Mr Mike Buckley
General Manager
Network Regulation North Branch
Australian Energy Regulator
Via email: AERInquiry@aer.gov.au

Dear Mr Buckley

Thank you for the opportunity to provide a submission on the Issues paper Potential development of demand management incentive schemes for Energex, Ergon Energy and ETSA Utilities for the 2010–15 regulatory control period.

The Clean Energy Council (CEC) is the peak body representing the clean energy industry. The CEC is a member-based industry association that represents businesses ready to innovate, invest and act to safely and reliably meet Australia's energy needs while lowering greenhouse emissions. Our member organisations cover a quarter of Australia's total electricity production and are involved in renewable energy, gas, energy efficiency, distributed energy and greenhouse abatement markets.

Demand Management (DM) has a large and yet unrealised potential to reduce both cost to consumers and the environmental impacts of electricity supply. It does this by promoting both efficient investment in, and efficient use of, electricity services for the long term interests of consumers of electricity.

The national electricity market objective is to promote efficient investment in, and efficient use of, electricity services for the long term interests of consumers of electricity with respect to price, quality, reliability and security of supply of electricity and the reliability, safety and security of the national electricity system cannot be met unless an efficient level of investment in DM is undertaken and the AER facilitates an efficient level of investment in DM. The obligation and therefore a mandate for the AER to facilitate an efficient level of investment in Demand Management is clearly defined.

In the interests of social, economic and environmental outcomes the CEC calls on the AER to demonstrate leadership as the central proponent to implement DM for responsible and secure electricity network management and regulation for the 21st century.

If you have any points of clarification in the submission, please contact me via phone (03) 9929 4100 or email Vikki.McLeod@cleanenergycouncil.org.au.

Yours sincerely

Vikki McLeod
National Policy Manager
Clean Energy Council
11 August 2008

Proposed Demand Management Incentive Scheme
to apply to Energex, Ergon and ETSA.

Key points

The imperative for AER to remove barriers to DM

Demand Management (DM) has very large and yet unrealised potential to reduce both costs to consumers and the environmental impacts of electricity supply (and therefore the cost to consumers of moderating and repairing these environmental impacts). It does this by promoting both efficient investment in, and efficient use of, electricity services for the long term interests of consumers of electricity.

Total real electricity supply costs are rising significantly across national electricity market, particularly in relation to distribution and transmission network investment. Per capita electricity consumption is rising and peak demand is rising even faster. Consequently, electricity prices and electricity bills are expected to increase significantly over the next few years. The extent of these increases in consumption, demand, costs and prices is to a large degree due to a failure of economic regulation to provide appropriate incentives for efficient DM investment.

There is now a major risk through inaction or by continuing to adopt a minimalist, incremental or tokenistic approach to DM that the AER will perpetuate and thereby magnify the regulatory errors of the past.

Given:

1. The unprecedented level of proposed investment in network infrastructure;
2. The unprecedented economic and political imperative to redirect energy investment into reducing greenhouse gas emissions; and
3. The recent technological advances relating to smart metering, load management and distributed generation;

Failure by the AER to address the regulatory and institutional barriers to DM at this time will result in higher than responsible economic risks and could take a decade or more to unwind.

The National Electricity Law states that:

> "The national electricity market objective is to promote efficient investment in, and efficient use of, electricity services for the long term interests of consumers of electricity with respect to price, quality, reliability and security of supply of electricity and the reliability, safety and security of the national electricity system." (s. 7)

It further states that:

> "The AER must, in performing or exercising an AER economic regulatory function or power—
>
> > (a) perform or exercise that function or power in a manner that will or is likely to contribute to the achievement of the national electricity market objective;" (s. 16 (1))

The national electricity market objective cannot be met and the AER cannot fulfill its functions, unless:

1. An efficient level of investment in DM in undertaken and
2. The AER facilitates, through its economic regulatory function, an efficient level of investment in DM.

There is therefore a clearly defined obligation on and mandate for the AER to facilitate an efficient level of investment in DM.

In its consultation and discussion of DM, the AER should make clear its intention to fulfill this obligation. Similarly, if the AER believes there is not a clearly defined mandate and obligation, this also needs to be articulated, so that failure to address DM can be dealt with at a legislative and political level.

Despite relatively minimal DM activity being undertaken by the DNSPs, in the environment of numerous reports and decades international evidence identifying the large and unrealised potential for cost effective DM (and energy efficiency), the AER seems not to acknowledge current regulatory framework is a barrier to DM.

