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National Electricity Amendment –Implementation of the Demand Management Incentive Scheme Rule 2018

The Australian Energy Council (the Energy Council) wishes to make a submission with regard to the **National Electricity Amendment –Implementation of the Demand Management Incentive Scheme Rule 2018** (DMIS Rule Change).

The Energy Council is the industry body representing 21 electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. These businesses collectively generate the overwhelming majority of electricity in Australia and sell gas and electricity to over 10 million homes and businesses. The Energy Council has a number of members who will contribute their own submissions in this regard.

The AER proposes to make a Rule that would allow eligible Distribution Network Service Providers (distributors) to apply to the AER for approval to apply the new DMIS mid-way through an existing regulatory control period.

The Australian Energy Market Commission (AEMC) in the Consultation Paper propose to consider this proposal under the expedited rule change process in s96 of the National Electricity Law. The AEMC consider this rule to be non-controversial and unlikely to have a significant impact on the National Electricity Market.

The Energy Council object to this determination. We do not consider the current Ring-fencing and Compliance frameworks under which Network Businesses operate have proven to be sufficiently robust and enforceable to mitigate the risk of inefficient market outcomes in the short term. We are extremely concerned that the early application of the DMIS at this time could significantly hinder the development of competitive demand side markets in the future.

The rule change proposal

We note that the AER has consulted with a range of stakeholders in developing the DMIS. During this process, the AER identified only one submission, from Red/Lumo, opposing this rule change proposal. In the AER's view, this objection was based on the ring fencing framework, rather than the rule's early application¹.

¹ Australian Energy Regulator – *Request for Rule Change – Early Implementation of the Demand Management Incentive Scheme* - 14 December 2017.

Ring Fencing is of particular interest to members of the Energy Council as it facilitates a level playing field between DNSPs and competitors who to provide innovative and customer-driven services in energy related areas. The DMIS clearly overlaps the provision of such services and the membership of the AEC share Red/Lumo concerns that the DMIS could be brought forward in an environment where the governance and compliance regime for ring fencing is weak and poorly enforced.

If the DMIS is to be permitted, the entire Ring Fencing regime, including strict enforcement procedures, must be in place and demonstrably implemented to ensure the long term interests of consumers are protected.

Delaying the Scheme

The AER identified that Red/Lumo was the only submission objecting to the Rule Change. Red and Lumo expressed concern that a DMIS which provides distributors with a 50 per cent cost uplift will provide greater financial leverage to distributors to award demand side contracts to their ring-fenced affiliates.

Specifically, Red/Lumo contended the DMIS would increase the ability for a distributor's ring-fenced affiliate to price their demand side options lower than their competitors, knowing that this will be offset (within the distributor's corporate group as a whole) by the project incentive awarded to the distributor. Given this, Red and Lumo considered that the draft Scheme would increase the potential for distributors to undermine the AER's Distribution Ring-fencing Guideline. Such potential is not in the long term interest of customers.

The AER noted this position, but considered that the net benefit threshold mitigated the risk of cross subsidisation, ensuring that the total cost of the project, including the DMIS, would still be lower than the augmentation it was intending to avoid. The Council do not dispute this, however just because a project might be better for a consumer than otherwise would have been the case, this does not preclude the DMIS having a negative impact on the competitive demand side market.

Simplistically, a ring-fenced affiliate would be able to price a project below cost, and with the uplift payment to the network business, would be able to achieve a greater net benefit to the corporate group. A competitive business who priced at cost, while still providing a net benefit to the consumer, would fail to win the contract they would have won if the cross subsidy had not been in place.

This then skews the market in favour of the ring-fenced affiliate in that they may be able to capture more market share than they otherwise would have. This would have the potential to crowd out potentially more efficient service providers from the DR/NS market in the short-term, which diminishes productive efficiency, and would have a chilling effect on competition and technological development in the behind the meter (BTM) market in the long-term, which diminishes dynamic efficiency.

Ring Fencing

From the Energy Councils perspective, evidence of weak and poorly enforced ring fencing was apparent in the eleven applications the AER solicited from distributors for waiver of obligations under the Distribution Ring-Fencing Guideline.² In spite of the AER statements that wished to make clear that it does not see the availability of waivers as representing a business-as-usual approach, the apparent lack of genuine steps by distributors to become compliant since 1 December 2016, and the routine granting of the applications has diminished retailer confidence in ring fencing. This precedent is not in the long term interest of customers.

We have not been assured by the AER that these waivers were a once off, given the 1 January 2018 commencement date signalled a turning point in ring fencing compliance. Conscious of the existing state of ring fencing enforcement, we are not convinced the AER will be able to appropriately mitigate the risk of cross-subsidisation under the DMIS in any early implementation of the scheme.

² Australian Energy Council submission to the AER on *Applications for waiver from the Distribution Ring-Fencing Guideline* – 30 August 2017

To provide suitable reassurances, the Energy Council consider that more work needs to be done by the AER in its strict enforcement of ring-fencing to ensure that prior to the application of the DMIS appropriate mitigations are in place.

Any questions about our submission should be addressed to by email to david.markham@energycouncil.com.au or by telephone on (03) 9205 3107.

Yours sincerely,

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