Suite 2, 89-97 Jones Street, Ultimo, NSW 2007
Ph: 02 9211 5022 | Fax: 02 9211 5033
www.tec.org.au

Total Environment Centre

Submission to the AER on the Draft Determination on NSW DBs' Regulatory Proposals 2014-19

February 2015

Linda Parmenter
Energy Market Consultant

Mark Byrne
Energy Market Advocate
markb@tec.org.au

Total Environment Centre's National Electricity Market advocacy

Established in 1972 by pioneers of the Australian environmental movement, Total Environment Centre (TEC) is a veteran of more than 100 successful campaigns. For nearly 40 years, we have been working to protect this country's natural and urban environment, flagging the issues, driving debate, supporting community activism and pushing for better environmental policy and practice.

TEC has been involved in National Electricity Market (NEM) advocacy for ten years, arguing above all for greater utilisation of demand side participation — energy conservation and efficiency, demand management (DM)and decentralised generation — to meet Australia's electricity needs. By reforming the NEM we are working to contribute to climate change mitigation and improve other environmental outcomes of Australia's energy sector, while also constraining retail prices and improving the economic efficiency of the NEM — all in the long term interest of consumers, pursuant to the National Electricity Objective (NEO).

Summary

TEC welcomes the Australian Energy Regulator's (AER's) recent draft decisions reducing the revenues for each of the three NSW Distribution Businesses (DBs). TEC supports both the outcomes and the rationale for the downward adjustments made in relation to:

- Replacement capex (repex).
- The substitution amount for the base year of operating expenditure (opex) to reflect efficient costs.
- The disallowance of the majority of step changes for opex in particular 'dissynergy costs.'
- The removal of the metering exit fee and the reclassification of the service relating to residual meter costs as standard control rather than alternative control.
- The businesses' rate of return proposals.

However, TEC is concerned with the treatment of DM in the AER's draft determinations. Not only are we disappointed with the AER's view on the merits of Ausgrid's broad based DM proposals and the AER's failure to adequately incentivise businesses to undertake DM as an alternative to costly network augmentation, we view the limited regard that is given to DM in the regulatory process as a whole to reflect poorly on the current regulatory framework.

Despite significant evidence to the contrary, the major premise of the AER's argument is that the businesses will be incentivised through a range of old and new elements of the National Electricity Rules (NER) to undertake DM where it is the least cost alternative; and further, that broad based DM projects may no longer be required in the longer term, as the demand reductions required would be achieved through pricing reform and contestability in metering services.

TEC does not agree with this rationale, and while we accept the AER decision not to apply a revised DMEGIS ahead of the AEMC rule change process, we ask the AER to consider ways in which its commentary and decision making can better guide the businesses towards improved both consideration of non network options in its network planning as well as both Business as Usual (BAU) DM and effective use of the DM

Innovation Allowance (DMIA). Requiring the businesses to report annually, and advising the businesses (through framework papers and determinations) about the specific metrics or performance indicators that the AER are looking for, would be one way of doing this. An even clearer approach could be outlined through the development of a guideline on DM. Without obtaining such information from the businesses the AER will have insufficient information on which to monitor whether the new incentives are in fact working to promote the effective use of DM as the AER believes they should be.

TEC would also support a revision of the rate of return guideline to better reflect the actual costs of equity and debt in the current environment.

Introduction

TEC welcomes the opportunity to make comment on the AER draft determinations on the NSW electricity DBs' proposals. As we noted in our submission on the original proposals, they and the AER's determinations are not only of great significance to consumers in terms of price outcomes; they also importantly reflect how both the businesses and the AER are planning for the future and responding to environmental imperatives, technological innovations and market shifts.. Economic regulation of the monopoly DBs plays a key role in ensuring the long-term interests of consumers are being served by these plans. While the doubling of revenue and unprecedented levels of augmentation capex (augux) over the previous regulatory period was evidence of a seriously deficient regulatory system, TEC is pleased that recent reforms to the NER and the AER's Better Regulation program have provided for a more sensible outcome for NSW consumers in the current period.

