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Mr Warrick Anderson
General Manager, Network Finance and Reporting
Australian Energy Regulator
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Business SA
Chamber of Commerce
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Dear Mr Anderson

I write in response to the AER's request for responses on its draft demand management incentive scheme and innovation allowance mechanism.

Working for your business.
Working for South Australia

Executive Summary

- If a new demand management incentive for network businesses is necessary, it should be designed to optimise the benefits of demand response to alleviate both network related constraints and supply related constraints, ensuring consumers more broadly are not paying for schemes with overlapping incentives, particularly given the dramatic electricity rises prices which have occurred since mid-2015.
- Business SA is mindful that the energy market is already delivering quite innovative solutions to Australia's current energy crisis and the extent to which regulated entities need further incentives to do what others are doing already needs to be very carefully considered.
- Network companies should be encouraged to avoid augmenting existing networks if there is a demand response available, and with the increasing amount of technological solutions now in the market, the Australian Energy Regulator should be in a better position to understand whether or not all demand response options have actually been exhausted.
- Considering all large market electricity consumers are already on cost-reflective electricity tariffs, there should be ample incentive for network companies to work with business consumers directly or through demand response aggregators to enable demand response options at times of peak network demand.
- Any further incentive to elicit demand response from network companies should only be considered once there is alignment in the market between peak times for retail energy rates and the peak times for network charges.

Should you require any further information or have questions, please contact Andrew McKenna on (08) 8300 0000 or andrewm@business-sa.com.

Yours sincerely,

Anthony Penney





Why this matter is important to South Australian businesses

As South Australia's Chamber of Commerce and Industry, Business SA is the peak business membership organisation in the State. Our members are affected by this matter in the following ways:

- The increase in electricity prices, particularly over the last two years, has had a devastating impact on South Australian businesses and unreliability issues have also resulted in many businesses feeling their only option is to install back-up diesel generation to guarantee supply, even very small businesses in metropolitan Adelaide.
- South Australia has the highest proportion of non-firm renewable generation in the National Electricity Market (NEM) and the exit path of Alinta's Northern Power Station which began in mid-2015 has put significant pressure on South Australia's wholesale electricity market, effectively leaving two key players to hedge the base-load electricity needs of industry meaning large market customers, which consume as little as 160MW hours per annum, have experienced peak energy cost increases from seven cents per KWh to as high as 18 cents today after falling off recent peaks of up to 22 cents.
- South Australia's small market customers, which include most small businesses, have also been caught up in the energy crisis and although the impacts have been delayed due to the nature of annual price reviews, last year bill increases were approximately 10% on average, depending on the retailer, and small businesses have been hit again this year with circa 20% bill increases effective from 1 July 2017.
- Up until mid-2015 when South Australia's wholesale electricity prices began to rise dramatically, network costs had been the primary driver of the significant increases in electricity costs over the past decade and South Australian businesses cannot afford to return to the spending patterns associated with that period which have been compounded through rising regulated asset bases.

Key Policy Points

1. There is no doubt that network businesses need to be encouraged to look for non-network solutions to ensure rising Regulatory Asset Base (RAB) values do not further burden electricity consumers, particularly businesses which are export orientated. The general commentary from Government entities, including the Australian Energy Market Commission (AEMC), seems to be that relatively speaking, there has been no issue in South Australia and that 'gold plating' if you like is all confined to New South Wales and Queensland. While Business SA does not claim South Australian networks have overbuilt to the extent of those northern states, the AER and Essential Services Commission of South Australia's (ESCOSA) own published RAB values in determinations for South Australian networks over the past decade still demonstrate material real growth.

Going back to ESCOSA's price determination for 2005-10, then ETSA's Regulatory Asset Base (RAB) opened at \$2.46 billion for 2005/06 and was forecast to close at \$2.46 billion at the end of 2009/10. That close ended up being \$2.9 billion and the RAB closed at the end of 2014/15 at \$3.79 billion. Even if the AER's full revenue reductions from 2015-20 are implemented, SA Power Networks' RAB is still forecast to reach \$4.82 billion by the end of 2019/20.

Looking at ElectraNet, the South Australian transmission company, as at 1 January 2003, its RAB stood at \$824 million. By 2008, this had grown to \$1.27 billion and by 2013, \$2.09 billion. ElectraNet estimate their current RAB to be \$2.55 billion by the end of 2017/18 which is predicted to increase marginally to \$2.7 billion by the end of 2022/23, albeit not growing in real terms over the next regulatory period.



2. As the peak business representative organisation in South Australia, Business SA is regularly approached by businesses looking to access our 3,500 strong membership to market a whole range of products and services related to demand response. Not surprisingly this activity has picked up significantly over the past two years and the sophistication and capability of such products continues to grow. Interestingly many of these companies have their origins overseas and see significant opportunities to benefit from South Australia, and now Australia's, energy crisis.

