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24 February 2017

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

Dear Mr Anderson

RE: Consultation Paper – Demand Management Incentive Scheme and Innovation Allowance Mechanism – Reference ERC0206

1. Introduction and context

We welcome the opportunity to comment on the Australian Energy Regulator's (AER) Consultation Paper on the demand management incentive scheme and innovation allowance mechanism (Consultation Paper) and look forward to working closely with the AER to develop the new Demand Management Incentive Scheme (DMIS) and innovation allowance mechanism (Allowance Mechanism).

It is timely to develop a new DMIS and Allowance Mechanism in the context of the ongoing transformation of the electricity market. This transformation is being driven by increased competition from alternative service providers, the emergence of new electricity services and technology and customers' changing needs and expectations.

Regulators across the world are considering how their regulatory frameworks should evolve to support and facilitate the transformation of the electricity sector. Great Britain's electricity and gas regulator, Ofgem, is a leader in this area and has introduced various successful incentives schemes to promote innovation and investment in non-network solutions as a means of facilitating and supporting the ongoing transformation of their energy market.

The recent changes to the National Electricity Rules (Rules), which require the AER to develop (i) a DMIS consistent with the demand management incentive scheme objective; and (ii) an Allowance Mechanism consistent with the demand management innovation allowance objective, are key critical to facilitating and supporting the transformation of our electricity market. The development of the DMIS and Allowance Mechanism are necessary to assist in ensuring that our regulatory framework drives an optimal level of investment in the research and development of demand management as well as investment in proven and efficient demand management solutions.

Our high level comments on the development of the DMIS and the Allowance Mechanism are set out below. Attachment 1 of this submission sets our response to each of the questions posed in the Consultation Paper.

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2. DMIS

The Rules define the objective of the DMIS as follows:

> *To provide Distribution Network Service Providers with an incentive to undertake efficient expenditure on relevant non-network options relating to demand management (Clause 6.6.3(b).*

We are committed to investing in non-network solutions and do so, in partnership with our customers and industry, where they provide the most cost effective and economic solution. Examples of this include our Summer Saver initiative, solar-storage programme and engagement of third-party non-network service providers (e.g. GreenSync).

A key challenge for us, however, is that currently the only benefits which we derive from implementing non-network solutions stem from the costs savings from avoided network expenditure. Therefore, we consider that a key consideration in driving the uptake of non-network solutions is our ability to secure a fair proportion of all benefits created by these investments across the supply chain.

To this end we strongly support the net market benefit sharing (type 2) approach outlined in section 6.2 of the Consultation Paper. This would allow distributors to monetise a share of non-distribution benefits arising from demand management projects. We consider however that monetising 50 per cent of these benefits may not be sufficient in some cases. We propose that the per cent share of non-distribution benefits should vary between 50 and 100 per cent, until the demand management solution becomes the preferred option.

We also consider that:

- Consistent with the Australian Energy Market Commission's (AEMC) final rule determination on the Demand Management Incentive Scheme[1] the scope of possible investments eligible for inclusion in the DMIS should be as broad as possible. For instance they should include:
  - Embedded generation projects to the extent they are related to demand management; and
  - Power factor correction and voltage control projects. If these are deployed at the customer end ("behind the meter") they can reduce demand on our distribution substations and therefore defer augmentation of the network.
- Demand management solutions should not be excluded from the service target performance incentive scheme (STPIS). We consider that this may compromise the intended network reliability associated with these solutions at the expense of customers;
- There should be no bias against innovative tariff design projects under the DMIS. The scheme should include both tariff and non-tariff -based demand management where it meets the objective of the scheme;
- The introduction of targets could incentivise the uptake of demand management solutions to meet the targets rather than drive the most efficient solution. Accordingly, we consider that the introduction of targets may not be consistent with the objective of the DMIS or the National Electricity Objective; and
- While we support simple, concise and fit for purpose information reporting to facilitate demand management activities we already provide significant amounts of information to assist third party demand management providers. Therefore, we encourage the AER to ensure that any changes to our information and reporting requirements are closely reviewed to ensure they will not simply duplicate information already provided and any new reporting requirements deliver clear benefits to consumers.

[1] Found at: http://www.aemc.gov.au/getattachment/f866b41b-753b-471c-91cf-4f558ca130b2/Final-rule-determination.aspx

3. Allowance Mechanism

Innovation involves entrepreneurship with a view to reducing costs or improving performance outcomes, including in relation to safety, reliability, and customer service and workforce renewal. For a business such as ours, innovation associated with demand management would typically involve investigating ideas to create knowledge and ideas about emerging but as yet unproven non-network technologies and other demand management activities. Innovation is therefore critical to sustaining the transformation of the electricity market.

