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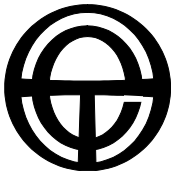

SUBMISSION

to

Australian Energy Regulator

Proposed Demand Management Incentive Scheme and Framework and approach paper for Aurora Energy

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Submission

AER's Proposed Demand Management Incentive Scheme and Framework and approach paper for Aurora Energy

Demand Management Incentive Allowance

The proposed Demand Management Innovation Allowance (DMIA) of $2 million for Aurora Energy over 5 years is an indictment of how counter to the long term interests of consumers are the concerns of the Australian Energy Regulator (AER), the Australian Energy Market Commission (AEMC) and the Ministerial Council on Energy (MCE).[1]

Based on Aurora's previous approved capex spends, the DMIA will be well below 0.1% of total spending over the five year period. This is contrasted with the vast, untapped potential of demand management (DM) to redress the massive over-investment in peak driven network expansion that is occurring across the National Electricity Market (NEM). We estimate that around one third of network spending could be deferred or avoided if the full potential of DM was captured.

Clearly, projects such as the $100 million Smart Grid Smart City, implemented by the Commonwealth Government, demonstrate the failure of the AEMC and the AER to facilitate the efficiency improvements urgently needed in the grid.

The appalling DMIA level across the NEM is coupled with the almost entire absence of any planned DM investment in the most recent revenue determinations, which parodies the AER's claim that:

> Before approving forecasts of operating and capital expenditure the AER will require DNSPs to satisfactorily demonstrate that efficient non-network alternatives to capital and operating expenditure have been properly considered in the development of forecasts.[2]

In reality, there is no such demonstration of proper consideration and no such requirement from the AER for networks to do so. It is clear, for example, that DM has not been properly considered by Aurora Energy, as evidenced by its most recent reports into major upgrades of the Hobart Eastern Shore Region ($49m), the Launceston Area ($47m)and the Kingston Area ($40.6m). Indeed, the reports indicate that an embarrassing 'cut and paste' approach has been taken to DM in these reports.[3]

Clearly, the regulatory framework has significant disincentives to DM, as the AER notes:

> Conversely, the regulatory framework may also provide some disincentives to undertake demand management. Most notably, non-network solutions may offer a lower (inherent and/or perceived) level of reliability when compared to network solutions, which has implications for a DNSP's network reliability obligations and ability to meet service performance targets.[4]

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[1] Australian Energy Regulator, *Framework and approach paper Aurora Energy Pty Ltd, Regulatory control period commencing 1 July 2012*, June 2010, p.5.
[2] Australian Energy Regulator, *Proposed Demand Management Incentive Scheme Aurora Energy,* June 2010, p. 3.
[3] At: http://www.auroraenergy.com.au/electricity_network/network/reports_and_consultations.asp#hobart_dev
[4] Australian Energy Regulator, *Explanatory statement, Proposed demand management incentive scheme, Aurora Energy*, June 2010, p. 2.

Assertions of lower reliability continue to go undocumented and unproven. At the same time, the minimal DM that has been carried out by distribution networks has been shown to be at least half the cost of building new infrastructure, *not including the avoided costs of new transmission, new generation or carbon costs*. TEC's report *Demand Management and Energy Policy Development: A Case Study of NSW* clearly illustrates the cost-effectiveness of demand management using the industry's own data.[5]

We reject the basis upon which the AER has capped the DMIA. Rather than being based on the 'typical demand management project costs', the DMIA should be set at the level of DM potential that the AER has failed to capture through its regulatory determinations. An assessment of the level of DM potential has clearly never been considered by the AER.

By comparison, we note the Essential Services Commission of SA's (ESCOSA's) provision for ETSA in 2005 with a demand management allowance of $20.4 million. Reporting on the results of this allowance include a 19 - 35% reduction in peak load using direct load control demand management in trials.[6]

We therefore recommend that the AER initially sets the DMIA at an initial 5% of projected network capital expenditure until it rectifies its revenue determinations to ensure that an initial 5% of projected network spending is directed towards DM projects aimed at constrained areas. Once this modest target has been achieved, the AER should consider raising it to a more appropriate level.

Control Mechanism

The proposed revenue cap is supported by Total Environment Centre as a 'lesser evil' than a price cap.[7] The price cap approach rewards DNSPs for increased sales of electricity and therefore reduces even further the incentive for DM. The pass-through of foregone revenue (that has been applied in other jurisdictions with a price cap) is not an appropriate compensation, as it introduces more uncertainty for the DNSP (there is no guarantee that the regulator will approve the foregone revenue claimed) and requires more resources, well outside the DNSP's area of expertise, to recover this revenue.

[5] Attached to this submission as Appendix A. Total Environment Centre, *Demand Management and Energy Policy Development: A Case Study of NSW,* May 2010, at: http://www.tec.org.au/reports-and-submissions/393?task=view

[6] http://www.etsautilities.com.au/centric/our_network/demand_management.jsp

[7] See Headberry Partners/Bob Lim & Co, Does current electricity network regulation actively minimise demand side responsiveness in the NEM? Report prepared for Total Environment Centre, June 2008.