12 October 2017

Mr Warwick Anderson
General Manager, Network Finance and Reporting
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

Energy Networks Australia – Response to AER Draft Decision on Demand Management Incentive Scheme and Innovation Allowance Mechanism

Dear Mr Anderson,

Energy Networks Australia welcomes this opportunity to respond to the Australian Energy Regulator's (AER's) Draft Decision on the Demand Management Incentive Scheme and Innovation Allowance Mechanism for distribution network service providers (DNSPs) published on 28 August 2017.

Energy Networks Australia is the national industry association representing the businesses operating Australia's electricity transmission and distribution, and gas distribution networks. Member businesses provide energy to virtually every household and business in Australia.

Demand management can play a crucial role in enabling networks to provide the best value solutions for their customers. Energy Networks Australia is supportive of the AER's approach as currently outlined in its Draft Decision, including the proposal for an early application of the scheme.

Demand Management Incentive Scheme

The AER's Draft Decision on the Demand Management Incentive Scheme contains a number of features to ensure that the current regulatory system better incorporates demand management in the toolkit, which networks can draw on to achieve efficient service outcomes for all customers. These include:

» **A demand management project incentive of 50 per cent of the DNSPs' expected demand management costs.** Energy Networks Australia supports the incentive amount, recognising that this would only apply if it can be demonstrated that demand management delivers benefits to retail customers.

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- **A broader definition of demand management to recognise that demand management need not be specific to removing network constraints at peak.** This represents an improvement on the previous definition, which focused on managing demand at peak, and a positive step toward increasing the effectiveness and benefits of the scheme.
- **A 'base case' being a do-nothing option (unless the project is for reliability corrective action).** For projects without a reliability corrective action component, the base case being a 'do nothing option' allows the evaluation of demand management solutions through network risk prior to the network investment being fully quantified.

Further, the draft scheme provides safeguards to ensure that demand management projects deliver value to consumers. The proposed scheme operates under two caps:

- the project cap to ensure that the incentive does not exceed the project's expected net benefit; and
- the total cap, which limits the incentive payments under the scheme to the maximum of 1 per cent of total allowed revenue in any one year.

We consider that this is a balanced approach and note that future reviews of the scheme may adjust the initial design to ensure it continues to achieve its objectives over time.

However, Energy Networks Australia considers that the Demand Management Incentive Scheme could be further strengthened by including a mechanism in the scheme that would smooth the recovery of incentive payments.

Depending on the demand management contract, it is possible that a DNSP would make a large upfront payment and smaller ongoing payments. Therefore, there is the potential that incentive payments accrued by a DNSP in a particular year will exceed 1 per cent of maximum allowable revenue for that year; and in subsequent years may be below 1 per cent (noting that the 1 per cent cap applies to total incentives and there can be several demand management projects accruing incentives).

The desirable policy outcome that is sought in these circumstances is one that ensures the efficient uptake of demand management is achieved without causing unnecessary volatility in customer prices.

Demand Management Innovation Allowance Mechanism

The Draft Decision provides for a demand management incentive allowance of $200,000 + 0.075% of a DNSP's annual revenue. This represents a small increase to the innovation allowance that currently applies to DNSPs.

This additional funding will contribute to future trials of innovative demand management options and enhance knowledge and experience with the alternatives to traditional network solutions. However, this is only a modest change to the current demand management innovation allowance for larger DNSPs in particular. Innovation expenditure from networks in Australia is quite low when compared internationally.

Customers would benefit more from greater incentives for innovation, particularly in a time of rapid energy transition.

On this basis it is important that the Guideline does not constrain the AER from determining a higher cap as part of its distribution determination if the AER is satisfied (based on the evidence put forward by the DNSP or other stakeholders) that the long term customer interests are served by doing so. Flexibility to allow further funding (beyond the proposed cap) facilitates exploration of demand management innovations in a timely manner, and ensure beneficial innovations are not unduly constrained or deferred due to the cap limit.