Due to its highly uncertain nature, not all of the knowledge and ideas generated through innovation will result in initiatives that reach commercialisation. Therefore, in order to drive the optimal level of innovation, distributors need to be compensated for the cost of efficient research and development that satisfies the objective of the demand management innovation allowance mechanism being:

> *To provide Distribution Network Service Providers with funding for research and development in demand management projects that have the potential to reduce long term network costs*

Currently, there are limited incentives under the Rules to encourage distributors to pursue innovation, such as ground breaking research or high risk initiatives, despite this being necessary to increase the use of demand management initiatives. The current Demand Management Innovation Allowance (DMIA) under the current DMIS is intended to incentivise us to implement efficient non-network alternatives through demand-side or generation solutions,[2] as opposed to generate knowledge or ideas in relation the use of demand management.

We therefore support the introduction of an innovation mechanism structured similarly to the arrangements that Ofgem has implemented for electricity distributors in Great Britain. This comprises two key components being:

- A network innovation competition (NIC). Under the NIC, distributors compete for funding for the research, development and demonstration of new technologies, operating and commercial arrangements. Funding is provided for those innovation projects which meet Ofgem's evaluation criteria; and
- Network Innovation Allowance (NIA). This is a set allowance that distributors receive as part of their annual revenue requirement which can be used to fund:
    - Small technical, commercial, or operational projects that have the potential to deliver financial benefits to the distributor and its customers; and/or
    - The preparation of submissions to the NIC.

We support an Allowance Mechanism that comprises a combination of:

- Option 1 – minor extension to the status quo. This would involve a fixed ex-ante allowance in our annual revenue requirement to facilitate knowledge or ideas generation or the preparation of a submission for Option 3. On its own, the minimal nature of this option would not be sufficient to drive the optimal level of innovation;
- Option 2 – Hi-cap allowance with ex-ante approval. This would involve distribution businesses seeking funding for specific innovation projects as part of their Regulatory Proposals. The AER would assess whether or not to approve an allowance for these, having regard for specific criteria, as part of its distribution determination. On its own, this approach would not be sufficient to drive the optimal level of innovation because it only contemplate distributors being compensated for investments that they are aware of at the time of preparing their regulatory proposals. This approach is therefore not sufficiently flexible to encourage distributors to pursue projects that become known during the regulatory control period; and
- Option 3 – bidding to encourage "ground breaking" R&D. This would involve distributors bidding for funding for ground breaking R&D funding via competitive tender process similar to Ofgem's NIC.

[2] For the current regulatory control period, the AER approved a total DMIA allowance of $2 million over five years.

Taken together, we consider that the above options would provide a comprehensive approach to support investment in network innovation that is essential to enable us to continue to deliver on the National Electricity Objective, which is[3]:

> *to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to – price, quality, safety, reliability, and security of supply of electricity; and the reliability, safety and security of the national electricity system.*

4. Closing

Please do not hesitate to contact Stephanie McDougall on (03) 8846 9538 or stephanie.mcdougall@ue.com.au if you would like to discuss any of the matters raised in this submission.

Yours sincerely

Andrew Schille
General Manager Regulation and Corporate Affairs

[3] Section 7 of the National Electricity Law found at: http://www.austlii.edu.au/au/legis/nsw/consol_act/nel282/s7.html

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Attachment 1 – United Energy's responses to question in the Consultation Paper

