570 George Street
Sydney NSW 2000
All mail to GPO Box 4009
Sydney NSW 2001
T +61 2 131 525
F +61 2 9269 2830
www.ausgrid.com.au

12 October 2017

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

Dear Warwick

Demand management incentive scheme and innovation allowance

Ausgrid welcomes the AER's draft demand management incentive scheme and innovation allowance. We consider that the draft scheme and allowance developed will deliver value for consumers.

The new scheme and allowance will kick start investments to deliver greater use of non-network solutions to meet network needs. In turn this will benefit consumers by reducing the longer-term costs of operating our network. We also consider these changes will help foster the transition to a clean, distributed energy future, in line with the Energy Networks Association's transformation roadmap.

While our plans for the next regulatory period are not finalised, we have been exploring how demand management can be used to lower costs for consumers. While demand management has traditionally been used to reduce the need to build additional capacity we are looking at how demand management can be used to defer replacing aged assets, the driver of the bulk of our forecast capital expenditure program. We commend the AER for making modifications to the scheme to encourage these kinds of projects to be delivered.

The draft innovation allowance will allow us to explore a wide range of new demand management solutions and encourage a greater sharing of lessons learned. For example, we plan to explore the permanent reductions through energy efficiency improvements and new solar power systems by customers to defer investment. We also expect another planned project will explore the willingness of over 1,000 customers with battery systems to provide peak demand reductions in return for incentive payments.

In considering the AER's draft decision we have identified two minor areas where the incentive scheme and innovation allowance could be further improved. We provide details in the attached note.

Lastly, we would like to recognise the AER's collaborative approach. We found the AER's consultation process (involving several workshops, surveys, and a consultation paper) to be genuine and effective. We believe that this process has produced a robust scheme that will serve consumers long term interests.

If you have any queries or wish to discuss this matter in further detail please contact Craig Tupper on (02) 9269 2277 or via email at ctupper@ausgrid.com.au.

Yours sincerely

Rob Amphlett Lewis
Executive General Manager, Strategy &Regulation

Appendix A

Demand Management Innovation Allowance

We propose that the formula to calculate the demand management innovation allowance is amended to provide additional clarity. We consider this can be achieved by calculating the Demand Management Innovation Allowance using the *annual revenue requirement* rather than *maximum allowed revenue*.

Currently, the allowance is based on maximum allowed revenue, as defined in the National Electricity Rules. However, maximum allowed revenue refers to the revenue calculated for a transmission network service provider in accordance with Rule 6A.3

Annual revenue requirement is the corresponding term for a distribution network service provider, defined as the amount of revenue calculated in accordance with Part C of Chapter 6.

We also note that this approach will provide an innovation allowance based on revenue that includes dual function assets. This will ensure that the innovation allowance is not affected by whether some assets are priced under the transmission or distribution pricing rules.

Demand Management Incentive Scheme

We suggest that a smoothing mechanism is introduced to avoid distorting the incentives around when and which demand management projects are undertaken. In the absence of a smoothing mechanism there is a disincentive to undertake projects with significant up-front expenditure. This provides an incentive to deliver alternative projects that do not have a spikey expenditure profile or to stagger the investment over time – even when this is not the lowest cost option.

The distortion arises as the cap applies on an annual basis rather than over a wider period of time. We think that this could easily resolved by allowing any part of the cap not used to be carried over into subsequent years. We are keen to engage with the AER to work through any specific changes.