



2 August 2012

Mr Warwick Anderson
General Manager, Network Regulation
Australian Energy Regulator
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Dear Sir

Proposed Demand Management and Embedded Generation Connection Incentive Scheme (DMEGCIS)

Essential Energy appreciates the opportunity to respond to the Australian Energy Regulator's (AER's) proposed Demand Management and Embedded Generation Connection Incentive Scheme (DMEGCIS) and accompanying explanatory statement dated May 2012 ('the proposed DMEGCIS'). Essential Energy's comments on the proposed DMEGCIS are outlined below.

Essential Energy's response is based on the understanding that substantial broad based demand management projects can be included in the regulatory proposal for evaluation as part of the AER's final determination. Essential Energy strongly supports broad based demand management initiatives and is planning to include a significant level of projects in its upcoming regulatory proposal for the AER's consideration.

Discontinuing the D-factor

In the current regulatory period the AER has applied a demand management incentive scheme (DMIS) that contained two components, the demand management innovation allowance (DMIA) and the D-factor scheme. In the next regulatory control period the AER is proposing to discontinue the D-factor scheme, replacing it with the ability for Distribution Network Service Providers (DNSPs) to recover foregone revenue associated with demand management under Part B of the proposed DMEGCIS.

Essential Energy believes that this change is a retrograde step that will reduce the incentives for DNSPs to pursue demand management opportunities when compared to the incentives provided under the existing DMIS. However, Essential Energy appreciates that this softening of incentives is viewed by the AER as an interim step so as not to second guess potential recommendations of the Australian Energy Market Commission's (AEMC's) study into Demand Side Participation (DSP) through its Power of Choice review. Essential Energy understands that the AER will further review the proposed DMEGCIS upon completion of the AEMC's Power of Choice review in order to incorporate appropriate amendments. Essential Energy is supportive of this approach.

Ex Post Approvals

Under the proposed DMEGCIS, DNSPs will include their annual DMIA expenditure in their annual Regulatory Information Notice (RIN). The AER will review the DMIA detailed in DNSPs annual RIN for the preceding regulatory year, to assess whether the expenditure is compliant with the criteria. Following that review the AER will then publish a report stating the amount of DMIA expenditure that has been approved, and the amount of allowance remaining for the regulatory control period.

Essential Energy believes that reviews of DMIA expenditure should be made on an ex-ante basis, rather than an ex-post basis. If the AER was able to confirm that a DMIA project met the DMIA criteria on an ex-ante basis it would:

- eliminate the risk that DNSPs would incur DMIA expenditure which later may not be approved; and
- contribute to the overall objectives of the scheme by ensuring only eligible DMIA projects were commenced.

Foregone Revenue

The proposed DMEGCIS notes that foregone revenue under part B is limited to revenue foregone each regulatory year up until the end of the regulatory control period in which the DMEGCIS applies. However, typical investments in distribution infrastructure, including demand management projects, are long term and the benefits of those projects extend well beyond one regulatory control period.

In Essential Energy's opinion, limiting the calculation of foregone revenue to one regulatory control period does not provide the maximum incentive to undertake demand management projects. This is particularly the case where a demand management project is implemented towards the end of a regulatory control period.

Essential Energy believes that the calculation of foregone revenue should be expanded to include the regulatory control period in which the DMIA expenditure is incurred plus the following regulatory control period. This would allow a maximum of ten years to reflect the longer term nature of demand management projects.

Power of Choice Review

Essential Energy acknowledges that the AEMC is currently reviewing DSP through the Power of Choice Review. It seems likely that further provisions may need to be added to the proposed DMEGCIS at the conclusion of this review. Essential Energy looks forward to the AEMC's findings and will be happy to provide further input into the proposed DMEGCIS following the completion of that review.

Essential Energy would be pleased to discuss this matter further with the AER. Should you require further information please feel free to contact Jason Cooke on 02 6338 3685.

Yours sincerely



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Executive General Manager Infrastructure Strategy