#	Question	Response
1	Do stakeholder support our interpretation and proposed implementation of new rules? If you have alternative views, please share these and provide supporting evidence.	We support the AER's interpretation and implementation of the new rules. However, we note that power factor correction and voltage control projects if deployed at customer end (i.e. behind the meter) can result in reducing demand on distribution substations (DSS) and therefore can be used to defer DSS augmentation projects. Therefore, we consider that both these techniques should be categorised as demand management activities and therefore requires more clarity in the new rules.
2	Do you agree with our view on the main demand management incentives (or disincentives) provided under the regulatory framework and the potential issues associated with these incentives? Please provide reasons to support any alternative views you may have.	We do not support the exclusion of demand management solutions from the STPIS as we consider that this may compromise the intended network reliability associated with these solution. In this case, customers will be paying for a service which they may not be getting and they may also be suffering from the power outages. We only support the introduction of mechanisms to incentivise distribution businesses to pursue demand management initiatives which will result in a clear increase in net customer benefit.
3	Do you see value in exploring this option further, despite the difficulties associated with measuring net-market benefits? If yes, what detail of guidance should we provide on calculating market-wide costs and benefits? Should we (and if so, how should we) establish a method for valuing smaller demand management projects in a way that reduces the administrative burden of applying the Scheme to these projects?	Yes, we support the intent of the net market benefit sharing mechanism and would like to explore this option in further detail. We would welcome worked examples which provide clarity on how to calculate value of demand management in different levels of the electricity supply chain and how these benefits can be utilised by distributors. We already treat third parties with a level playing field and do not support a need to introduce incentives for that purpose. We would welcome the opportunity to work with the AER to develop a standard methodology/calculator and accompanying worked examples, to foster a shared understanding of how to estimate market benefits associated with small demand management projects. This would reduce the burden on distributors associated with assessing small demand management projects with the same level of detail as required under the RIT-D.
4	Since the RIT–D already requires distributors to select the option with the highest total market benefit, should we (and if so, how should we) treat RIT–D projects differently under this type of Scheme?	We consider that there should not be a distinction between RIT-D and small demand management projects in calculating market benefits (except for a cost threshold to determine if it is a RIT-D project or not).
5	How might we best combine the mechanisms discussed in section 6	We strongly support the proposed Type 2 Net market benefit sharing as detailed in section 6.2 of the Consultation Paper. This would allow distributors to monetise a share of non-distribution benefits arising from their demand management projects.

#	Question	Response
	above into an option that achieves the Scheme's objective? If you prefer a mechanism that we did not discuss in in section 6, please provide details on this mechanism.	We consider, however, that restricting distributor's share of the non-distributors benefits to 50 per cent may not be sufficient in some cases. We propose that distributors be allowed to monetise between 50 and 100 per cent of the non-distribution benefits - i.e. until the demand management solution becomes a preferred option for the distributor. We do not support the introduction of incentive payments to distributors for the provision of information. We currently provide all necessary information requested by the interested third parties during solution investigation and development phase. We already promote bidding mechanisms via a competitive capex panel and through the RIT-D Non Network Options Report (NNOR). We support mechanisms to promote competition to be made mandatory for all projects under the new scheme.
6	If you have views against applying any of the particular mechanisms discussed in section 6, please provide reasons to support this view.	We do not support Type 4 – target based schemes. We consider that setting targets and financially rewarding distributors for meeting these will create unnecessary complications and distortion in and therefore undermine the intent of encouraging demand management. In our opinion a demand management solution should only be adopted if it is the most economic option (in maximising the net market benefits) and not just for the sake of meeting arbitrary targets to claim incentive payments. Sometimes the 'Do nothing' option may be the preferred solution.
7	How we might best give effect to or enhance the information and reporting requirements discussed in section 6.5 above?	We support the provision of information to improve participation in the market and improve decision making. We already provide significant amounts of information to assist third party demand management providers. We therefore consider that any changes to information and reporting requirements should be closely scrutinised to ensure that they will deliver clear benefits to consumers and rather than become an administrative burden for distributors. To this end we consider that any changes to information and reporting requirements should: • Have regard for the significant information already provided and seek to duplicate this. For example, we currently provide a significant amount of information in our DAPR and are concerned that the AEMC will now seek us to provide much of this information again in a different format under the Local Generation Network Credits rule change from 1st July 2017. The provision of information is costly for consumers and therefor unnecessary duplication should be minimised; • Only involve collecting information that is necessary to promote the objectives of the Scheme • Standardise report formats to allow industry participants to easily compare information provided by different businesses; • Request concise and suitable information for projects of all different values.

#	Question	Response
8	Which of the options discussed above in section 7 would best achieve the Allowance Mechanism's objective? Please provide reasons supporting your view. If you prefer an Allowance Mechanism design that we did not discuss as an option in section 7, please provide details on this option.	We support a combination of: • Option 1 - Minor extension of the status quo and O • Option 2 - High cap allowance with ex-ante approval. • Option 3 - bidding to encourage "ground breaking" R&D However in relation to option 3, we do not consider it necessary to always partner with a third-party. In our experience, it is not always possible to find a willing partner with whom to pursue initiatives with and therefore this should not be a barrier to initiatives under this option.
9	If you have views against applying any of the particular mechanisms discussed in section 7, please provide reasons to support this view.	Option 4 limits us from growing our in-house capabilities in the space of demand management solutions. We would like to be able to develop fall-back non-network solutions as alternatives to network augmentation in the event that third parties are not able to provide and deliver economic non-network solutions.
10	How we might best give effect to or enhance the information and reporting requirements discussed in section 7.5 above?	We support information reporting and encourage knowledge sharing from each pilot or trial. We would welcome the opportunity to work with the AER to develop a standard template for reporting should be provided by the AER.