TEC has reviewed and largely supports the AER's recent draft determinations in relation to Ausgrid, Endeavour Energy and Essential Energy. TEC notes that the AER has proposed substitute revenues for all three businesses that are between 24% and 28% lower than the proposals submitted by the businesses. As the AER outlines in various areas of their draft determinations, changed economic conditions, revised reliability standards, and significantly reduced demand forecasts all support a lowering of costs to consumers in the new period. TEC is pleased that the AER's determination, if made final, will result in price reductions rather than the CPI level increases proposed by the businesses. The reduction in annual household bills of between $159 and $346 per annum will provide some long needed relief for NSW consumers who have experienced an average 70% increase in prices over the previous regulatory period. It is therefore very disappointing that both Endeavour and Essential have submitted revised proposals that make only minimal adjustments to their capex expenditure and actually increase their opex requirements, resulting in overall higher expenditure. We note that only Ausgrid has proposed an overall lower revenue proposal as a result of the AER draft decision. Ausgrid has also made the most significant capital reduction of the three.

We now turn our comments to specific aspects of the decision, including comments on the consideration of DM as this is an area of major interest for TEC.

Capex

TEC observes that the AER was not satisfied that any of the three proposals met the capex criteria and has therefore substituted its own estimates, resulting in reduced allowances of between 26% and 43%. TEC understands that the AER applied a 'top down' approach using metrics such as capex per customer and capex per maximum demand in order to test the efficiency of the 'bottom up' developed revenues that the businesses proposed. TEC supports the approach of establishing efficiency benchmarks to assess the reasonableness of the base costs claimed by distributors. While the capex proposals made were significantly reduced from the previous period and much was made of this point in the DBs' overviews of

their proposals, as the AER points out they were nonetheless still on average higher than in the preceding regulatory period from 2004-2009. TEC agrees that the immediately preceding regulatory period should not provide a baseline for comparative purposes.

TEC notes that allowances for augmentation have been reduced not only due to revised demand forecasts submitted by the businesses, but also due to engineering advice that efficiencies could be achieved through risk based cost benefit analysis assessment techniques. TEC notes that there is opportunity to use non-network solutions in this context.

TEC notes a key reduction in the revised capex allowances flows from the AER disallowing the claims made by the businesses for replacement of assets. TEC supports the specific reductions here, noting that the businesses had significantly increased their claims for repex relative to the previous period; and as the AER notes, such claims were between 40 – 55% higher than the long term average spending of the businesses to date. Given that there is no evidence that the average age of assets has been increasing, and given the extraordinarily high levels of spending on augex in the previous period, TEC believes the claims for additional expenditure are not justified. TEC appreciates the AER's efforts to obtain detailed engineering advice and to undertake predictive modelling to make significant reductions to these allowances.

TEC notes that Essential Energy and Endeavour Energy have offered only the smallest possible revision of their capex proposals in response to the AER's draft decision, while Ausgrid's revised expenditure proposal puts forward a more acceptable 25% reduction in capex. As TEC is unable to assess the arguments the businesses have put for maintaining a higher expenditure than that substituted by the AER, we will leave that assessment to the AER.

Opex

With the exception of the comments following in relation to DM opex, TEC supports the AER's proposed replacement revenues for each of the businesses' opex, noting it will result in reductions to opex revenue of between 22% and 39% across the three businesses. TEC understands that the AER is not satisfied that the proposals have met the expenditure criteria, as they do not reflect the costs that a prudent and efficient operator might reasonably incur. We understand that the revised AER proposal results from adjusting the base year to reflect the level of efficiency that might be expected from DNSPs, and because the AER has not accepted the step change proposals put forward by the businesses.

TEC supports the AER's decision to ensure that the distribution businesses are meeting efficiency benchmarks and observes that NSW distribution businesses are performing well short of the most efficient operators within the NEM[1]. TEC also agrees that the AER should ensure that any step changes to opex proposed by the businesses are fully justified and supports the AER in rejecting various step changes including those related to vegetation management and network reform.

