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The slow re-balancing act:

Submission in response to the Demand Management Incentive Scheme Rule 2015 Consultation Paper

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The Public Interest Advocacy Centre

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit law and policy organisation that works for a fair, just and democratic society, empowering citizens, consumers and communities by taking strategic action on public interest issues.

PIAC identifies public interest issues and, where possible and appropriate, works co-operatively with other organisations to advocate for individuals and groups affected. PIAC seeks to:

- expose and redress unjust or unsafe practices, deficient laws or policies;
- promote accountable, transparent and responsive government;
- encourage, influence and inform public debate on issues affecting legal and democratic rights;
- promote the development of law that reflects the public interest;
- develop and assist community organisations with a public interest focus to pursue the interests of the communities they represent;
- develop models to respond to unmet legal need; and
- maintain an effective and sustainable organisation.

Established in July 1982 as an initiative of the (then) Law Foundation of New South Wales, with support from the NSW Legal Aid Commission, PIAC was the first, and remains the only broadly based public interest legal centre in Australia. Financial support for PIAC comes primarily from the NSW Public Purpose Fund and the Commonwealth and State Community Legal Services Program. PIAC also receives funding from NSW Trade & Investment for its work on energy and water, and from Allens for its Indigenous Justice Program. PIAC also generates income from project and case grants, seminars, consultancy fees, donations and recovery of costs in legal actions.

Energy + Water Consumers' Advocacy Program

This program was established at PIAC as the Utilities Consumers' Advocacy Program in 1998 with NSW Government funding. The aim of the program is to develop policy and advocate in the interests of low-income and other residential consumers in the NSW energy and water markets. PIAC receives policy input to the program from a community-based reference group whose members include:

- Council of Social Service of NSW (NCOSS);
- Combined Pensioners and Superannuants Association of NSW;
- Ethnic Communities Council NSW;
- Salvation Army;
- St Vincent de Paul Society;
- Physical Disability Council NSW; and
- Tenants Union.

1. Introduction

The Public Interest Advocacy Centre Ltd (PIAC) is pleased to have the opportunity to respond to the Consultation Paper on the Demand Management Incentive Scheme (DMIS) Rule 2015 as Demand Management (DM) is an area of high priority for consumers and consumer advocates. Capital expenditure (capex) has always been the focus of network businesses (especially the NSW distribution businesses over the last five years) and this rule change is part of a long process of attempting to re-balance the focus of network businesses to include non-network, as well as network solutions.

1.1 The importance of Demand Management

Demand management needs to be part of ensuring efficient costs for consumers, which is why it was included in the National Energy Market (NEM) ambitions from the beginning. The National Grid Management Protocol in 1992 included the objective 'to provide a framework for long-term least cost solutions to meet future power supply demands including appropriate use of demand management'.

The DM performance of many networks in the National Electricity Market (NEM) has to date been very poor by international standards, with current DM being equal to less than two per cent of NEM-wide peak demand and only about one per cent of the generation capacity in the NEM. The AEMC has identified substantial DM opportunities that could lead to savings of $4 to $12 billion over the next ten years. These savings, if passed on to electricity consumers, could result in annual bill reductions of between $120 and $500.[1]

The Productivity Commission's (PC's) 2013 report, *Electricity Network Regulatory Frameworks*[2] noted that 'there are several reasons why, at present, the network business's decision might be skewed unduly towards undertaking network investments'. The PC recommended the introduction of an efficiency benefits sharing scheme 'to ensure that network businesses earn an equal return from reductions in capital or in operating expenditure'.[3]

To combat the cultural barriers that exist to DM, an effective DM Incentive Scheme and other mechanisms (beyond monitoring through the Annual Planning Reports) are required. Unfortunately, despite DM being a long-term stated priority for the NEM, there is still a capex-bias in the way the NSW network businesses operate. Until such time as there is reform of the NEM or significant change in network service providers' (NSPs) business models to counter this bias, an incentive scheme can provide a mechanism to encourage change in business practices.

PIAC also notes that DM can be done in a way which results in additional net costs to consumers, so any incentive scheme needs to be well designed with sufficient focus on efficient costs and monitoring, reporting and verification. For example, in the current determination process for the NSW networks, PIAC did not support Transgrid's proposed DM program, in large part because it had not been subject to a cost-benefit analysis.

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1 Dunstan, C, et al, 'Restoring Power: Cutting bills & carbon emissions with Demand Management', (Report, Institute for Sustainable Futures, University of Technology Sydney, 2013), 5.

2 Productivity Commission, 'Electricity Network Regulatory Frameworks', (Report No. 62, Productivity Commission, 2013), 479.

3 Idid, 481.

1.2 The continuing importance of addressing the gap in the current framework

Issue 1

Having regard to current and potential future market conditions, and in light of recent changes to the regulatory framework for distribution businesses, is there a gap in the current framework which may be discouraging distribution businesses from pursuing demand management projects as an efficient alternative to network investment?

