11 July 2019

Mr John Pierce AO
Chair
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Electronic Submission – ERC0266

Consultation paper – Demand Management Incentive Scheme and Innovation Allowance for TNSPs

Dear Mr Pierce

Energy Networks Australia welcomes the opportunity to provide a response to the AEMC's Consultation Paper, Demand Management Incentive Scheme (DMIS) and Innovation Allowance (DMIA) for Transmission Network Service Providers (TNSPs).

Energy Networks Australia is the national industry body representing Australia's electricity transmission and distribution and gas distribution networks. Our members provide more than 16 million electricity and gas connections to almost every home and business across Australia.

The proposed rule changes mirror those that were introduced for distribution network service providers (DNSPs) in 2015 and are consistent with the Australian Competition and Consumer Commission's recommendation in its recent Retail Electricity Pricing Inquiry that the DMIS/DMIA arrangements be extended to TNSPs.[1]

This rule change will promote innovation in non-network solutions and encourage TNSPs to utilise non-network resources at sufficient scale to address constraints that manifest at the transmission level. Non-network solutions have an increasingly important role to play in minimising total system costs. Increased uptake of efficient non-network solutions is expected to benefit customers through lower transmission and total system costs.

In discussions with the AEMC, it is seeking further clarity on some aspects of the rule change request:

- Incentives for transmission demand management,
- Practical hurdles to deploying non-network solutions; and

[1] Australian Competition and Consumer Commission, *Restoring electricity affordability and Australia's competitive advantage; Retail Electricity Pricing Inquiry – Final Report*, June 2018, recommendation 22.

- Implementation issues.

Each of these issues is addressed below:

A balanced incentive framework for transmission demand management

The AEMC has raised the question of whether an 'incentive gap' exists in the current regulatory framework that may discourage TNSPs from pursuing demand management projects as an efficient alternative to network investment. Rather than addressing a gap in the framework, Energy Networks Australia considers that our rule change proposal addresses an imbalance of incentives that currently exists when pursuing demand management projects.

Specifically, it addresses the absence of positive financial incentives for TNSPs to adopt efficient non-network solutions. While there are reputational and compliance risks associated with procuring these solutions, the provision of funding for innovation can be expected to lower costs to consumers in the long-term.

Our proposed changes would complement existing opportunities for businesses to consider non-network options, including through revenue determinations, the Regulatory Investment Test for Transmission (RIT-T) and the Transmission Annual Planning Report (TAPR), in much the same way that the DMIS/DMIA complements equivalent regulatory mechanisms for distribution businesses.

Crucially, our proposal provides the AER with discretion to apply the DMIS/DMIA to individual TNSPs, so it offers a 'no regrets' change that does not preclude the consideration of wider regulatory reform going forward.

The Australian Energy Regulator (AER) has had some form of demand management incentive scheme in place for DNSPs since about 2009, it considers that a DMIS or DMIA is needed to help address an imbalance in the incentive framework for DNSPs. The AER updated the DMIS and DMIA for DNSPs in 2017.

Similar schemes have also evolved in the United Kingdom (UK) as part of the CPI-X regulatory framework. In the UK, Office of Gas and Electricity Markets (OFGEM) has schemes to encourage innovation and to develop these types of service offerings in the market. Innovation findings reports are published on an industry body website to encourage collaboration across stakeholders.

In relation to the DMIS, the AEMC has sought clarity from Energy Networks Australia on whether most TNSP expenditure is required to go through the Regulatory Investment Test – Transmission (RIT-T) which already requires the consideration and therefore execution of efficient non-network alternatives.

As in distribution, non-network solutions have a significant potential to provide solutions to reducing overall capital expenditure including for projects which would sit outside of the RIT-T. The RIT-T includes the requirement to consider, but no positive incentive to develop, non-network solutions. Energy Networks Australia sees this rule change request as complementary to the RIT-T, as the application of the DMIS and DMIA could result in more non-network solutions being viable through the promotion of a more mature non-network solution market.

Energy Networks Australia considers that there is merit in applying the DMIS/ DMIA framework to TNSPs to build scale in the demand management market and where the potential benefits are commensurately larger than for DNSPs. Energy Networks Australia is not aware of any evidence that non-network solutions are any less viable for transmission than distribution. Indeed, the UK Transmission Electricity System Operator commenced a program in 2015 (Power Responsive: www.http://powerresponsive.com/) to grow demand side response services to its network to 50 per cent by 2020, saving consumers £500M per year while reducing carbon emissions and reducing peak demand by more than 3 MW.