For example the AER states:

> "… there ***are existing incentives*** for DNSPs to conduct demand management within the current regulatory framework…. Conversely the regulatory framework ***may also provide some disincentives*** to undertake demand management." (p.5, emphasis added)

The approach to economic regulation currently adopted by the AER is highly unlikely to support an efficient level of investment in DM. For example, the overview of current DM activities in the DMIS Issues Paper (April 2008) suggests that the AER has yet to establish an effective system for the measurement and verification of the level of DM investment, the resulting impacts and effectiveness.

The establishment of a Demand Management Incentive Scheme (DMIS) is only one mechanism that can be deployed by the AER to meet this obligation to facilitate an efficient level of investment in DM.

The Issues Paper also lacked reference to any assessment regarding the efficient level of investment in DM to ensure "efficient investment in, and efficient use of, electricity services".

It is crucial for the interests of social, economic and environmental outcomes but also for the AERs own credibility that DM is taken seriously and acknowledges the central role that DM must play in electricity network management and regulation in the 21st century.

Specific comments on proposed DMIS

The CEC agrees that the DMIS should not be "the sole, or even the primary source of recovery of expenditure associated with DM initiatives." (p.5)

The CEC also agrees "that the primary source of funding for demand management programs in a regulatory control period ***should be*** the forecast Opex and Capex approved in the distribution determination" (p.5, emphasis added).

The CEC strongly supports the need for a DMIS for Queensland and South Australia. However, the specific purposes, functions and scale of a DMIS depends very much on what barriers to DM are created by or are not redressed by other elements of the regulatory structure. The following comments are made subject to this qualification.

Unless the regulatory structure for Queensland and South Australia are harmonised, there should be separate DMISs designed for each state. In particular, the proposed revenue cap form of regulatory control in Queensland provides a much more transparent and effective means of "decoupling" DNSP revenue form electricity sales volume than the "Q" factor attached the South Australian average revenue cap (price cap). If these forms of control are to be continued then this would suggest that a DMIS in South Australia needs to be relatively stronger to offset the disincentives to DM there than in Queensland.

The AER states that the size of the DMIS "will be caped at an amount that is broadly proportionate to the size of the DNSP's annual revenue requirement in the previous regulatory period" (p. 6). While it is unclear what this would mean in practice, it would seem more appropriate to link the size of the DMIS to forecast revenue requirements rather than past ones. In any case, the DMIS should be set at a level significantly higher than the current DM Pilot Fund in South Australia and the DM Innovation Allowance created by the AER for NSW and ACT.

The CEC supports the exclusion of DM costs from the Efficiency Benefit Sharing Scheme (EBSS).

The CEC supports the application of a NSW style D-factor, unless the DMIS effectively supplant the need for it. While the AER regards the D factor as "complex", it is a much simpler mechanism than the regulatory formula (including the "Q" factor) currently being applied in SOutha Australia.

The NSW D-factor has two components:

1. The recovery of electricity sales foregone as a result of DM activity ; and
2. Recovery of DM costs.

The application of a revenue cap form of control in Queensland in principle obviates the need for the first of these components. However, the second component was created in NSW not to decouple revenue from electricity sales volume but to address decades of built up regulatory and institutional barriers to DM. These barriers are just as prevalent in Queensland and South Australia as in NSW. The application of a DMIS could in principle fulfill the role of the second component, but only if it is set at a reasonable size, such as at least 1 to 2 % of DNSP revenues. By incorporating such a DM allocation into the regulated

revenue requirement, this would stimulate additional DM *without* increasing cost to customers.

While such a level sounds large compared to current DM expenditure by DNSPs, it is modest by international standards. Furthermore, as it would be applied on a "use it or lose it" basis and subject AER approval regarding its prudence, there is little risk of such an allocation being misspent. On the contrary the much greater risk is that the AER will set too small a DMIS and thereby send a signal to DNSPs that they should excessively limit their DM expenditure.

The CEC proposes that the "use it or lose it" aspect of the DMIS should be applied on an annual basis rather than be applied the regulatory period as a whole. This is necessary to ensure that the DNSPs prioritise and resource DM early in the regulatory period. If the AER considers it necessary to relax this provision, then this relaxation should be limit to carrying over no more than one year of DMIS allocation. This would provide ample flexibility, without negating the intent of the "use it or lose it" provision.

Additional Information

The principal author of this submission was Mr Chris Dunstan, Clean Energy Council's NSW State Manager and now confirmed Doctoral candidate, Institute of Sustainable Futures.

The Clean Energy Council would like to submit the following paper Prepared by the Institute for Sustainable Futures and Regulatory Assistance Project to AER as reference and background information.

> 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, January 2008.

This paper can be downloaded from
http://www.isf.uts.edu.au/publications/dunstanetal2008winwinwin.pdf