TEC also supports the AER's disallowance of the businesses' claims for lost economies of scale and scope through the previous removal of retail services (dis-synergy costs). As argued in our submission to the AER on the regulatory proposals, TEC does not believe that consumers should be asked to bear the costs related to the sale of the retail arms of the businesses, since theses sales were made for political reasons rather than being motivated by the long term interests of consumers.

Given that the NSW businesses benchmark poorly against other DBs in the NEM, and noting that the AER is seeking views on whether costs associated with 'transitioning to more efficient operations' should be

[1] Australian Energy Regulator, *Annual distribution benchmarking report*, November 2014.

allowed, TEC objects to consumers being asked to foot the bill for this fix when they have already paid for the problem. We note that the AER has already generously adjusted the reductions to the businesses' opex by 10% to account for any factors not allowed for in the benchmarking model applied, and that the benchmarking is against the weighted average of all networks with efficiency scores above 0.75, rather than against those achieving the highest scores. The businesses should therefore have sufficient room to move to restructure their cost bases and transition to greater levels of efficiency in the future without passing such costs on to consumers.

TEC is aware that the businesses are refuting the validity of the AER's benchmarking report and the adjustments to the base year, and that they have offered their own expert critiques of the AER's methodology. TEC is unable to consider the businesses' objections in any detail, and therefore relies on the AER and others to determine the reasonableness of their claims. However, we are concerned that that Endeavour Energy and Essential Energy have submitted higher opex expenditures in their revised proposals. We understand this is partly because the businesses have not accepted the AER's assessment of efficient levels of opex, and partly due to new information resulting in increased costs being allocated for vegetation management. These increases in opex outweigh any of the small reductions in capex expenditure that have been proposed, and TEC finds it difficult to believe that the businesses could not find *any* opex savings given the evidence of greater efficiencies being achieved elsewhere in the NEM.

Demand management

Capex and opex related DM

Our comments in this section are premised on the view, outlined and accepted by numerous expert reviews, that DM is key to reducing the need for costly augmentation projects in areas of network constraint and localised demand growth. This fact stands regardless of falling demand over the previous period and lower revenue requests for the current reset. In our submission on the NSW proposals we noted that despite the reduction in overall demand, localised peak demand was continuing, according to the businesses, to drive a requirement for capital augmentation expenditure. In addition, both NSW distribution businesses and the AER have outlined a case for the relevance of DM in a flat demand environment:

> In this demand growth environment there is a stronger economic case for the use of demand management as investment in long-life network assets can be deferred until there is a more certain need, reducing the risk of stranded network assets. Further, the option value of demand management also increases.[2]

It is also generally accepted that businesses have both regulatory incentives towards, and a cultural bias in favour of using capital solutions to network problems, and that the opportunities for DM to deliver large cost savings are significantly greater than what is currently occurring. Our comments in this section are therefore also premised on the view that there is a need to incentivise businesses to invest in non-network solutions to network constraints; and that the AER through its 5 year regulator resets has a significant role to play in this process.

In light of this context, TEC is disappointed by the AER's treatment of DM in the recent draft determinations. In our view the AER has missed an opportunity to clearly state or demonstrate to the businesses that it wants them to take efforts to reduce peak demand seriously. Our first concern is that the AER provided only a very limited overview provided of its views on, and approach to, DM. In the context of the large volume of material making up the draft decision, this in itself tends to marginalise the role of DM.

---

[2] AER, *Draft Decision Ausgrid: Appendix 6 Capital Expenditure*, November 2014, p83.

TEC has found the majority of the detailed DM information in appendices concerning the businesses' capex and opex proposals, and in the appendix relating to the DMand Embedded Generation Connection Incentive Scheme (DMEGCIS). This disparate and limited commentary did not lend itself to clarity about the AER's broad framework and approach, or the way that DM proposals (whether as part of avoided capex or through opex or DMIA proposals) are being specifically assessed.[3] We acknowledge that the current regulatory framework set out in the NER may lead the AER to focus more specifically on each of the revenue building blocks, and that DM features not separately, but within or impacting on these building blocks. However, the limited attention paid to DM does not give us confidence that the AER is serious about the need to incentivise greater levels of DM into the future. TEC believes it would be greatly beneficial if AER documents were to not only to address in some detail its approach to DM, but also to set out for the businesses the expectations and requirements that the AER has about the efficient and prudent use of DM and the content and format of DM plans.