Energy Networks Australia also believes the AER should have flexibility to allow DMIA funding to support initiatives that promote collaboration between DNSPs and with stakeholders, including transparent reporting mechanisms. Incentives that encourage greater cross-pollination of ideas and engage the AER and stakeholders at an industry level will deliver more value than incentives that only focus on individual business outcomes.

Demand Management Incentive Scheme early implementation rule change

Energy Networks Australia supports the AER's proposed rule change for early implementation of the scheme and its rationale for the change.

While electricity networks are already introducing initiatives in demand management, the delays in the introduction of the revised Demand Management Incentive Scheme have been a matter of concern. Providing the best environment to promote efficient demand management solutions to the benefit of customers is a crucial priority. Where networks wish to be voluntary 'early adopters' of the Demand Management Incentive Scheme, there should be scope and flexibility for this to occur.

Further responses to the AER's Consultation paper questions are provided in Attachment 1.

Overall, the new measures will play a crucial role in preparing networks and the market for a future in which non-network options will become increasingly important as new technology and better affordability make them suitable substitutes for network solutions. We also see this as the start of a rollout of new incentive arrangements where customers with distributed energy resources are able to receive incentives for providing network support services that improve the system's efficiency across the market.

The ENA-CSIRO *Electricity Network Transformation Roadmap* demonstrates how networks could buy grid support from millions of customers with solar, storage, smart homes or in demand response programs, with annual payments worth $1.1 billion within 10 years. Up to $16 billion in network infrastructure investment could be avoided by orchestration of distributed energy resources 2050.[1]

[1] CSIRO and the Energy Networks Association, *Electricity Network Transformation Roadmap, Final Report*, p.12-13.

Should you have any additional queries, please contact me on (02) 6272 1555 or gcrawford@energynetworks.com.au.

Yours sincerely,

Garth Crawford

Executive Director, Economic Regulation

Attachment 1

Demand management incentive scheme early implementation rule change - Consultation paper questions

What will be the effect of the proposed rule?

The proposed rule will allow for the early application of the Demand Management Incentive Scheme. The incentives provided through the scheme will encourage the efficient uptake of demand management by DNSPs and the proposed rule ensures that consumers benefit from the increased use of demand management without delay.

Whilst the early application of the Demand Management Incentive Scheme is welcome, Energy Networks Australia is disappointed that the AER is not proposing to implement the Demand Management Innovation Allowance Mechanism early. We understand that it is a modest change to the current demand management innovation allowance for the larger DNSPs, but for smaller DNSPs the change is relatively significant. We suggest the AER reconsiders its position on the early application on the Demand Management Innovation Allowance Mechanism.

Will the proposed rule contribute to the *National Electricity Objective*?

Energy Networks Australia considers that the rule change will promote the *National Electricity Objective* for the long-term interests of consumers by promoting clear efficient investment signals for demand management where circumstances justify it.

We note that the AER's proposal addresses concerns raised by the AEMC in its final determination *National Electricity Amendment (Demand Management Incentive Scheme) Rule 2015*. This because the AER has designed the scheme in a way that does not require any amendments to the distribution determinations of businesses that wish to become early adopters of the scheme.

The delays in the introduction of the revised Demand Management Incentive Scheme have been a matter of concern. The rule change proposal to create this new incentive framework for DNSPs undertaking demand management activities was submitted in 2013, with the rule change finalised in 2015. We consider that there are no grounds for any further delays in light of the proposed design of the scheme, which includes inbuilt protections for customers and the early implementation rule, which does not impose significant administrative burden on either the businesses or the AER.

Do the benefits of early implementation outweigh the costs?

Energy Networks Australia considers that the benefits of having an early application of the Scheme will outweigh the costs associated with its early implementation. As discussed in the AER's Consultation paper, there will not be any undue costs to distributors caused by this rule change.[2] On the other side, early implementation will avoid a three-year delay in some cases (e.g. in Victoria), which is significant in terms of potential benefits that can be realised to customers through providing them access to efficient demand management projects on an earlier timetable.

[2] AER, Consultation Paper, *Demand management incentive scheme early implementation rule change*, August 2017, p.20.