Mr Mike Buckley
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Australian Energy Regulator
GPO Box 3131
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Clean Energy Council

5 February 2008

Dear Mr Buckley,

Re: Preliminary Positions: Matters relevant to distribution determinations for ACT and NSW DNSPs for 2009-2014

Email: AERInquiry@aer.gov.au

The Clean Energy Council appreciates the opportunity to comment on the AER staff paper on Preliminary Positions: Matters relevant to distribution determinations for ACT and NSW DNSPs for 2009-2014 (the Position Paper), particularly as it relates to a proposed "Demand Management Incentive Scheme".

The Clean Energy Council is an industry association representing over 400 member organisations in the clean energy sector in Australia. It was formed in 2007 through the merger of the Business Council for Sustainable Energy and Australian Wind Energy Association. The Clean Energy Council covers renewable, gas and distributed energy generation equipment suppliers and installers, energy retailers and generators and energy efficiency and load management service providers. The common feature of our membership is their interest in meeting Australia's energy needs with lower greenhouse gas emissions.

The Clean Energy Council strongly believes that the AER has clear obligations to the interests of consumers to take decisive action to address the barriers to the efficient development of Demand Management (DM- including load management, energy efficiency and distributed generation) by distribution network service providers (DNSP's).

The National Electricity Law states that:

> *"The objective of this Law is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to—*
>
> *(a) price, quality, safety, reliability and security of supply of electricity; and*
>
> *(b) the reliability, safety and security of the national electricity system."*

It is clear that "efficient investment in, and efficient operation and use of, electricity services" requires that DM options are adopted wherever cost-effective.

The Clean Energy Council believes that the AER has already made decisions in relation to the 2009-14 determination that are damaging to the competitive position interests of our members and to the long term interests of consumers. The AER decision to maintain the Weighted Average Price Cap (WAPC) form of regulation in NSW will continue to link DNSP profitability to the volume of electricity carried through their wires and discourage them from investing in customer energy savings measures and other DM (even where these represent lower cost options for the DNSP's). This decision is also likely to damage the financial interests of the DNSP's and their shareholders. The WAPC not only discourages the DNSPs from taking advantage of otherwise cost effective options to help customers save energy, it also exposes the DNSP's to the risk of major revenue shortfalls if actual energy consumption falls short of forecast levels. Given the likely establishment of effective energy savings measures by state, territory and Federal governments over the next six years in order to reduce greenhouse gas emissions, the likelihood of such a revenue shortfall is significant unless these measures are accurately anticipated by the AER in the determination.

The establishment of a DM Incentive Scheme may be the last chance for the AER to ameliorate some of the negative consequences of its decision to continue the WAPC form of regulation.

Notwithstanding the above, the Clean Energy Council welcomes the preliminary position to continue the D-factor in NSW. The D-factor was established by IPART to 2004 in order,

> *"to ensure that these regulatory barriers* [to the use of DM options] *are removed, and to neutralize the potential disincentives for demand management created by the change to a weighted average price cap form of regulation (which links revenue to volume sold)."*[1]

This objective is even more relevant today than it was in 2004.

The Clean Energy Council also welcomes the preliminary position to broaden the potential scope for DM by introducing a "learning-by-doing fund".

However, we believe that these proposals fall far short of what is required to protect consumers by encouraging an efficient level of expenditure by the DNSP's on DM.

If the approach indicated in the Position Paper is adopted, electricity consumers will suffer due to:

1. higher than necessary electricity bills; as DNSP opportunities to assist consumers to reduce energy consumption are discouraged in favour of traditional electricity supply options; and
2. higher than necessary electricity prices; as more expensive infrastructure options are implemented in place of less costly DM options in both the 2009-2014 regulatory period and beyond;
3. higher than necessary greenhouse abatement costs; as consumers and taxpayers incur the additional costs of abatement policies and programs to offset the rising greenhouse gas emissions associated with additional electricity consumption.

As noted in the Position Paper, the submissions by the DNSP's themselves indicate that they recognise the need to undertake more DM and they are clearly seeking better and broader incentives to undertake cost effective DM. Consumers and DNSP's are now in the hands of AER to provide appropriate regulatory incentives to remove the barriers to DM.

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[1] Independent Pricing and Regulatory Tribunal of NSW (IPART), *NSW Electricity Distribution Pricing 2004/05 to 2008/09 Final Report*, June 2004, p. 89, http://www.ipart.nsw.gov.au/documents/op-23.pdf

The Clean Energy Council believes the AER should respond to these concerns by adopting the following specific suggested improvements to the AER preliminary position.

1. **Incorporate cost recovery of the "learning-by-doing fund" into the D-factor structure in NSW**

   There seems little to be gained by establishing a new administrative, reporting and regulatory structure for the NSW learning-by-doing fund, particularly given the very small size of the proposed funds for each DNSP. As the cost recovery of the learning-by-doing fund will operate on a very similar basis to the D-factor, it seems more sensible and efficient to use the same processes. The learning-by-doing fund could then be treated as a category within the broader D-factor. The key difference between the learning-by-doing fund and other D-factor categories would be that approval for learning-by-doing fund would be available for DM activities where the outcomes are uncertain or impossible to estimate in advance.