A growing number of Business SA members who have not been able to absorb high contract prices since mid-2015 are now participating in the spot market, either being fully exposed or partially exposed with cap contracts or back up diesel generation. It is this cohort who seem to be most aware of how they use electricity and their means to either dial back or restructure operations based on extreme price events, not that it is ever quite that simple, particularly when having to consider other factors such as penalty rates through awards and enterprise bargaining agreements. Furthermore, there are significant risks in having wholesale market exposure, particularly to the most volatile commodity market in the world, and none of these businesses take the decision to expose themselves lightly and are generally still optimally looking for contract price certainty, just not at the present uncompetitive rates.

In considering the AER's proposal for a demand response incentive, while Business SA would agree that moving away from network to non-network solutions is preferred in light of reducing price pressure from high RABs, this change needs to be deliberated in the context of a rapidly changing electricity market where the extreme prices are seeing a significant market response from firms savvy enough to understand how limiting demand at peak times can deliver enough savings to consumers to justify their margin. Furthermore, all large market customers are already on demand based tariffs so are incentivised to reduce demand during times of network constraints.

3. Business SA acknowledges that the supporting materials in this consultation define demand management as including embedded generation and storage as a means of providing network support. There is no argument that all options should be available to networks to solve issues of network constraints through demand management, but every option must also be structured to ensure the optimum benefits are delivered. For example, any generation or battery support to offset additional network spending needs to be put to the market on a competitive basis so proponents will bid against one another to deliver required network support at least cost by maximising the total market benefit of that non-network support. This has particular relevance to generation options recently put forward by SA Power Networks to improve reliability on the Eyre Peninsula.
4. The supporting material does not adequately explain the potential for differing peaks in the market that are driven by either a shortfall in supply or a spike in demand and how that relates to how the proposed incentive works to avoid network spending. Over the past several years, and carried through reforms such as Power of Choice, the thrust of demand management has been to reduce future investments in meeting peak demand on the network, with an assumption that electricity generation is always able to meet that demand. Unfortunately over the past eighteen months, and particularly in South Australia, the latter assumption has not held true which has caused a significant shift in thinking and support from various levels of Government for measures which can elicit demand response to avoid load shedding.

What Business SA wants to avoid from additional demand management incentives for networks is spending designed to alleviate network constraints in addition to other incentives in the market, for example through what is being proposed by the Australian Energy Market Operator (AEMO), offering incentives to offset demand at times of insufficient supply, with both sets of incentives ultimately being paid for by all energy consumers.



This is exacerbated by the current situation where the times for peak energy rates as charged by retailers are typically 7am to 9pm on weekdays, which differ to the times of peak demand set by network businesses to determine their demand based pricing. For example, in South Australia the year round network demand shoulder period is from 12 to 4pm on weekdays and the peak demand period for summer from 4pm to 9pm. Given wholesale energy charges have overtaken network charges for most large market customer businesses in the last two years, it has become more critical that such times are aligned to ensure that demand based pricing is structured to elicit appropriate responses from consumers at times of high demand on the network, or from a supply side perspective.

5. While the independent Finkel Review into optimising the security and reliability of the NEM at lowest cost acknowledged the role of network businesses in implementing demand response programs, most notably Energex's program to control air-conditioners to reduce peak demand, the main thrust of its advice in relation to demand response was for reasons related to the wholesale market. Considering this review was the most comprehensive of its type into cost and reliability issues across the NEM, and informed from experts around the world, Business SA has some concern about the additional need to incentivise network businesses to enact demand response when it was not considered a substantive issue in the final Finkel Review report.
6. Business SA would like to recognise that the time this demand incentive discussion began, August 2016, coincided with a much more expansive crisis in the energy sector, particularly in South Australia where the wholesale electricity market had already doubled since mid-2015 and we had a state-wide blackout in September 2016. Subsequently, the limited resources of member funded organisations such as ours was focused elsewhere. From our view of the submissions received from consumer advocates to date, they are quite limited and may not necessarily be indicative of the interest in such topics from consumers more broadly, particularly businesses.

Subsequently, we caution the AER making strong assumptions about consumer support for such schemes, particularly the willingness of consumers to support further network spending on demand response and innovation. The reality for all businesses is that innovation is necessary just to survive and there are various incentives already in the market, including the research and development tax incentive. At some point, we need to question just how much additional incentives are required to solicit a desired response from electricity markets, particularly if there are a growing number of innovative companies offering demand response and aggregation technology. If the network tariff settings are right, and peak times aligned, recognising that moving all consumers onto cost-reflective tariffs has various challenges and needs to occur slowly, will the market not solve the need for demand response savings to avoid further network augmentation?