions to network constraints may be superior. For example, controlled load or other demand response mechanisms may be equally or more effective in managing network constraints and we disagree with the presumption that embedded generation is always the least cost solution.

We are also concerned with the broad nature of the rule change in that it would mandate payments to all forms of embedded generation, irrespective of reliability and whether or not it was constructed in response to a network constraint. The notion of a payment to a 'portfolio' of embedded generation, only some elements of which offer genuine and certain network benefits, is counterintuitive and as the AEMC has noted, creates arbitrary cross subsidies between those different elements.

The business case for embedded generation should not be influenced by a mandated payment from distributors – that may or may not reflect the network benefits attributable to that form of generation – but instead by benefits across the entire energy supply chain (e.g. wholesale, network) and any other quantifiable environmental or social benefits.

The proponents acknowledge there are few obstacles to large scale embedded generation and yet the proposal does not differentiate according to size or indeed, any other characteristic, including reliability. The Oakley Greenwood analysis of the rule change proposal notes some challenges for small scale embedded generators in entering into arrangements with networks, most notably:

- *High transaction / administrative costs* – smaller embedded generators are unlikely to be able to access any of the benefits they provide to network businesses as a result of their export to the grid because these benefits to the embedded generator are likely to be small relative to the administrative costs the embedded generator would have to incur in entering into bespoke arrangements required in order to receive Network Support Payments; and

- *Requirements for firm capacity in an individual contract* – small embedded generators are likely to find it difficult to impossible to provide a 'firm' guarantee of capacity support (which is likely to be a pre-requisite for the receipt of Network Support Payments), despite the fact that on a probabilistic basis (i.e., when treated as part of a broader portfolio of capacity support), their ability to provide capacity support could be quantified.

These issues are indeed valid but rather than revealing a flaw in the regulatory framework that must be addressed, this discussion simply indicates that not all forms of embedded generation are able to offer material and certain network benefits that outweigh the associated costs. This suggests that the currently observed level of small scale embedded generation reflects wholesale market and other benefits that accrue to their owners (and other stakeholders) or a response to direct and indirect subsidies. The latter includes implicit cross subsidies inherent in current network tariffs for most small business and residential customers. The case for mandating payments to all embedded generators, even those that are part of a broader portfolio, is not compelling.

Finally, the AEMC has noted that many practical and operational aspects of the proposal remain unclear. For example:

- What level of locational granularity is expected in the estimation of avoided network costs?
- What is the base case against which the avoided cost of network augmentation is estimated?
- Does the inclusion of existing embedded generation mean that networks would be required to calculate the cost of network augmentation that would be required if there was no embedded generation in a particular location?
- What are the costs for distributors in establishing a new pricing relationship and how would it align with existing pricing processes, such as the preparation and approval of Tariff Structure Statements?

The absence of such details makes it difficult to compare the expected costs and benefits of the proposal. We expect the cost for distribution networks will be material but the networks themselves will be better placed to comment on the magnitude of any additional operational or administrative costs that different options might generate.

3. Encouraging efficient network utilisation and investment

It is important that the National Energy Rules do not distort the revenue determination process in favour of particular solutions to network constraints. This can occur in a number of ways, including the ability to incorporate investment in a regulated asset base, and the certainty (and magnitude) of rates of return on more conventional network augmentation solutions. As noted, there are numerous initiatives that seek to encourage efficient network utilisation and investment. EnergyAustralia views the proposed rule change as an unnecessary measure within this context.

EnergyAustralia has long supported the concept of more cost reflective network tariffs. In addition to encouraging more efficient investment over the longer term, such tariffs unwind cross subsidies – of which owners of small scale embedded generation have often been the

greatest beneficiaries – and therefore, represent a more equitable way of recovering network costs. Customers will face the right incentives and make consumption and investment decisions accordingly, this includes investment in technologies such as small scale embedded generation to provide them with greater flexibility and control over the timing and volume of consumption. We view this as a policy measure that will work effectively in conjunction with the various efficiency schemes built into the incentive structure for networks and will encourage networks to identify and implement efficient solutions to network constraints.

We are aware that networks have considered a number of different tariff options, all of which are intended to better reflect costs. Some could involve payments to entities such as embedded generators who are able to shift consumption away from periods of high demand or who draw on alternative energy sources.

The emergence of more cost effective forms of embedded generation also challenges the traditional definition of network boundaries, creating challenges for economic regulators in their classifications and in the assessment of network expenditure proposals. There is no easy solution for the AER, who must clearly specify the boundary between network (i.e. monopoly) and non network (i.e. contestable) services. It also has an important role to assess network expenditure proposals and identify the most economically efficient solution out of a number of potential solutions that may differ significantly.

EnergyAustralia supports recent rule changes relating to the Demand Management Incentive Scheme and the Demand Management Incentive Allowance. However, these schemes need to be cognisant of whether the activities are the sole responsibility of the regulated businesses. Consumers should not be funding improvements in capability where they duplicate work being done in the competitive energy markets nor support innovation in services which the regulated businesses might or should not be providing. Moreover, the competitive sector is best placed to capture the full range of benefits that non network solutions can offer. The AER is best placed to determine the appropriateness of any allowance proposed by a regulated business, given its historical performance.

These challenges also highlight the need to incorporate adequate stakeholder consultation in network planning processes and regulatory investment tests for transmission and distribution as a mechanism for addressing the commercial incentives of networks. Consultation must occur in advance of the decision about the form of investment; this will provide all entities, including owners of embedded generation, with the opportunity to contribute to the solution.

As noted in our submission to the AEMC's *Discussion Paper – Integration of Energy Storage Regulatory Implications*, EnergyAustralia recommends that distribution networks should be required to publish regular information on network constraints and network planning strategies to enable third parties to consider non network solutions. We also see merit in reviewing elements of the regulatory investment test for distribution to determine whether it remains valid as the cost of alternative technologies is falling.

A final issue is the need for appropriate ring fencing arrangements to encourage competitive outcomes. As we noted in our submission to the Commission's DMIS rule determination, there are inherent risks in maintaining competitive neutrality when a party is not just competing to provide a service but where they (or a closely related partner) is also the procurer of a service and / or holds important information. EnergyAustralia recommends that distribution networks should be required to evaluate and tender for non-network solutions for any material network investment proposal (augmentation and replacement).

Careful consideration should be given to whether a distribution business should be prevented from providing non-network solutions to itself, especially where it can influence the competitive process, and as a minimum the network business should be ring-fenced to ensure competitive neutrality is maintained.

The AER's proposed review of ring fencing arrangements is welcome and we also recommend the implementation of revised arrangements as soon as possible to facilitate the competitive provision of storage and other competitive services, rather than allowing some market participants to take advantage of the limitations of existing arrangements.

Should you require further information regarding this submission please call me on (03) 8628 1479.

Yours sincerely

A handwritten signature in black ink, appearing to read 'G Hargreaves', with a stylized flourish at the end.

Geoff Hargreaves
Industry Regulation Lead