2. **Assess and approve learning-by-doing activities in advance**

   The position paper proposes that "Applications for the AER's learning-by-doing fund will be assessed annually… and the costs for approved … programs will be recovered in the year following their implementation…"   This seems to indicate that the AER may disallow cost recovery ex-post for some learning-by-doing programs. This creates an inappropriate element of risk for learning–by-doing. To overcome this, the AER should approve the learning-by-doing programs in advance. Ex-post assessment should be limited to checking that the programs undertaken have complied with any conditions for approval established by the AER in advance. Provided the DNSP's undertake the programs as approved by the AER, cost-recovery should be automatic.

3. **Increase the cap on the learning-by-doing fund at least tenfold**

   Compared to the DNSPs' total expenditure over the regulatory period of more than $10 billion, the proposed allocation for learning-by-doing of $2.3 million over 5 years seems tokenistic at best. It is hard to see how any worthwhile learning can be achieved with such a relatively tiny allocation of resources.   Even in South Australia, with a much smaller revenue and population base, the Essential Services Commission of South Australia (ESCOSA) established a $20 million DM Fund for ETSA for essentially the same purpose.

   The Position Paper proposes that each learning-by-doing program will be subject to AER approval. If the learning-by-doing activities are subject to ***prior*** approval by the AER as proposed above, then it is unclear why a funding cap is required at all.   If the intent of the funding cap is to encourage the DNSP's to focus on DM with more predictable and quantifiable peak demand and energy reduction outcomes then this should be made explicit. If a cap on the learning-by-doing fund is imposed, then it should be increased to at the very least, the level of the South Australian fund.

4. **Set appropriate criteria for learning-by doing.**

   The NSW D-factor is currently narrowly focussed on projects that deliver easily quantifiable reductions in peak demand in areas of imminent network constraint.   This provides no incentive for DNSP's to undertake the following types of DM:

   - Pilot programs and experimental DM where the outcomes are either hard to forecast in advance, hard to quantify afterwards or both;

- "Long term" DM programs in locations that are not facing an imminent capacity constraint in the next couple of years, but may do so in the longer term; and
- Energy efficiency DM that may not reduce peak demand but reduces costs to customers.

While the proposed learning-by-doing fund as described in the Position Paper is in principle directed at supporting all three of these types of DM, the proposed criteria for the learning-by-doing fund mean that it would be even more narrowly prescribed than the current D-factor. Instead, the learning-by-doing fund should only be directed at the first of these neglected types of DM. The latter two should be addressed by simply broadening the scope of D-factor, as discussed in points 5 and 6 below.

The Clean Energy Council suggests that the proposed eligibility criteria for approving the learning-by-doing fund be amended as follows:

- **Demand managements programs should not be recoverable under other categories of the D-factor.** (This would allow pilot programs and experimental DM where the outcomes in energy savings and reduced peak demand are either hard to forecast in advance, hard to quantify afterwards or both. This should ***include both*** broadly-based demand reductions across the distributor's network ***and*** projects in network constrained areas that would not otherwise be subject to cost recovery under the D-factor)
- **Cost recovered must not be recovered under any other state of federal schemes.** (This would allow the learning-by-doing fund to complement funding from a range of other sources, while preventing "double dipping" to over-recover any specific costs.)
- **Demand management programs should be innovative.** (This should encourage DNSPs to develop measurement and verification processes at the pilot program stage so that future stages can be recovered through the normal D-factor process.)
- **Recoverable programs may be tariff or non-tariff based, however the foregone revenue of tariff based demand management will not be recoverable under the fund**. (No change suggest to this criteria.)

5. Allow recovery of DM program costs outside network constrained areas.

As noted above, energy efficiency and "long term" DM programs in locations that are not facing an imminent capacity constraint should be addressed outside the learn-by-doing fund by simply broadening the scope of D-factor.

The WAPC not only offers no incentive to undertake energy efficiency and long term DM outside of capacity constrained areas, it effectively penalises any DNSP that undertakes such measures as a result of the reduced sales volume and profitability. It is very hard to understand why any modern regulator would wish to impose such incentives on DNSP's when they are so clearly contrary to customers' interests. This perverse incentive has been partially redressed under the current NSW D-factor by allowing the DNSP's to recover through the D-factor, *revenue foregone* due to DM measures undertaken *outside* as well as within network constrained areas. This mechanism benefits consumers both in the short term, as the retail price savings to consumers far exceed the value of foregone revenue recovered by the DNSP, and in the long term as the energy savings contribute to deferring the need for expensive new electricity supply infrastructure.

However, to the Clean Energy Council's knowledge only one DM project has ever taken advantage of this provision outside of a network constrained area[2].

The Clean Energy Council supports **DNSP's being permitted to recover, via the D-factor, a contribution towards the direct cost of DM measures outside network constrained areas**, up to a long term default Avoidable Distribution Cost (ADC). This long term default ADC could be set at a level that reflects the long term average value of avoidable network investment. (This cost recovery should be in addition to the current allowance to recover foregone revenue.)

