energy networks association

DEMAND MANAGEMENT INCENTIVE SCHEME

Response to AEMC Draft Rule Determination - ERC0177

9 July 2015

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EXECUTIVE SUMMARY

The Energy Networks Association (ENA) welcomes the opportunity to provide a response to the Australian Energy Market Commission's (AEMC) draft rule determination with respect to the Demand Management Incentive Scheme.

The ENA supports the overall structure of the draft rules, including a specification of two separate objectives for the Demand Management Incentive Scheme (DMIS) and the Demand Management Innovation Allowance (DMIA) followed by detailed principles to guide the Australian Energy Regulator (AER) in its regulatory decision-making.

The ENA broadly supports the approach that the AEMC has taken in its draft determination. In this submission, the ENA provides a number of enhancements which would further strengthen the AEMC's framework. Specifically, the ENA considers that:

» There is value in amending the DMIS draft rules to explicitly provide for the recovery of foregone revenue or profit impacts of demand management projects, where there is a reduction in the quantity of energy sold directly attributable to these projects. While a foregone revenue adjustment is not necessary under a revenue cap, it should be specified in the rules to ensure the recovery of approved revenues is not compromised in the event the control mechanism changes in future regulatory determinations.

» Consistent with the design principle of regulation being outcome focused, the specific provisions of the DMIS should be carefully drafted to ensure that there is no bias against innovative tariff design projects. These projects provide an opportunity to reward customers who assist in mitigating peak demand and are additional to the introduction of cost reflective network tariffs under the new distribution pricing rules. To the extent that tariff based projects can contribute to the achievement of the DMIS objective; it is unclear why they should be excluded from the scope of the scheme.

» Similarly, the AEMC should not distinguish embedded generation projects from other demand projects within the scope of the DMIA. It would be inappropriate to limit the forms of demand management permitted under the allowance within the AEMC's explanatory statement or the rules themselves.

» The AEMC needs to give further consideration in drafting the DMIS and the DMIA rules to ensure that greater transparency around the methodology for calculating incentive rewards under the DMIS, as well as the methodology for determining the level of the DMIA and decisions relating to the allocation of funding under the DMIA can be achieved.

» It is important to clarify the drafting principle 7 in the DMIS rule to ensure that it is sufficiently flexible to allow the AER to consider any element of the regulatory framework that may be inter-related to the operation of the DMIS in terms of affecting incentives for distribution businesses to undertake demand management.

» It would be beneficial for the final rule to clarify that additional reporting requirements under the DMIA must be proportionate to the project and resources employed. This is to avoid the potential administrative burdens and compliance costs.

The ENA notes that the AEMC has decided that consideration of the application of the DMIS and the DMIA to transmission businesses is out of scope of this rule change process. This position appears to be based on the AEMC's view that this matter should be addressed in a separate rule change process and that the AEMC agrees in principle that similar incentives should apply to transmission businesses.

The ENA continues to be of the view that there is no compelling reason to exclude the potential realisation of benefits associated with demand management projects and innovation in electricity transmission and would welcome further discussion in the AEMC's final determination on how it sees transmission businesses participating in the emerging demand management market.

BACKGROUND

The Energy Networks Association is the peak national body representing gas distribution and electricity transmission and distribution businesses throughout Australia.

Energy networks are the lower pressure gas pipes and low, medium and high voltage electricity lines that transmit and distribute gas and electricity from energy transmission systems directly to the doorsteps of energy customers.

Twenty-five electricity and gas network companies are members of the ENA, providing governments, policy-makers and the community with a single point of reference for major energy network issues in Australia.

With more than $100 billion in assets nationally and 13 million customer connections across the National Energy Market, Australia's energy networks provide the final step in the safe and reliable delivery of gas and electricity to households, businesses and industries.