DMIA

The AER has maintained the position outlined in the Stage 2 Framework and Approach paper and determined that it will only apply Part A of the DMIA, and not part B of the DMIA or the D-factor scheme. We accept that it is appropriate to remove the D-factor in the context of revenue caps, and that the AER has chosen to wait for the TEC/SCER DMEGCIS rule change process to be completed before introducing an incentive scheme, and that it has also rejected Ausgrid's proposal for a DMBenefits Sharing Scheme). We also note, however, that Endeavour has criticised the RIT-D process as an impediment to DM, and that Ausgrid has recognised that the current determinations wil result in less DM if its proposed new scheme is no timplemented. We are disappointed that an opportunity to properly incentivise DM has been missed for the current regulatory period, and look forward to the consultation on the revised DMEGCIS and ask that the AER proactively engage in the rule change process and amend the DMEGCIS immediately following the rule change, applying the scheme to the remainder of the next regulatory period in order to maximise the incentives to undertake DM. AIt is critical that the new DMEGCIS should include annual reporting, voluntary performance targets and incentives for exceeding targets.

Business as usual DM

In relation to all three businesses, the AER has decided not to include an explicit reference in the capex or opex forecasts for DM proposals. This has been interpreted as disallowing the revenue proposals for DM by most stakeholders, though we understand that the AER's decision does not prevent the businesses investing in DM specifically, and is referenced only as part of the assessment leading to the total approved revenue. The AER expressed the view that it is most appropriate to rely on the incentive framework, alongside the requirements around the Regulatory Investment Test for Distribution (RIT-D) and the Distribution Annual Planning Reports (DAPRs), to drive the efficient use of DM and share the benefits with consumers through the Capital Expenditure Sharing Scheme (CESS). We are concerned that the AER has chosen to rely so heavily on the broader incentive mechanisms, particularly in view of the fact that no effective DMEGCIS is in place or is likely to be in place for the first year or two at least of the current regulatory period. Most of the incentives on which the AER are relying are relatively new and at this stage the AER has no way of knowing whether or not the DBs will respond to these incentives in the way the AER anticipates.

---

[3] We do however note and appreciate the AER's willingness to meet with consumer groups to explain and answer questions on this aspect of the decision.

Ausgrid had included a $22 million business as usual DM program within its operational expenditure, presenting the expenditure requirement as a 'step change' from their base costs. In rejecting this step change, the AER stated that it did not believe the expenditure would be efficient, and more specifically, that the benefits of DM will not be available till towards the end of the regulatory period, by which time new tariffs with cost reflective pricing structures are likely to produce similar outcomes in terms of demand reductions. In outlining this view, the AER has provided little explanation of the factors that led it to their conclusion that Ausgrid's DM program was not efficient, or alternatively what the AER would expect to see from businesses to meet the efficiency criteria. We read this decision in two ways - that the AER is putting all its DM eggs in the tariff reform basket, and that it only has an interest in DMoutcomes that can be achieved in the short term. Linked to the latter is a preference for targeted or network DMactivities over broad based programs.

TEC does not support either of these views. In the same way that the new incentive framework is as yet an unproven mechanism for incentivising DM action, the benefits, demand reduction outcomes, not to mention the timing of tariff reform are unknown and uncertain. While TEC is supportive of pricing reforms, we acknowledge that it may take some time before it is fully in place, particularly in jursidictions where the metering technology and experience of time of use pricing is currently limited and transitional arrangements are likely to extend beyond 2017. Further, while cost reflective pricing may be part of the solution, it is more likely to be of benefit when combined with enabling technology. Where the main issue is critical peaks on a few very hot days each summer, a rebate and/or automation of response from appliances may be more useful than a year round time of use tariff. Looking at a review of international trials of household demand side response, Dr Gill Owen points out that regardless of the pricing structure, greater peak reductions are generated when combined with 'automation' (ie, such as controlled load for hotwater or airconditioning) than without.[4] She also argues that the approach may produce better outcomes for vulnerable households than time of use tariffs, plus provide more certainty of response.[5] We support the view expressed by Ausgrid, that broad based DM and the enabling technologies it provides is complementary with rather than supplementary to cost reflective tariffs.[6] TEC also notes that Ausgrid's strategy is to transition from direct incentives to tariff based incentives, and agrees that this is a sensible transitional approach and one which is consistent with the 'consumer impact' principle outlined by the AEMC in its rule change on cost reflective network pricing.

