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Mr John Pierce
Mr Neville Henderson
Dr Brian Spalding
Australian Energy Market Commission

Dear Commissioners

Lodged electronically: www.aemc.gov.au (ERC0177)

Demand management incentive scheme, Rule Determination, 28 May 2015

EnergyAustralia welcomes the opportunity to make a submission on the Demand Management Incentive Scheme (DMIS) rule determination. This rule change seeks to improve network planning and decision making by aligning incentives on Network Service Providers with consumer benefits.

We support the principles behind the draft rule and recognise the importance of encouraging more efficient expenditure decisions by distribution businesses, particularly the goal of creating an environment where physical investments in distribution businesses are made only when they are the most efficient considering all alternatives.

EnergyAustralia is one of the country's leading retailers, providing gas and electricity to more than 2.6 million customer accounts. We own and operate a range of generation and storage facilities, including coal, gas and wind assets, in NSW, Victoria and South Australia.

We understand the key features of the draft rule aim to amend and strengthen the existing Demand Management and Embedded Generation Connection Incentive Scheme (DMEGCIS) by creating separate provisions in the NER and principles and objectives for the demand management incentive scheme and a demand management innovation allowance mechanism. There will also be a requirement for the AER to develop, consult with industry and publish the incentive scheme and innovation allowance by 01 Dec 2016.

EA endorses the discretion provided to the AER in the design and application of the DMIS in the draft rule. We agree the AER is best placed to consider the need for a scheme, its longevity, and the merit of specific elements such as payments for market benefits or innovation allowances. The draft rule grants the AER prudent and appropriate flexibility to develop and apply the scheme alongside recent and pending market developments, and therefore whether there is a need to incentivise distribution business in this area at all.

In noting the features of the draft rule, we would also like to encourage the AEMC to consider the broader implications of the proposed approach to demand management. As noted in the draft determination:

> *"Distribution businesses will always need to be the decision makers with regard to whether a network or non-network option provides the most*

efficient solution to address a constraint of their networks. The question of who is best placed to provide possible non-network solutions is a separate question."

The focus of EnergyAustralia's submission is on the second part of this statement and our recommendations focus on encouraging competitive outcomes as the primary means of developing non-network solutions, and improving transparency of electricity network constraints and their impacts so that decisions by distribution businesses are subject to the appropriate public scrutiny at the planning stage.

The AEMC recognises the rules should encourage distribution businesses to identify and pursue the most efficient (or least cost) solution, irrespective of whether that solution is a network or non-network option or, in the case of the latter, whether it is provided by the distribution business in house, or by a third party through a competitive tender. EA would like to highlight the inherent risks of maintaining competitive neutrality when the procurer of a service, the information holder and decision maker is also competing for the provision of that service.

In the same way distribution businesses have limited means to access the benefits of non-network options, retailers and third parties cannot directly factor in the benefits of avoided or deferred network investments. Cost Reflective Network Pricing will go some way to achieving this and we encourage further reforms towards achieving this ideal. Treatment of network support payments should be consistent, transparent and clearly aligned to avoided network spend.

We support the AER's views on competition in the provision of demand management as outlined in their submission. Consideration should be given to the strategic direction of the provision of demand management services. Principles regarding competitive services should be included in the rule change or the final determination should advise on whether a further rule change would be required.

Context

When considering the draft rule it is important to reflect on the broader context in which it is being developed. The energy industry is in a period of transition. The AEMC's Power of Choice review was a timely examination of consumer empowerment in a changing environment. Significant changes, such as the introduction of cost reflective network pricing, will play a role in giving consumers an insight into their impact on electricity networks and empower them to change their behaviour to alter that impact. This will enable retailers (or third parties) to develop products to meet consumer needs to facilitate demand side participation.

Future energy markets will be defined by exponential growth in new technologies which shape how consumers engage with suppliers (if at all). We have seen with solar PV that as technology evolves the cost curve can reduce significantly. It is important that the regulatory framework is well equipped to support this evolution with consumer benefit given primary consideration. Opening activities to competitive markets where possible will deliver this value. Networks will not pursue this without appropriate regulation.

DMIS

The proposed amendments to Chapter 6 of the NER provide scope for the AER to include two forms of reward under the DMIS:

- a payment based on a proportion of the net market benefits (or avoided or deferred network costs) produced by a demand management project; and

- a payment as compensation for any lost revenues or profits that occur as a result of reduced demand from implementing a demand management option, where appropriate.

The DMIS rule change aims to balance network and non-network incentives so that DNSPs are incentivised to progress the most efficient solution regardless of technology. It does not, however, adequately incentivise DNSPs to test the competitive market for non-network solutions.

Non-network solutions will involve a range of benefits, often to multiple parties. The focus of any regulatory framework should be to ensure the full value of those benefits can be delivered to consumers and factored into decision making. We would only support incentives for network businesses that allow them to consider the broader market benefits of non-network solutions when all other market based solutions fail, particularly when noting that networks are not best placed to deliver the full value to consumers.

EnergyAustralia recommends that DNSPs be required to evaluate and tender for non-network solutions for any material network investment proposal (augmentation and replacement). A competitive tender process would consider the full value of any activity and consider the best way to deliver that to consumers.

Careful consideration should be given to whether a distribution business should be prevented from providing non-network solutions to itself, especially where it can influence the competitive process, and as a minimum the network business should be ring-fenced to ensure competitive neutrality is maintained.

To enable this process to work effectively third parties must have access to adequate information. EnergyAustralia recommends that DNPSs be required to publish regular information on network constraints and network planning strategies to enable third parties to consider non-network solutions.

In regards to payments to network businesses for foregone revenue, we agree these are no longer required under the application of a revenue capped framework, but accept this may change should there be future amendments to control mechanisms

DMIA

EnergyAustralia endorses the principle of the Demand Management Incentive Allowance (DMIA) and that it should be considered by the AER in its discretion, noting the proposed changes simply formalise the current arrangements.

However, EA considers any allowance needs to be cognisant of whether the activities are the sole responsibility of the regulated businesses. Consumers should not be funding improvements in capability where they duplicate work being done in the competitive energy markets nor support innovation in services which the regulated businesses might or should not be providing. The AER is best placed to determine the appropriateness of any allowance proposed by a regulated business, given its historical performance, its objectives and its 'need to learn'.

Conclusion

EnergyAustralia supports the principle behind the draft rule to encourage efficient demand side management via the DMIS and DMIA but have concerns relating to maintaining competitive neutrality in the provision of such services. The natural conflict between a business seeking such services and the same business providing the service to itself against alternative providers needs careful consideration in the context of how consumers fund the services.

We endorse the provision of discretion to the AER in developing the guidelines but consider that the overall framework could be improved by:

- An improved public tender process for demand management activities to deliver a competitive outcome and to ensure the separation of monopoly and competitive services.

- Careful consideration of how it interacts with recent developments such as cost reflective network pricing, which aims to introduce and improve mechanisms through which demand side service providers are rewarded.

- Application of ring fencing arrangements where DNSPs choose to be part of the competitive process since it is difficult to foresee many demand management activities that won't be provided competitively

- Improved public reporting of network constraints and network planning strategies to enable third parties to consider non-network solutions at the planning stage.

We consider that this package of reforms will best deliver value to consumers and promote competitive and dynamic efficiency in the electricity market.

If you any have further questions relating to these issues please contact me on (03) 8628 4518 or Ben.Hayward@EnergyAustralia.com.au.

Regards

Ben Hayward

Wholesale Regulation