DEMAND MANAGEMENT INCENTIVE SCHEME

Rewards under the scheme

The draft rule would allow the AER to take into account the net economic benefits produced by a demand management project. This is a welcome balance between explicitly recognising rewards for non-network market benefits within the rules and providing the AER with discretion as to how these benefits should be estimated.

The ENA considers that expanding the scope of the DMIS in such a way will provide greater incentives for distribution businesses to invest in projects that deliver broader market benefits. This is consistent with the DMIS objectives, as drafted by the AEMC.

The ENA recognises that the draft rules do not assume one form of regulation over the other, which is a desired outcome. However, the ENA considers there remains value in amending the rules to explicitly provide clarity around the recovery of foregone revenue or profit impacts of demand management projects, where there is a reduction in the quantity of energy sold directly attributable to these projects. This clarification would ensure that the incentives to undertake efficient demand management are not unintentionally undermined as a result of any separate AER decisions on the form of regulation made under Clause 6.2.5 of the *National Electricity Rules*.

The ENA is aware that that the AER intends to apply a revenue cap form of control in future distribution determinations. While a foregone revenue component is not necessary under a revenue cap, it should be specified in the rules to ensure the recovery of approved revenues is not compromised in the event the preferred form of control mechanism changes in future regulatory determinations.

Further, the ENA observes that ActewAGL is subject to an average revenue cap for the 2015-19 regulatory period. This means that demand management projects can have direct impact on recovery of the approved revenue. Therefore, the issue of foregone revenue is not redundant under the current arrangements as was suggested by some stakeholders.

Finally, the ENA considers there would be significant benefit in terms of transparency and regulatory certainty in requiring the AER to provide more detailed guidance with regard to its proposed approaches to calculate incentive rewards under the DMIS. The ENA would welcome further consideration of this matter in the final determination. For example, the AEMC may wish to clarify in relation to the requirement for the AER to develop and publish the DMIS in accordance with the distribution consultation procedures that the scheme should set out the methodologies the AER proposes to use in calculating incentive rewards under the scheme.

Applicable demand management projects

The ENA is concerned with the AEMC's view that it is not appropriate for the DMIS to be used for tariff based projects. The ENA acknowledges that despite this view, the AEMC's draft rule is flexible enough to allow for both tariff and non-tariff based demand management projects to be included within the scope of the DMIS.

Networks are more likely to utilise demand management tariffs or other rebate type incentive to manage critical peak loads, and where network constraints are evident. These projects provide an opportunity to reward customers who assist in mitigating peak demand. They are <u>*additional*</u> to the general network tariffs to be offered to mass market customers which signal the long term cost of supplying capacity. However, under the new rules, other factors than long-run marginal costs must be considered, including customer impacts and jurisdictional obligations, and the need for retail customers to be able to understand and respond to the tariffs. Demand management tariffs provide an opportunity for innovation in sending sharper price signals to customers of the value of reducing peak demand, in locations where the value could be high.

With the passage of the AEMC's recent network tariff rule changes, networks and customers will be more closely engaged than ever before in developing new and revised tariff offerings that drive lower system costs for consumers in the long-term. In this environment, mechanisms which promote and encourage a trialling of range of innovative tariff design options will serve as a useful empirical base of knowledge for future network tariff approval processes. For example, Jemena electricity distribution network proposed a project aimed at managing peak demand through customer engagement in its regulatory proposal for 2015-20 regulatory period. This project is proposed under the existing Demand Management and Embedded Generation Connection Incentive Scheme. As part of this project, Jemena proposes to design and undertake a tariff trial aimed at managing peak demand.

It is important to ensure that the final rules do not have the unintended consequence of precluding tariff based projects from the DMIS, as it would limit potential benefits to consumers from businesses being able to better utilise their assets.

The ENA considers that the specific provisions of the rules should be carefully drafted to ensure that there is no bias against innovative tariff design projects. To the extent that tariff based projects contribute to the achievement of the DMIS objective; it is unclear why they should be excluded from the scope of the scheme.

