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Total Environment Centre

AEMC draft rule determination

Demand management incentive scheme

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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 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 consumer power bills and improving the economic efficiency of the NEM — all in the long term interest of consumers, pursuant to the National Electricity Objective (NEO).

Introduction

TEC welcomes the opportunity to provide input into the draft determination on our, and COAG's, rule change requests. We will restrict our response to general comments and several key points.

Overall, we are pleased that the draft determination largely reflects both organisations' requests, which is not surprising since they were in turn based on the draft specifications attached to the AEMC's own 2012 Power of Choice final report. We note that the overwhelming majority of submissions on the consultation paper were strongly in favour of introducing an effective DMIS. The AER continued its longstanding scepticism towards network demand management (DM). Only GDF Suez, which potentially stands to lose profit from lower peak pool prices and lower demand for its generation, was unequivocally opposed. In our view, the fact that a generator which makes most of its profit during high price peak events was opposed to the idea of a DM incentive is a good indication of the benefits of an effective DMIS, and of the need to introduce one.

In particular we are pleased to see that:

- The AER will be *required* to introduce a demand management incentive scheme (DMIS).
- There are separate provisions in the draft rule relating to the DMIS and the demand management innovation allowance (DMIA).
- Networks will be able to capture a share of market (non-network) benefits, and these can be recognised over more than a single regulatory period.

There are several areas where we disagree with the AEMC's draft ruling. In some cases the AEMC's position has differed from our request, but this does not do fundamental damage to the integrity of the rule change. Examples of this include: not allowing for the recovery of foregone revenue; not allowing tariff-based DM, and not prescribing a formula or cap for the network share of non-network benefits.

There are, however, several respects in which we consider that the draft rule can and should be improved to ensure an effective DMIS. These are now considered in more detail.

AER discretion

The AER has a long history of undervaluing DM and evidently not understanding its importance and application. This is evidenced by the AER neglecting to implement a meaningful DM incentive scheme; sending no signals to networks in its framework and approach and issues papers about how DM programs will be assessed, and then refusing most of their DM opex spending in revenue determinations; setting an arbitrary cap on the innovation allowance; chronically failing to even monitor and report performance on network DM (beyond the trivial DMIA); and so on. It also expressed deep ambivalence about a DMIS rule change in its submission on the consultation paper, in spite of having expressed the need for more direction over the current DMEGCIS. In particular, it stated that

> …our preference is to have discretion to consider the need for a scheme, its longevity, and the merit of specific elements such as market benefits payments via a guideline and framework and approach process.

As such, TEC considers it is highly likely that the AER could design a DMIS because it will be required to do so under the new rule, but then fail to apply it to any or all networks on the basis that other incentives are (in the AEMC's words) "working as intended."[1] This is to prioritise other incentives such as the capital expenditure saving scheme (CESS) over the DMIS, which we consider is unwarranted in view of the untested nature of these other incentives as well as their inherent limitations. It also assumes that the AER will objectively and comprehensively assess the implications of other network incentives for their impact on DM, which we consider is not warranted at present.

Conversely, there are no circumstances we are aware of in which *no* demand management would be appropriate over an *entire* network for an *entire* regulatory period, so the logic of making the scheme discretionary for the AER escapes us. That would be to assume that the AER knows networks better than they do. Networks should have the discretion to apply the scheme to their businesses, not the AER. We therefore propose that the AER should be required to apply the DMIS to all network revenue determinations. There is no point having a scheme and not using it.

Timing of implementation

The draft determination states that "The Commission does not consider it is appropriate to provide for the application of the new DMIS or DMIA midway through a regulatory control period."[2] We agree that no change may be needed for the DMIA, since the AER has already applied it to every network. However, the DMIS is another matter entirely.

Since the DMIS as proposed in the draft rule change is not obligatory for a network to implement, it would be up to each network to determine whether the benefits outweigh the costs. Depending on the design of the scheme, there may be no need to amend other capex/opex incentives (outcomes for which have not been applied ex ante in the NSW determinations) or maximum allowable revenues. We note that concern over the timing was not part of the AER's submission on the draft determination. Indeed, the AER has previously indicated that it would be prepared to introduce transitional arrangements for the coming round of revenue determinations:

[1] AEMC draft determination, p ii.

[2] AEMC draft determination, p 61.

