AER Demand Management Feedback Forum: Discussion summary

Matter name:	Demand Management Incentive Scheme and Innovation Allowance Mechanism
Date:	Wednesday 8 November 2017
Time:	10:00 am to 12:30 pm (AEDT)
Location:	ACCC/AER Offices in Sydney, Melbourne, Canberra, Brisbane and Adelaide (videoconference)
Chair:	Jim Cox, Board Member, AER

Note: This document provides an overview of the main points discussed during the AER Demand Management Feedback Forum. Its use is purely informative.

The Australian Energy Regulator (AER) held a feedback forum as the pre-final stage of its' consultative process for developing the Demand Management (DM) Incentive Scheme (the Scheme) and DM Innovation Allowance Mechanism (the Mechanism). The AER presented its proposed changes to the draft Scheme and Mechanism, following the stakeholder submissions it received. This presentation has been published on the Scheme project page. The AER then held an open discussion with stakeholders on those proposed changes.

The draft Scheme

Most stakeholders expressed support for the implementation and overall design of the Scheme and considered the process in designing it was collaborative. Most stakeholders saw clear value in having an incentive available to reward non-network, DM options. However, some participants argued that the Scheme should not be implemented because of ring-fencing concerns. Others suggested that it is a temporary solution before larger regulatory reform can be implemented. Overall though, there was general agreement with the Scheme and on how we propose to respond to submissions made on the draft. There were also a few suggestions about how we could better realise the Scheme's intent.

Two key points of focus for stakeholders were:

- Whether distribution network service providers (distributors) should receive incentives once they commit DM projects (ex-ante) or after they incur DM expenditure (ex-post); and
- How to account for government subsidies in the Scheme.

Ex-ante or ex-post incentive accrual

Stakeholders discussed whether incentives should be provided ex-ante or ex-post. The discussion identified two preferred options for the provision of incentives:

- Maintaining the incentive accrual mechanism in the draft Scheme, where distributors would receive project incentives after they commit, but before they incur, project expenditure. Some stakeholders felt the AER would have to complement this by introducing mechanisms that defer or claw-back incentives for projects that distributors delay or terminate early.
- Changing the incentive accrual mechanism in the draft Scheme so distributors would receive project incentives after they incur DM expenditure. Several stakeholders supported this approach because it would make the annual total incentive cap less restrictive.

The Chair sought stakeholder views on whether the Scheme should change form an ex-ante to ex-post approach. Stakeholders provided a number of arguments against this suggestion. Stakeholders considered that an ex-post approach would create a greater administrative burden. An ex-post approach would also poorly incentivise projects where lower than expected demand drove lower DM costs (that is, this would poorly reward option value when the option is not exercised). Some stakeholders also felt they would need additional time to fully consider the change and that it may not be appropriate to consider such a change at this late stage of the project. Ultimately, the Chair concluded that generally, stakeholders preferred the simplicity of the ex-ante approach.

Accounting for government subsidies in the Scheme

The AER proposed requiring distributors to calculate an incentive net of any subsidies received for eligible and committed projects. Stakeholders were of the view that the Scheme should prevent distributors from receiving an incentive payment on costs that are also recovered through government subsidies.

There were contrasting views and questions about the AER's approach to accounting for government subsidies under the Scheme. Some stakeholders suggested that subsidies third parties receive to provide distributors with DM services under the Scheme should also be deducted from the incentive payments. Most stakeholders, in contrast, believed that this approach would be inappropriate, as it is the third parties, rather than the distributors that receive the subsidies. Another suggestion was that since subsidies would reduce the overall cost of a project, they should be considered as part of the net benefit analysis, rather than at the incentive calculation stage.

The Chair informed the forum that the AER will consider the points/questions raised before finalising the Scheme.

Other issues

- *Overall incentive cap* - some stakeholders considered the cap should be increased or the AER should have an option to remove the cap in specific years where expenditure over the cap is justified. A few stakeholders considered that the overall incentive cap should be set over a regulatory control period, instead of a regulatory year, allowing distributors to use their period cap during any individual year of the period. Others indicated that they would like a mechanism to carryover the cap between regulatory years.
- *Definition of a benefit* – a stakeholder considered there should be an allowance for distributors to support DM that reduces electricity generation constraints rather than just the network constraints. Others contrastingly stated there is little value in expenses that do not resolve a network constraint.
- *Cross-subsidy concerns* - a stakeholder considered the cost uplift will undermine the ability of third party DM providers to compete with ring-fenced affiliates of distributors.

- *Cost uplift revisions* - some stakeholders considered the cost uplift rate should be set for a regulatory control period and any revision should only apply from the next regulatory control period.

The Mechanism

Stakeholders generally supported r the implementation of the Mechanism and considered that it would result in greater engagement with DM projects. Some stakeholders questioned the level of certainty distributors would have when investing due to uncertainty about which projects would be defined as innovative. Stakeholders also considered the following issues:

- *The allowance cap* - some stakeholders wanted to raise the allowance cap to encourage more innovative projects, by increasing the base component and/or the scaling component of the allowance cap.
- *The allowance cap* - stakeholders questioned whether the total revenue used in calculating the cap included revenue from dual- function assets.
- *Definition of an eligible project* - some stakeholders wanted to include projects that have the potential to reduce generation constraints as well as network constraints.
- *Distributor cross-collaboration* - stakeholders widely supported the implementation of clarifying clauses that would enable distributors to collaborate on projects.

Next steps and rule change for early implementation of the Scheme

The Chair updated stakeholders on the early implementation rule change for the Scheme and showed a summary of the submissions on the rule change consultation paper. The Chair indicated that the AER prefers to seek a fast-track rule change instead of an expedited rule change. The reason is that the expedited rule change process requires the change be non-controversial and one of the submissions received indicated that it likely would be controversial.

The Chair indicated the AER would publish the Scheme and Mechanism in early December. When the final Scheme and Mechanism are published, the AER will also submit its rule change proposal to the Australian Energy Market Commission.

The Chair noted that collaboration on the Scheme and Mechanism development had been very productive and it would consider today's stakeholder input in the final design.