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Mr John Pierce

Chairman

Australian Energy Market Commission

PO Box A2449 SYDNEY NSW 1235

By email: aemc@aemc.gov.au

Dear Mr Pierce,

ERC0177 - Demand Management Incentive Scheme Draft Rule Determination

AGL Energy (**AGL**) welcomes the opportunity to make a submission on the AEMC's Demand Management Incentive Scheme Draft Rule Determination (**Draft Determination**).

AGL is a significant retailer of energy with over 3.7 million electricity and gas customers nationally. Accordingly, AGL has a strong interest in the efficient investment in, and operation of, the distribution networks in the long term interests of consumers.

The energy market is currently undertaking a major change, with policy heading in the direction of demand-side participation by focussing on customer choice and promoting innovation and competition for the provision of demand side services. The COAG Energy Council and AEMC's Power of Choice review have already begun to make significant changes to the existing energy framework to implement this vision.

As AGL strongly supports the principles that support the Power of Choice reforms, it cannot support the proposed rule change as outlined by the AEMC in the Draft Determination, as it does not adequately consider the following policy objectives:

- Regulated network businesses should only provide demand management services at the grid level;
- Demand management services behind the meter should be excluded from any regulatory incentive schemes that are existing or new;
- The provision of demand management services at the grid level should occur on an open and competitive basis to maximise the efficiency of network investment; and
- The test for network investment should always consider grid level demand management as an alternative to traditional network expansion.

Unfortunately, the proposed rule change is clearly in opposition to these policy objectives, as it seeks to expand artificial incentives to promote investment by regulated businesses at the expense of other solutions that support consumer choice and promote competitive neutrality among businesses providing the same demand management services.

Limiting Demand Management by Distribution Businesses to the Grid Level

The Draft Determination recognises that demand management services can be located at the customer level (what the rule change proposal refers to as 'non-network' solutions) or at the grid level ('network' solutions). However, the Draft Determination does not adequately consider the appropriate framework of competition that should stimulate demand management activities at these different levels.

Although distribution businesses should always consider network demand management solutions as an alternative to traditional network investment, they should not be allowed as monopoly businesses to utilise their regulated funding for technologies and offers to customers for non-network solutions. This is contradictory to the AEMC's Power of Choice recommendation to ensure that demand side technologies and services are provided under a competitively neutral basis, which is fundamental for customer choice and ensuring customer engagement and participation.

Clearly, the development of some demand management options by distribution businesses at the customer level would see a reduction in customer choice in technology and energy supply options, as customer options may be restricted through monopoly arrangements relating to mandated demand management activities. Such an arrangement would be in opposition to previous policy directions outlined by the COAG Energy Council and the AEMC.

Non-Network Demand Management Services Should be Excluded from Regulatory Incentive Schemes

Neither the existing nor the proposed Demand Management and Embedded Generation Connection Incentive Scheme (**DMEGCIS**) should be able to be used as a lever to gain a competitive advantage against businesses providing services to customers behind the meter.

Additional incentives to promote demand management behind the meter are not warranted in the context of alternative initiatives being developed, such as cost reflective network pricing, which are likely to encourage the uptake of demand management activities without the requirement for incentives. This has already been recognised in the AEMC's network pricing reform reviews.

Furthermore, it is a fundamental principle of the Power of Choice reforms that all participants within the market for services behind the meter should be able to compete openly on their merits to provide different products to customers within a framework that does not affect market competition. Interference by incentivised distribution businesses behind the meter will distort the current competitive market for solar PV, battery storage, and other technologies that are already being provided in response to customer demand without the requirement for any regulated subsidy or incentive.

As such, distribution businesses wishing to compete for the provision of new products and services to customers behind the meter must be ring fenced both structurally and financially, and be subject to the same rules as others competing in those markets. The continued review of the AER's Distribution Ring Fencing Guidelines should consider this issue as it relates to the provision of demand management services.

Competition for Demand Management Services at the Network Level

More than simply providing an incentive to invest in a particular type of technology, the overarching aim of the rule change proposal should be to reduce overall network expenditure while still supporting other important policy objectives.

Unfortunately, within the Draft Determination, the AEMC has not satisfactorily recognised that other parties may be in a position to provide demand management services at the grid level at a more competitive cost than distribution businesses. Efficient delivery of demand management should primarily occur through an open competitive market, and any incentive to deploy such activities should be either completely avoided or implemented such that it does not stifle innovation and the development of lowest cost solutions.

The lack of a competitive process for demand management means that any solution will be limited to options that are available to or chosen by the network, and will be priced only on the basis of the cost to the distribution business of providing that service. Foreseeably, networks may develop incentivised demand management solutions that meet the test for investment under the revised DMEGCIS, despite these being suboptimal solutions that do not represent the best option available at the lowest cost to consumers.

In this regard, the Draft Determination appears to fail to meet the National Electricity Objective in providing for the most efficient outcome in the long-term interests of consumers. Furthermore, the Draft Determination does not meet the AEMC's own criteria of ensuring that demand is met at lowest total system cost, that the most efficient investment in and use of assets takes place, and that efficiency and innovation by all energy market participants is adequately supported and allowed.

Alternatives to Promote Efficient Network Investment

As outlined above, the scope of demand management activities available to distribution businesses should be limited to those that can be achieved at the network level, without interfering with customer's individual supply arrangements.

Even so, network investment at the grid level should always reflect the most efficient investment available to address the impact of load growth or congestion over a period of time. Whether this investment relates to traditional network investment or demand management activities, the methodology to fund network investment should clearly only reward investment where it can be conclusively shown that the most cost-effective investment option has been chosen. Competing incentive mechanisms create a poor structure for realising optimal investment.

If the most efficient options for network investment are not being identified by distribution businesses, then clearly there are structural issues with the process to approve network investments that warrant more significant changes than simply adjusting the DMEGCIS.

If it continues to be the case that the most cost effective investment option is not being identified by these businesses or by the AER, then clearly the current investment test is not sufficiently transparent to prevent regulated monopoly businesses from recouping money for investment that has occurred at a price which did not reflect the lowest cost to consumers.

If you have any further questions regarding this submission or would like to discuss this matter further, please contact Aleks Smits at asmits@agl.com.au or (03) 8633 7146.

Yours sincerely,

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Nicole Wallis

Head of Energy Market Regulation