Energy Networks Australia would expect the DMIS/DMIA for TNSPs to work alongside the existing incentive mechanisms for TNSPs including the Capital Expenditure Sharing Scheme (CESS), Efficiency Benefit Sharing Scheme (EBSS) and Service Target Incentive Performance Scheme (STIPS) in broadly the same manner in which these schemes work alongside each other in distribution.

The AEMC suggested that government funding could be an alternative way to build up the market for demand management. Energy Networks Australia considers that the DMIA will directly promote the National Electricity Objective and therefore forms a logical part of the existing incentive framework under the rules, in the same way other elements of these arrangements operate.

Practical hurdles to adoption of non-network solutions in transmission

This rule change proposal will facilitate building up possible non-network solutions, contractual terms and vendors for consideration in a timelier manner in regulatory investment processes. This is preferred to starting from a minimal base today and expecting a contract at scale to be commercially, technically and operationally viable when needed.

Allowing the AER the discretion to introduce the schemes for transmission businesses will promote market development which would otherwise be deferred or not occur if left only to RIT-T and other transmission incentives arrangements.

NSPs' investment decisions to deploy non-network solutions are affected by considerations such as contracting and compliance risk relating to licence and other legislative obligations (including reliability obligations), along with the reputational risk that might arise from any non-compliance. As such it is important that TNSPs can build confidence with vendors that demand response has enough diversity, will be available when required and will be oversubscribed so that the required demand response can be achieved.

The mechanisms to enable demand response and notify customers or DNSPs all need to be worked through as do the commercial terms and conditions. It would not be prudent or efficient to contract at scale and expect the required response without first building up confidence with vendors, communications and engagement processes for response, technology viability, durability and scale. Building enough maturity in the market for non-network solutions is a focus of the proposed rule change.

The AEMC expects that the wholesale demand response mechanism and the ability for demand response aggregators to gain access to the wholesale electricity spot price will be completed by the end of this year. There may be some time allowed for underlying procedures and systems to be developed, before market commencement. Energy Networks Australia considers that this rule change will facilitate TNSPs partnering with these new market participants to develop and build scale solutions to meet identified transmission needs, including developing the hierarchy of use across the value chain as these new providers seek to develop the services market.

The rule change proposal will provide a certain and robust reporting framework for demand management which will allow TNSPs to take a more proactive approach in innovation and research and pursue developments in this area. This will provide more visibility for consumers over how TNSPs are using these arrangements to lower total system costs through the specific information provided to and published by the AER. This will facilitate lower long-term costs for consumers.

Annual transmission reports update forthcoming network constraints and timing which enables opportunities for demand response vendors to engage with TNSPs. This rule proposal also does not prevent TNSPs from publishing any findings from demand response activities and learnings to encourage demand management opportunities and improved collaboration.

Technology, markets and regulatory frameworks are evolving rapidly. The rule change proposal provides increased flexibility to dynamically respond to these changes.

Implementation of DMIS and DMIA

Energy Networks Australia proposed that the DMIS scheme be allowed to apply from 24 months before the end of the regulatory control period in the same way the scheme applies to DNSPs. This was proposed in recognition that TNSPs have staggered commencement dates for the next regulatory period and was considered a better option than seeking to adopt the scheme earlier in the current regulatory period. Re-opening and amending existing regulatory determinations to commence the schemes with a more coordinated starting timeframe is not considered a proportionate approach as, it would result in significant cost and complexity.

The AEMC has suggested that at the time of the DMIS rule change for DNSPs, the AER had completed the development of the DMIS scheme so that the AEMC and other stakeholders would understand how it applied. Energy Networks Australia notes that the AEMC is expecting to reach a final determination on this rule by the end of the year. The AER should be afforded enough time to develop and consult on the guidelines once the final rule is made. The existence of a distribution DMIS guideline is also likely to be informative for stakeholders as a transmission scheme is developed. Energy Networks Australia would welcome the opportunity to discuss the approach and timings with the AEMC and AER.

Energy Networks Australia agrees with the previous AER sentiment that DMIA should only be enabled at the start of the next regulatory control period.

Energy Networks Australia looks forward to the further consultation on the development of the demand management incentive framework applying to TNSPs with the relevant market bodies as the rules and guidelines are developed later this year.

Should you have any queries on this response please feel free to contact Verity Watson, vwatson@energynetworks.com.au.

Yours sincerely,

Tamatha Smith

Acting Chief Executive Officer