While TEC was also critical of the Ausgrid DM proposal for the reduction in targeted or network DM programs in the next regulatory period ($2 million) compared to the last (approximately $8 million), we believe there is merit in broad based DM activities even where the gains are only likely to be realised in the longer term although the investment occurs in the current period. In our view it is entirely consistent with the 'long term interests of consumers' to value outcomes beyond the regulatory period when deciding whether to approve expenditure. TEC notes that Ausgrid proposes using DMIA funds for its broad based program if the AER maintains its position not to make an allowance within opex. TEC prefers to see the DMIA used for genuinely innovative programs, and therefore would prefer that the expenditure is allowed as an operational expense.

TEC agrees that the businesses' DM proposals should be scrutinised, and that they should not be funded if the outcomes are spurious or the benefits do not exceed the cost, or if the programs themselves are not well conceived. However, we also want to encourage the businesses to invest in DM, and we are not

---

[4] Dr Gill Owen, *Addressing Peak Demand: The Opportunities and Risks for Vulnerable Households*, Monash Institute of Sustainability Report !3/3, April 2013, 18.

[5] ibid.

[6] Ausgrid, Revised Regulatory Proposal, *Attachment 5.14 Demand Management Capex and Opex Overview*, 4-6.

convinced that the current decision will assist this. TEC was critical of the businesses' DM proposals for not being ambitious enough, but we expect to see some level of investment in DM and believe that this would be best aided by an explicit reference to DM expenditure by the AER. We are concerned that without this, the AER will not send the right message to the businesses, and that it will be an excuse for the businesses to do even less DM than previously.

We also understand that the AER is questioning whether the level of capital deferrals attributed to DM are being understated by the businesses. We agree this is an important question, however we find the AER's response to this problem not only confusing but also counterproductive, to the extent that it has resulted in no allowance for DM and therefore the likelihood of even less DM and even lower levels of capital deferral occuring in the future. The AER suggests that it expects the businesses to achieve a level of capital deferral similar to that achieved by Ausgrid in the previous regulatory period, where the benefit was 2.5 times higher than the level of DM investment.[7] For each of the three businesses they have stated:

> We have considered whether it is appropriate for us to determine an explicity amount of capex that could be deferred through demand management, based on the scale and positive outcomes achieved by Ausgrid during 2009-14 and the Productivity Commission report. Using this approach we could apply an explicit systems capex forecast offset of 9.2 per cent….[8]

Despite this, our understanding is that the AER has not applied this offset but has instead reduced capex, as noted earlier, by applying a 'top down' assessment of efficient costs using benchmarking data.

The AER has noted that it has avoided determining an explicit amount of capex that could be deferred through DM, stating that to accurately calculate a capex-opex tradeoff it would also need to assess the efficient opex required based on actual expenditure data that is currently lacking. The AER has also asked for stakeholder comment on whether this is the most appropriate approach in providing incentives for the optimal amount of demand management.[9]

TEC agrees it would be appropriate to have an explicit recognition of DM, and believes that placing a value on it through determining a capex-opex tradeoff would send a stronger message about the AER's expectations. It would also help give weight to factor 10 of the expenditure criteria in the NER – ie, the extent to which the businesses have considered non–network alternatives. However, to do so would seem inconsistent with the overall approach taken by the AER in relation to capex, particularly the use of high level benchmarking. Given the level of capex reduction achieved through this approach, it would also seem unnecessary.

