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Clean Energy Council submission to AER issues paper on NSW electricity distribution regulatory proposals: 2014-15 to 2018-19

Summary

The Clean Energy Council (CEC) is greatly concerned that the NSW Distribution Network Service Providers (DNSPs) have taken a '20th century' approach to this determination cycle. This will result in inflexible networks that have failed to adapt to technological advancements and present unnecessary costs to consumers.

Australia's DNSPs are in the midst of a structural shift, which will be shaped by consumer choices over the next five years. The CEC believes that the proposed distribution service costs presented by the NSW DNSPs would be significantly lower if they were to adequately account for ongoing technological advancements.

Future trends

Based on current trends the period to which these regulatory proposals will apply can be reasonably expected to witness the following changes:

- Continued long-term growth in deployment of rooftop PV, subject to a potentially significant slowdown in the short to medium term, depending on the outcome of the RET Review;
- Significant and rapid reductions in the costs of residential storage and correlating uptake rates, subsequent intensification of uptake as the NSW's Premium FiT winds down;
- Increased expectations for electric vehicle (EV) charging requirements;
- A range of rule changes that relate to barriers to consumers making choices about their sources and use of energy, and;
- Adjustments to DNSP tariff designs and levels, and associated consumer responses.

DNSPs have acknowledged the attractiveness of using embedded generation and storage to defer network investment, especially in rural areas where costs are very high relative to consumption. Ergon Energy (which services rural and regional Queensland) and SP AusNet (servicing Eastern Victoria) are two examples. In many rural networks it is now more cost effective to install a storage

system to defer a network upgrade, effectively 'sweating' the assets, avoiding augmentations and running on an operating-costs basis. This represents a significant opportunity in the form of savings for NSW consumers.

The regulatory environment must ensure that incentives on DNSPs achieve the appropriate outcomes during this period of reform. DNSPs need to see a more adequate incentive to incorporate distributed generation and storage where it is a more economically efficient investment compared to network augmentation. Concurrently, the financial incentives for DNSPs that make economically inefficient investments in poles and wires need to be decreased.

Opportunities for the DMEGCIS

The Demand Management and Connecting Embedded Generation Incentive Scheme (DMEGCIS) is intended to provide the appropriate incentive. However, the DMEGCIS is widely understood to be ineffective and grossly inadequate. Moreover, the recent reforms of the DMEGCIS to include embedded generation research[1] have not resulted in any noticeable improvement since implementation. Collectively, these matters should give the AER some clear guidance that the DMEGCIS is unworkable without closer monitoring and cooperation by the AER, or an entirely new regulatory environment being implemented.

Historically DNSP's that have had the opportunity to implement the DMEGCIS have nominated token values to the scheme's allowance, and have then been unsuccessful in spending this allowance. The current proposals simply follow suit, with less than 0.3% of the proposed revenues nominated for demand management initiatives. Clearly, the NSW DNSPs have taken a 20th century view of their roles in market[2], despite the pressures their businesses will be placed under in the coming years.

In taking this approach NSW consumers are likely to be exposed to unnecessarily high costs. An outcome which may be in the financial interest of the owner of the networks (in this case, the NSW Government), but clearly not in the interests if NSW customers.

The CEC does not believe that anticipated changes to the DMIS are a barrier to setting aside realistic funding levels to the scheme. The AER should push hard for the NSW DNSPs to provide innovative solutions to network investment. The CEC's view is that there are no barriers to the AER being more aggressive in requiring the DMIS allocation to be *realistic*.

In addition, the practice of each individual DNSPs reinventing the wheel in relation to reform is imposing extremely high costs on consumers. The AER should be allocating a significant portion of the DNSP's revenue to the DMIS. The CEC suggests that this should be in the order of five to ten percent of a DNSP's the total revenue.

Future efforts need to be placed on designing an incentive scheme which carries the appropriate reward (incentives) and risks (penalties) for DNSPs. Such a scheme should be target-based and underpinned by appropriate regulatory levers for the AER to pull.

[1] AEMC 2011, *Inclusion of Embedded Generation Research into Demand Management Incentive Scheme, Rule Determination*, 22 December 2011 , Sydney.

[2] The CEC notes that although AusGrid is more committed to demand management solutions than Endeavour Energy and Essential Energy, none of the NSW DNSPs have made a serious commitment to adapting to consumer expectations for embedded generation and demand management.

The AER's role in a time of rapid reform

The poor execution of the DMIS scheme is not the only challenge facing DNSPs. The coming decade will be a period of wholesale reform for these organisations. Failing to fully appreciate and plan for the anticipated extent of changes occurring in this regulatory period will lead to a missed opportunity for consumers.

If this regulatory determination does not properly adapt, consumer expectations for the next one will require a step change far greater than the NEM's reform processes can deal with. At this time consumers will have choices and inflexible networks will likely be adversely affected by these choices. Consumers whose choices are restricted will ultimately be the losers if the NEM's regulatory arrangements are no longer relevant to their needs.

The AER must work to ensure that flexible and innovative provision of network services can deliver lowest costs to consumers. An active role is required in this transitional period. The CEC's view is that some of the challenges that the AER must prepare for include:

- Fundamentally reconsidering the assumptions which underpin NEM arrangements, in particular whether it is in the long-term interests of consumers:
    - for DNSPs to continue to be treated as monopoly service providers, and
    - for network services and retail offerings to be segregated, in the absence of a flexible rules framework that encourages information sharing and cooperation.
- Improving the quality and utility of published planning information about available grid capacity to accept embedded generation by substation zone and the potential economic present value of deferment of network augmentations if the available potential can be realised.
- Reforming the DMEGCIS scheme to drive positive outcomes, including refined incentive and penalty arrangements and targeted demand management levels.
- Consideration of the business models for ownership and operation of storage on the grid and the regulatory, economic and competition issues potentially associated with them. Some examples could include:
    - A DNSP merchant model, in which DNSPs would build, own and operate assets with full operational control;
    - A DNSP incentive model, under which the DNSP would own, operate and maintain storage assets as part of its wider role of actively managing its network under a regulatory incentive scheme;
    - A DNSP contracted model, in which the DNSP finances, maintains and operates the asset and a third party manages energy trading when it is not required for local network security purposes;
    - A contracted services model in which the DNSP runs a tender for third parties to build and operate storage at a specific site, providing payment in return for network services and with the third party managing the asset when it is not required for local network security purposes; and
    - A charging incentives model, in which financial incentives are put in place by regulation and third parties may or may not respond to incentives by building storage.
- Overcoming regulatory hurdles to DNSPs investing in distributed generation and storage:

    - including enforcing consideration of these options for all capex investment options; and,
    - facilitating long-term planning for distributed resources by means of technical and economic information about the network potential to accept connection of local generation;
    - noting that there may be competition issues while DNSPs continue to enjoy a quasi-regulatory role over other market participants investing in distributed generation and storage.
- Opportunities for new planning arrangements, such as integrated resource planning.

The AER should address these matters during this regulatory reset process. Additionally, if barriers to reform, or a more active role for the AER, are identified the AER should outline prospective reforms which would overcome these barriers. The CEC recognises that the AER may be restricted in its capacity to act on some of the matters raised in this submission. However, the AER should ensure that the broader energy market reform debate is fully informed of the challenges that these restrictions impose and the AER's view of how these matters should be brought forward in this debate.