INFORMATION

Demand management incentive scheme and innovation allowance for TNSPs

Consultation commences on a rule change request to introduce demand management incentives to transmission networks

Energy Networks Australia's rule change request

Energy Networks Australia (ENA) submitted a rule change request proposing amendments to the National Electricity Rules that would require the Australian Energy Regulator (AER) to develop a Demand Management Incentive Scheme (DMIS) and Demand Management Innovation Allowance (DMIA) to apply to transmission networks.

The DMIS provides for incentive payments to undertake efficient expenditure on non-network options. The DMIA provides funding for research and development (R&D) on demand management projects that have the potential to reduce long term network costs. Under the current rules, the DMIS and DMIA are only available for distribution networks. ENA proposes to apply the same approach to transmission, including giving the AER discretion as to whether to apply the schemes and in determining incentive powers.

Issues addressed by ENA's proposal

ENA submits that the proposed rule change would promote innovation and create positive incentives for transmission businesses to undertake demand management approaches, which would benefit customers through lower transmission network and total system costs.

Electricity network demand management generally helps to remove, reduce or defer network constraints, which potentially provides a less costly alternative to capital investment. Transmission businesses may be able to shift or reduce net demand on the network by, for example, providing financial incentives to encourage behavioural change, contracting for local generation support, or physically controlling electricity usage. Lower total system costs mean lower electricity prices for consumers, all other things being equal.

ENA considers there are 'practical hurdles' associated with putting in place a non-network solution – such as reputational and compliance risks, particularly when the market for non-network solutions is still developing. ENA considers that this potentially creates unbalanced incentives and a bias towards network capital investment under the current rules.

Consumers would ultimately fund the allowances under the DMIS and DMIA. These payments increase total allowed revenue, which in turn means higher network charges for consumers in the short term. ENA considers that these costs would be outweighed by longer-term cost savings for consumers as a result of more efficient expenditure.

The current rules already require transmission businesses to adopt least cost network solutions. The AER's allowed revenue determinations are based on forecasts of efficient capital and operating expenditure. The Regulatory Investment Test for Transmission, which applies to all major investment decisions, is designed to explicitly consider non-network options and deliver the most efficient solution – regardless of both technology and ownership. Information asymmetries make it difficult for the AER to accurately assess the efficiency of the network businesses' regulatory proposals in practice.

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Issues for consultation

The Commission identified three key broad issues for stakeholder consultation.

First, there is the question of whether there is an ‘incentive gap’ problem in the current regulatory framework for transmission and, if so, whether there are alternative approaches that would better achieve the objective of ENA’s rule change proposal. In parallel, the Commission is currently consulting on different expenditure assessment and remuneration regulatory approaches to address the potential for expenditure bias more broadly – as part of the 2019 *Electricity network economic regulatory framework review*.

Second, the Commission will consider whether the benefits of introducing a transmission DMIS and DMIA are likely to outweigh the upfront costs to consumers. The Commission is seeking information on examples of non-network solutions that could be developed through R&D and implemented as an alternative solutions, as well as their potential payoffs.

It is generally acknowledged that the market for non-network service providers at the transmission level is in its relative infancy, which may mean there is uncertainty about future benefits. Third party providers are expected to innovate and grow especially as technology develops and the energy market evolves. Increasing integration of small customers into the electricity market may lead to a range of new services that are yet unknown.

ENA proposes to provide the AER with significant discretion in deciding whether to apply the DMIS and DMIA, and the rule change would allow the incentives/revenue allowances under these schemes to vary by business and over time. The AER would develop guidelines for the DMIS and DMIA, and then consider the benefits and costs at the time of deciding whether to apply the schemes for a regulatory determination. In this context, a consideration for the Commission is whether enabling the AER to apply the DMIS and DMIA would improve the flexibility and responsiveness of the regime to changing technologies and regulatory methodologies.

Third, allowing for ‘early applications’ of the DMIS as proposed by ENA, rather than waiting to implement this scheme at the start of the next regulatory period, potentially creates transitional issues as the AER's transmission network revenue determinations across jurisdictions are staggered over three years. The Commission is seeking views on how implementation would be best managed in these circumstances.

The consultation paper contains further discussion the above issues. Submissions are due by **Thursday 11 July 2019.**

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