We note that if this approach were taken, we would not agree with the specific cost benefit that has been suggested as the benchmark by the AER, at least to the extent that it might act as a constraint on the level of DM expenditure allowed. While we would be very happy with benefit to cost outcomes of 2.5:1, TEC would also be satisfied with a lower ratio, because to the extent that operational expenditure on a DM option will not add to the value of the regulated asset base and is extending the utilisation of DM generally, it is the preferred option. A benefit to cost ratio greater than 1:1 should therefore be supported.

Given that a project by project level scrutiny of the businesses capex proposals is not possible, we support the AER's use of benchmarking, and therefore accept the AER's (implied and explicit) reasons for not determining an explicit amount of capex that could be deferred. However, a middle road might be to

[7] AER, *Draft Decision Ausgrid: Appendix 6 Capital Expenditure*, November 2014, 82.

[8] ibid, 83.

[9] ibid, 84.

'ground truth' the results of benchmarking by undertaking a bottom up assessment of a selection of high cost augex and repex projects to determine the extent to which the businesses have considered non network options. We also consider that the AER needs to scrutinise the results of RIT-D processes carefully rather than simply relying on benchmarks. One approach for assessing the proposals of the DBs might be to review their RIT-Ds over the previous determination period to identify what their performance in those processes suggests about how carefully and creatively they are considering non-network options.

Given the businesses have all claimed to have built the demand reductions attributable to DM into their demand forecasts resulting in reduced capital expenditure, once these expenditure claims have been scrutinised and reduced (as they have been in the current circumstances), in our view it would be reasonable to then provide an explict amount for opex and capex related DM activities based on the businesses' DM proposals.

As noted in our recent submission on the Queensland regulatory proposals, TEC believes that substantial reform to the regulatory system is required to drive the efficient use of DM by DBs. Beyond reform of the DMEGIS, TEC suggest there would be merit in developing a guideline, similar to the Consumer Engagement Guideline, which would set out the framework through which the businesses' performance in relation to DM will be assessed. This guideline would assist the businesses in understanding what the AER will consider when having regard to DM both as part of expenditure proposals (either DMIA or BAU) and as an expenditure factor relevant to capex plans. As part of this guideline, TEC would like to see the AER request that the businesses demonstrate the planning mechanisms and the internal processes by which supply and demand side options are weighed up prior to the inclusion of projects in the capex proposals. This guidance, supported by a requirement for annual reporting against consistent and common performance indicators, will not only reveal whether or not the incentives on which the AER are relying have worked or whether new incentives are required; it will also send a message to the businesses and to other stakeholders that the AER is serious about the benefits of DM to consumers.

Metering

TEC notes that the AER has made adjustments to the proposed annual metering fees proposed by the businesses, based on changes to capex, opex, and the value of the opening Regulated Asset Base (RAB). Though small, the downward adjustments are welcomed and TEC supports the AER in ensuring the costs proposed are no greater than what is required to cover the costs of an efficient operator. TEC supports the AER in rejecting the proposed exit fees for metering, noting that these costs will be a barrier to consumers exercising choice in relation to metering services in the future.

Consumer Engagement

TEC agrees with the AER's views that the businesses have failed to adequately seek and take into account consumer input in the development of their proposals, noting that this is one of the factors the AER may take into account in deciding whether the businesses have met the capex and opex criteria under the NER. TEC supports the comments made by the AER exposing the deficiencies in the consumer engagement processes leading to the publication of the regulatory proposals, and hope this will give greater direction to the businesses in their efforts to improve their engagement processes in the future.

As an example, the consumer forum held by Networks NSW on Friday 6 March was the first time in the two years since this regulatory determination process began that TEC was invited to participate in any direct discussion with the NSW networks – and that with only three days' notice. While it was useful, and we have reason to look forward to greater cooperation in future, given the timing it was obviously too late for either the networks or consumer groups to influence each other. Looking forward, as we stated at the time, our

overarching concern is that none of the NSW networks appear to have any clear plan to react to, let alone be a central part of, the rapidly evolving shift to a decentralised energy sector. Instead their overwhelming aim appears to be to protect their existing business model.