This mechanism would be particularly important in avoiding "lost opportunities" where short term DM opportunities may not be available later if not adopted now.

While it is acknowledged that this simple measure may do little to stimulate DM action by any DNSP that is reluctant to undertake DM due to cultural and institutional barriers, it would at least remove a significant financial penalty for those DNSP's that are already keen to implement cost-effective DM.

6. Stipulate a meaningful initial funding allocation for DM

Traditionally, both DNSP's and regulators have tended to plan around investment in supply infrastructure rather than DM. DNSP's have generally developed detailed network infrastructure investment plans with little or no budget for DM. Similarly, regulators have typically endorsed as prudent or reasonable forward capital budget allocations with little or no specified DM expenditure. At best, DM has tended to be seen as an option to be funded out of savings in network infrastructure costs rather than as a legitimate expenditure line item in its own right.

While in principle this approach makes provision to fund DM projects, in practice it encourages DNSP's planners, budgeters and management to relegate DM to an afterthought. This forces DM proponents among DNSP's staff to develop and advocate detailed business cases to try to reallocate funding and resources for DM from other parts of the organisation.

The AER can assist in restoring the balance within the DNSPs by **stipulating a minimum default annual DM expenditure that is incorporated into the first year of DNSP's price determination.** A level of say, 1% to 2% of DNSP revenues should suffice for this purpose. If this level of expenditure of DM is not undertaken, this allocation should be "recovered" through a negative D-factor in the annual price setting process. This once off boost in their revenue would provide both an incentive and a funding base for DNSPs to build their DM capacity and "prime the pump" of network DM activity.

In some cases, the DNSP's expenditure forecasts may already identify a significant proposed expenditure on DM. This approach could still be applied in this case, both in order to avoid disadvantaging DNSPs that are supporting DM and to encourage DNSP's to follow through on DM plans.

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[2] The Energy Australia Compact Fluorescent Lamp Give-away Program in 2004/05 and 2005/06. See Institiute for Sustainable Futures Win, Win, Win: Regulating Electricity Distribution Networks for Reliability, Consumers and the Environment- Review of the NSW D-Factor and Alternative Mechanisms to Encourage Demand Management, 2008

This approach would also be useful in addressing the perceived risk and cash flow difficulties associated with the NSW D-factor where DM costs incurred in any given year, can only be approved by the regulator in the following year and recovered through the D-factor in the year after that.

While the above proposals are primarily focussed on redressing the barriers to DM created by the WAPC in NSW, the above proposals numbered 2, 3 4 and 6 are equally relevant to the application of the proposed learning-by-doing fund in the ACT.

These comments are intended only as a response to the AER's Position Paper on a proposed DM incentive scheme. The above proposals are modest initiatives to improve a very flawed regulatory structure. The Clean Energy Council recognises that these proposals fall well short of regulatory best practice for DM. For example, they do not fully offset the perverse incentives created by the WAPC; they do not prioritise DM over other options (as is the case with the California "loading order"); and they do not allow a higher return on investment on DM compared to supply side options as applied in various parts of the USA. Rather these proposals have been deliberately developed as small but important amendments to the proposals outline in the Position Paper.

The above proposals are focused on non-tariff based DM options. However these measures are also essential to maximizing customer benefits associated with smart meters and time of use tariffs. The Clean Energy Council does not believe that network businesses should be the only or even the primary driver for DM, including load management, energy efficiency and distributed generation. But network businesses should not be discouraged by their regulator from using these options whenever they represent the most cost-effective option for maintaining and developing a safe and efficient electricity network. In the context of urgent community concern about climate change and rising greenhouse gas emissions and in the midst of the largest boom in network capital investment in Australia's history (and the associated rise in electricity bills and prices), the Clean Energy Council asks the AER to take decisive action at this determination to remove regulatory barriers to DM.

As noted in our previous submission, we recognise that the proposed DM incentive scheme is not the only option to reduce the barriers to DM which needs to be considered by the AER over the course of this regulatory review. In particular, additional actions that the AER should undertake to complement the proposed DM incentive scheme include:

- As a matter of urgency, gather and publicly report reliable, consistent and comprehensive data on DM activity by electricity network businesses across Australia.
- Ensure prudence of capital and operating expenditure reviews fully and fairly consider DM options.
- Ensure that any efficiency benefit sharing mechanisms do not create penalties for networks businesses that reduce electricity consumption or peak demand.
- Ensure Distributed Generators receive the full benefit of pass through of avoided transmission use of system (TUOS) charges and distribution network businesses are not disadvantaged in this process.

We hope the above comments are helpful and we look forward to further participation in the AER's consultation processes in this crucial regulatory determination.

If you have any questions or issues you would like to raise on this submission please do not hesitate to contact our NSW Manager, Chris Dunstan via phone: 02 9799 0695 or e-mail: chris@cleanenergycouncil.org.au.

Yours sincerely

Original signed by

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