24 October 2019

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

Electronic Submission – ERC0266

Draft Determination – 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 Draft Rule Determination to require the AER to develop a Demand Management Incentive Scheme (DMIS) and Demand Management Innovation Allowance (DMIA) that it may apply to 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 AEMC's Draft Determination is to require the AER to develop a DMIA that it may apply to transmission networks but to not develop a DMIS.

Energy Networks Australia supports the AEMC's draft decision to require the AER to develop a DMIA. The DMIA would provide funding for innovation and the exploration of new alternatives that can be expected to lower costs to consumers over the long term and create an incentive for TNSPs to undertake research and development.

In particular, the AEMC's draft decision recognises that the introduction of a DMIA for TNSPs will:

- Encourage transmission businesses to expand and share their knowledge and understanding of innovative demand management projects that have the potential to reduce long-term network costs and lower costs for consumers.
- Allow the AER to socialise network approaches and learnings by publishing DMIA reports on its website, providing a 'one-stop-shop' allowing third parties to more easily compare and contrast options.

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- Provide a formal mechanism whereby stakeholders, the AER and network businesses have certainty regarding the qualifying criteria applied to proposed innovation projects.

Energy Networks Australia does not support the AEMC's draft decision to not require the AER to develop a DMIS for transmission and has concerns with some of the AEMC's key reasons for this draft decision. Energy Networks Australia continues to consider that a DMIS will result in increased innovation and use of non-network solutions resulting in lower prices for consumers.

Accordingly, this submission provides further support to the value of introducing a DMIS for transmission, alongside a DMIA. However, if following consideration of all the evidence, the AEMC remains unconvinced that the benefits of requiring the AER to develop a DMIS outweigh the costs at this stage, Energy Networks Australia encourages the AEMC to continue to monitor the situation and reconsider the need for a DMIS for transmission going forward.

The Attachment provides further comment on the AEMC's draft decision to not require the AER to develop a DMIS for TNSPs and transitional arrangements for the proposed DMIA.

Energy Networks Australia looks forward to engaging with the AER on the development of the demand management innovation framework applying to TNSPs.

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

Yours sincerely,

Andrew Dillon

Chief Executive Officer

Attachment

Energy Networks Australia supports an incentive-based approach to drive behaviour and lower prices for consumers

The AEMC's main reasons for not including the DMIS component of the rule change request are:

- Ongoing incentive payments are not necessary to manage initial costs to transmission businesses to 'unlock' non-network solutions as these costs can be funded through AER revenue allowances and, potentially, other sources of funding.
- If the DMIS is implemented there is a significant risk that transmission businesses will receive incentive payments for undertaking non-network options that they already would have undertaken given they are required to consider them in the RIT-T.
- It is not clear from the evidence presented by Energy Networks Australia that the incremental benefits of introducing a DMIS are likely to outweigh the upfront costs to consumers.

More generally, the AEMC appears to have reservations with an incentives-based approach to facilitating efficient demand management for transmission networks. It also contends that:

- While consumers could benefit from transmission businesses utilising more efficient solutions that would not have otherwise been adopted, any benefits to consumers would be at least partly transferred to the networks through the incentive payments.
- It is concerned about "exacerbating a cost of service mentality – whereby networks believe they should only act to lower costs to the benefit of consumers if there are specific rewards for doing so."

Energy Networks Australia does not share the AEMC's apparent reservations about providing incentives for demand management. Incentive regulation underpins the regulatory framework in the NEM and is the foundation on which it is based. This is because incentives drive network businesses to be more efficient and result in lower prices for consumers through the sharing of efficiency gains. Energy Networks Australia supports incentive-based approaches to regulation to drive innovation and lower prices for consumers. In this context, we continue to consider that a DMIS for transmission is an appropriate mechanism to address a lack of a positive financial incentive for transmission networks to use non-network solutions in the current regulatory framework.

Energy Networks Australia makes the following specific comments on the AEMC's reasons for not requiring the AER to develop a DMIS that it may apply to TNSPs:

- One off, potential, mechanisms such as funding through the AER's revenue allowances and other potential sources of funding have not proven to be an effective way to address a fundamental problem in the regulatory framework, given the lack of previous AER determinations where such funding has been approved. A DMIA may prove sufficiently flexible for innovation and pure research but may not be sufficient to prove and build up scale solutions with potential demand response providers including gaining customer buy in to such solutions. Consistent with the way that the regulatory framework for distribution networks is designed, we think that a dedicated incentive mechanism for demand management is needed for transmission networks.

- The maturity of the demand side response market in Australia is poor. For example, ERC0247 Wholesale Demand Response Mechanisms intended to allow for a transition to a two sided market when technology is mature.
- While TNSPs currently have the obligation under the RIT-T to pursue non-network solutions under the current arrangements, they have little incentive to do so. The barrier to pursue non-network solutions and build capability with demand response providers is therefore currently higher than it should be – this applies equally to projects that go through a RIT-T as well as those that do not.
- The AEMC has over-estimated the risk of consumers paying more than they would have given TNSPs are required to consider non-network alternatives in the RIT-T. As noted above, TNSPs do not have a positive incentive to look for and deliver non-network alternatives under the current regulatory framework. The introduction of a DMIS will facilitate a greater use of efficient demand management which will result in benefits to consumers. While incentive payments would ultimately be funded by consumers, Energy Networks Australia expects these costs to be modest relative to the long-term cost savings brought about by increased use and availability of efficient non-network solutions.
- Contrary to the AEMC's view, Energy Networks Australia considers a DMIS would be complementary to the RIT-T as it could result in more non-network solutions being viable through the development of a more mature non-network solution market.
- The AEMC'S concern that networks may be incentivised to adopt non-network solutions that are more expensive than network solutions as a result of DMIS incentive payments, does not reflect how the scheme would operate in practice. This is because under the DMIS, networks would only be eligible for incentive payments for non-network solutions that are the preferred (i.e. the most efficient) solution. Therefore, networks would not be incentivised to adopt higher-cost non-network solutions – these solutions would not be eligible for DMIS incentive payments.

Energy Networks Australia notes the mixed response from consumer groups on the rule change request to date.

If the AEMC is minded not to make a rule to require the AER to develop a DMIS at this stage, Energy Networks Australia suggests that the AEMC continue to monitor the situation and revisit the need for a DMIS for transmission prior to the following round of revenue proposals when there is more known about the post 2025 market design.

Timing of application of DMIA

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

Energy Networks Australia also agrees that sufficient time should be provided to the AER to consult on and develop a scheme and mechanism for transmission businesses. The AEMC has proposed a final rule be made on 5 December 2019 and the AER provide a final scheme by 31 March 2021 some 16 months later.

With this in mind, the Energy Networks Australia considers that the DMIA should be applied to all TNSPs at the start of their next regulatory control periods.

- The DMIA would be in place before TransGrid, ElectraNet, Directlink and Murraylink's revenue proposals are submitted.
- Whilst AusNet Services and Powerlink would have lodged their next revenue proposal before the final DMIA is made, the DMIA would have been in place at least 10 months prior to final determinations for these businesses (which are due to be made on 31 January and 30 April 2022 respectively). The AEMC should provide appropriate transitional arrangements that allow the DMIA to be applied to AusNet Services and Powerlink's next regulatory control periods.