Rate of Return

TEC notes and supports the AER decision to set the rate of return at 7.15% given the changed economic conditions in the current period. This is a welcome and significant reduction from the 10.02% of the previous period, particularly given the impact that a single percentage point can have on the overall revenues recovered by the businesses. Given this impact it is critical that the rate reflect the real costs of debt and equity experienced by the businesses, and not a hypothetical model.

TEC agrees with the AER's view that the DBs have not provided sufficient justification for their proposal to deviate from the rate of return guideline established after broad consultation through the Better Regulation program. However, TEC questions whether in fact the guideline as it stands is already too generous. TEC believes that the AER would be justified in departing from the guidelines in view of the significant number of submissions from consumer representatives providing evidence in support of amendment. In particular, we agree with the advice provided by the Consumer Challenge Panel,[10] arguing that real world data about profitability and actual costs of borrowing should and could be considered. We find it concerning that the AER's rate of return seems to be higher than the rates allowed in similar circumstance by State regulators, and considerably higher again than the rates applied in international jurisdictions including New Zealand and the UK. TEC asks the AER to revise and reapply the guideline, or at least adopt the lower end rather than the higher end of the ranges provided for the various parameters within the existing guideline.

Recommendations

DM in the final determinations for NSW DBs

1. Ausgrid's proposed $22.1 million BAU DM plan should be approved as part of the opex building block, as long as it can be shown to result in more than this amount of deferred or avoided capex.
2. Both broadbased and targetted DM programs should be approved as legitimate opex (including step changes, where justified) where the anticipated reduction in capex exceeds the proposed opex expenditure (ie, where the benefit to cost ratio is greater than 1:1), as long as there is a mechanism for ensuring that the capex-opex tradeoff results in net savings in peak demand.
3. TEC supports the option of determining 'an explicit amount of capex that could be deferred through demand management,' but recommends that where capex revenue is adjusted through a benchmarking process, efficient DM capex should be part of this process.
4. Where capex revenue is discounted to include 'an explicit amount of capex that could be deferred through demand management,' in view of the differences between networks' DM programs and the differences in their internal accounting of DM programs this amount should be based for the 2015-19 regulatory period on an adjustment to each DB's DM outcomes in the 2009-14 period.
5. If the AER benchmarks approved capex revenues to include potential savings from DM programs, it should also approve proposed related DM opex (including step changes, where justified) without any

[10] Consumer Challenge Panel, *Smelling the roses and escaping the rabbit holes: the value of looking at the actual outcomes in deciding WACC*. July 2014.

additional reduction in capex revenue. Where the AER benchmarks opex revenue, efficient DM opex should be explicitly recognised as part of this process.

6. The AER should 'ground-truth' the DBs' proposed augex and repex plans by using available evidence (DAPRs and RIT-Ds) to analyse whether some of the more expensive proposals have involved adequate consideration of non-network options.

DM generally

7. In the forthcoming regulatory determinations for Victorian and Tasmanian DBs, the AER should sent a much stronger and more consistent signal about the importance of DM in constraining proposed augex and repex spending from the outset, in its Position, Framework and Approach and Issues papers, rather than limiting discussion to the planned application of the DMEGCIS.
8. The AER should develop a DM Guideline, setting out its expectations of networks in relation to regulatory determinations (not only in relation to regulatory incentives but also capex-opex tradeoffs, the presentation of data and DMIA plans), RIT-Ds and annual reporting of DM spending and results.
9. In order to assist the DBs to successfully transition to a decentralised energy system, the AER should consider making the typical $1 million DMIA a minimum allowance rather than an informal cap, as long as it is accompanied by a robust measurement, verification and reporting mechanism.
10. The AER should ensure that the TEC/SCER DMEGCIS rule change is implemented via amendments to the 2015-19 determinations as soon as practical after it has been finalised.
11. The AER should discuss with TEC, the AEMC and other stakeholders the adequacy of the existing RIT-D mechanism, in regard to its timing, scope, applicability and outcomes, with a view to a potentially strengthening of the NER to improve it.

Yours sincerely,

Jeff Angel
Executive Director