Interaction with other regulatory obligations

The ENA notes that the DMIS principle 7 requires the AER to consider the possible interaction between the DMIS and meeting any regulatory obligation or requirement. The ENA considers it important to clarify the drafting of this principle to ensure that it is sufficiently flexible to allow the AER to consider any element of the regulatory framework that may be inter-related to the operation of the DMIS in terms of affecting incentives for distribution businesses to undertake demand management.

For example, the interaction between the DMIS draft rules and the Service Target Performance Incentive Scheme (STPIS) needs to be considered if there is to be efficient demand management take-up given it is almost impossible for network businesses who contract for demand management (either directly or through a third party aggregator), to transfer the entire STPIS risk away. Without a mechanism to manage this risk it could inefficiently encourage network alternatives at the expense of demand management.

Therefore, such flexibility is required to give effect to the AEMC's intent and assist the AER in its development of the workable scheme.

DEMAND MANAGEMENT INNOVATION ALLOWANCE

Design of the innovation allowance

The ENA broadly supports the features of the AEMC's draft rule with respect to the DMIA. For example, the AEMC has rightly considered that:

» It was not appropriate to prescribe a limit for the application of the DMIA; rather, the AER should have discretion to determine when the DMIA is no longer required, and

» The timing of the projects may extend across more than one regulatory control period.

The ENA is generally supportive of the AER's role in determining the size of innovation allowance for each distribution business on a case by case basis. However, the ENA considers that there needs to be greater transparency around the methodology for determining the size of allowance and how the decisions relating to the allocation of funding under the DMIA are made. The ENA considers that it is an important consideration to ensure greater uptake of the allowance in the future.

The ENA would welcome further consideration of this matter in the final determination. For example, the AEMC may wish to clarify in relation to the requirement for the AER to develop and publish the DMIA mechanism in accordance with the distribution consultation procedures that the mechanism should set out a methodology that the AER proposes to use in determining the level of the allowance for the purposes of paragraph (3).

One further element of concern in the AEMC's drat rules relates to the reporting requirements. In particular, the draft rules provide that the AER should require distribution businesses to publish reports on the nature and results of demand management projects that are subject of the allowance. It would be useful for the final rule to clarify that additional reporting requirements need be proportionate to the project and resources employed. This is to avoid the potential administrative burdens and compliance costs.

Applicable innovation allowance projects

While the ENA recognises that the draft rules do not restrict the AER with respect to the nature of projects that can be subject to the DMIA, the ENA considers that the AEMC should not distinguish embedded generation projects from other demand projects within the scope of the DMIA.

Both the DMIA and the DMIS should encompass all forms of demand management, including connecting and exporting of distributed generation units. The ENA considers that it would be inappropriate to predicate the forms of demand management permitted under the allowance, as this may act to "pick winners" by precluding different forms of demand management, thereby stifling innovation.

ROLE OF TRANSMISSION IN PROVIDING DEMAND MANAGEMENT

The ENA welcomes the AEMC's recognition of the role that transmission business play in contributing to effective demand management. However, the ENA notes that the AEMC has decided considering the application of the DMIS and the DMIA to transmission businesses is out of scope of this rule change process.

As highlighted by the AEMC in its draft determination, transmission businesses are required to consider the potential for demand management options (non-network options) under the regulatory investment test for transmission. A similar requirement exists for distribution businesses under the regulatory investment test for distribution. Rather, the ENA understands the focus of this rule change proposal is the incentives (as well as providing regulatory clarity and certainty) to encourage efficient demand management in the National Electricity Market.

The ENA continues to be of the view that there is no compelling reason to exclude the potential realisation of benefits associated with demand management projects and innovation in electricity transmission. Indeed, broader consideration would achieve regulatory certainty across both network levels (transmission and distribution) and potentially maximise total system benefit, to the long-term benefit of all consumers.

The ENA would welcome further discussion in the AEMC's final determination on how it sees transmission businesses participating in the demand management market.