> We intend to introduce a revised DMIS as soon as practicable following the AEMC's rule change process. It is likely that transitional rules will be required to allow the revised scheme to apply within the 2015–19 regulatory control period.
>
> The AEMC will be able to consider how any changes to the NER can be implemented in the 2015–19 regulatory control period through transitional arrangements.

This rule change request was submitted to the AEMC in November 2013, in response to the AEMC's 2012 Power of Choice Final Report, with adequate time for a determination to be incorporated into the NSW and following network revenue determinations from July 2015. The AEMC's delay and the AER's decision not to countenance incorporating a new DMIS in the current round of revenue determinations pending the AEMC's final determinations, and now the AEMC's proposal to give the AER until December 2016 to publish a DMIS have conspired to delay the introduction of this overdue reform potentially for a whole revenue determination period – i.e. until 2019-2020. This is unnecessary and unacceptable.

It should be noted that while the AEMC's draft DMIS Rule makes some very important changes and clarification, the DMIS that it envisions would also be wholly consistent with the existing rules. In other words, the AER could and should have developed an effective DMIS at the beginning of the *current* regulatory periods, beginning 2009/10. Had this been the case, consumers could have been spared some of the recent massive overinvestment in network infrastructure. It would be a travesty if this rule change process becomes a pretext for further delay in this urgent and long overdue reform.

We understand the AER needs up to 9 months to design a DMIS. If the final determination is published in August 2015, a new Scheme could be published by May 2016. If networks have been advised of the likely design of the Scheme as it develops, as is the AER's normal practice, we see no reason why transitional arrangements could not be in force from July 2016. This would accelerate reform by a full three to four years over the alternative. Rarely does the AEMC have such power to accelerate the pace of reform in the NEM so easily. The AEMC's current proposal would expose the network businesses and especially their more vulnerable consumers to unnecessary risks, in particular as more flexible consumers engage in "load defection" by combining solar, batteries and energy management.

In short, the AER should be held to its previous commitment to introduce a new DMIS as a transitional arrangement.

Guidelines

The draft rule does not include an explicit requirement for the AER to prepare DM Guidelines. In TEC's view this is regrettable, since the AER's approach to DM in the current round of revenue determinations, and the networks' widely disparate responses, indicate that networks need guidance. The AER has been unwilling to provide guidance in relation to DM to date beyond a very narrow reading of its obligations under the DMEGCIS. However, it has provided guidelines in relation to other aspects of network regulation (e.g. the RIT-D), and has now accepted the need for a DM guideline (see quote above). The DMIS rule should also include reference to guidelines for DM and the application of the DMIS.

DMIA

Although this was not part of TEC's rule change request, because some networks do little in the way of innovation, to encourage more innovation there may be merit in the final rule requiring networks to justify in their DAPRs or RINs why they have not spent their total AER approved allowance on innovative DM projects.

Reporting

The draft rule includes a requirement for the AER to require networks to publish "reports on the nature and results of demand management projects". On close examination, these documents are typically vague at best in relation to DM and the DM projects and outcomes do not appear to be closely scrutinised by the AER. Whether in the DAPRs, RINs or elsewhere, we therefore consider that networks should be required to publish:

- Details of spending on all DMIS, DMIA and any other DM projects.
- Performance outcomes, using metrics such as peak kVA and GWh p.a. saved.
- Value of network investment saved in $million total and $million p.a.
- Cost effectiveness of each project, in $kVA p.a., $/MWh and benefit/cost ratios.
- Reporting of data in clear and consistent manner that allows transparent comparison of performance across networks and over time.
- Plans for sharing the outcomes of successful DMIA activities with other networks, and incorporating them into business as usual planning via capex reductions.

This would allow the effectiveness DM spending to be assessed on an objective basis. These should be matters addressed in the AER's DM Guidelines, but if the AER is not required to publish such Guidelines then reporting should be a stronger focus of the new rule.

Recommendations

The final rule should differ from the draft determination in the following respects:

1. The AER should be required to apply the DMIS and DMIA to all networks.
2. The AER should be required to publish the first DMIS and DMIA by 1 May 2016, and to introduce them into revenue determinations by 1 July 2016 via transitional arrangements.
3. The AER should be required to publish DM Guidelines including reporting requirements for DMIS and DMIA programs and projects with performance metrics as discussed above.

We thank the AEMC for its very useful consultations with TEC to date, and look forward to further consultations and the final determination.

Yours sincerely,

Jeff Angel
Executive Director