If a gap does exist, where does it lie? Is it a product of the provisions in the NER or a result of the current design of the DMEGCIS applied by the AER?

PIAC acknowledges there have been a number of significant changes in the market and the regulatory framework over the last few years, including falling overall demand. However, PIAC supports the position put by Ausgrid in its revenue proposal that falling and uncertain demand provides a more supportive environment for DM, given the short time frames for investment and implementation compared with augmentation and replacement infrastructure.[4] In terms of changes to the regulatory framework, the requirement for the preparation of a distribution annual planning report (DAPR), a demand side engagement strategy and the new RIT-D arrangements are all welcome. However, these alone are insufficient to encourage and support DM - as illustrated by the lack of DM in the NSW networks revenue proposals for 2014-19.[5]

In particular, PIAC is concerned about the apparent assumption that network tariff reform will do the work of demand management. The evidence that cost-reflective pricing creates changes in user behaviour is inconclusive. PIAC recommends the AEMC read closely the recent RMIT research that found:

- Engagement with tariff and retailer choice was low in many households with children. Many parents had little time, interest or trust to investigate tariff choice and available energy information. Provision of more information through websites or printed materials is unlikely to resolve this issue.
- Just under half the survey respondents who reported being on a tariff with an off-peak rate (TOU or two part off-peak tariff) did not know what time their off-peak tariff started.[6]

The research concluded that:

> occasional requests for households with children to disrupt their routines to assist with managing peak demand issues were a more positive proposition than incentivising families to regularly shift their weekday routines in response to a TOU tariff. While occasional and non-financial demand management programs, such as a 'peak alert', are unlikely to appeal to all households with children, they may provide a more positive platform to address demand management issues with this group of households.[7]

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4 Ausgrid, 'Demand management opex and capex overview' (Ausgrid revised regulatory proposal attachment, Ausgrid, 2015)

5 PIAC, 'Moving to a new paradigm: submission to the Australian Energy Regulator's NSW electricity distribution network price determination', (Submission to the AER, Public Interest Advocacy Centre, 8 August 2014), available at: http://www.piac.asn.au/publication/2014/08/newparadigm

6 Nicholls, L & Strengers, Y 2015, 'Changing demand: Flexibility of energy practices in households with children', (Final report, Centre for Urban Research, RMIT University, Melbourne).

7 Ibid.

PIAC considers that it is pre-emptory for AEMC to assume that network pricing will result in significant changes to consumer behaviour, which, in turn, will yield results equivalent to network demand management. In addition, Networks NSW has, in fact, ruled out implementing cost reflective pricing for above-average energy using households. It is not yet evident what will result from the implementation of new tariff structures. Further, it is noted that any sophisticated time of use pricing requires smart meters, which are only currently installed in a small proportion of NSW households.

As a result, PIAC believes there is still a gap in the framework for an incentive scheme for DM, as one of a package of measures needed to encourage and support DM by network businesses.

2. Proposed DMEGCIS

Issue 2

1 In making its decision on the network regulation rule change request, the AEMC considered how much prescription the NER should include. In this context, we welcome the views of stakeholders on the appropriate level of prescription to include in the NER to enable the AER to develop and apply an effective DMEGCIS. In particular:

a) Having regard to the level of flexibility and discretion afforded to the AER in designing and applying other incentive schemes under Chapter 6 of the NER, is the level of flexibility and discretion currently afforded to the AER in relation to the DMEGCIS appropriate?

b) If there is benefit in providing more prescription in the NER, is the level proposed by the COAG Energy Council and the TEC in their rule change requests appropriate?

Given the fact that the AER has not prepared a DMIS under the current rules, and, in fact, Ausgrid prepared its own incentive scheme in response to this void, it would seem that the AER requires greater direction or prescription. The TEC's rule change request provides this direction, by specifying:

- That the AER shall introduce a DMIS (compared with the current provisions that it may).
- An explicit objective.
- A scope that network DM may include 'demand response, energy efficiency or embedded or distributed generation'.
- A set of guiding principles, including 'the need to incentivise network DM over the long term, and not just for the forthcoming regulatory period'.
- A requirement for networks to monitor and publish the results of DM projects undertaken pursuant to the DMIS.
- An expanded series of criteria for applying the DMIS.
- Explicit recognition for the AER's DMIS to include a calculation of the share of non-network market benefits to be retained by networks.

The COAG Energy Council rule change request has a similar set of requirements to assist the AER. PIAC considers this level of prescription is both appropriate and necessary.

2.1 Grid connection for embedded generation

Issue 2

2. Having regard to recent changes made by the AEMC to Chapter 5 and 5A of the NER in relation to the arrangements for connecting embedded generators, are additional financial incentives for innovation in the connection of embedded generators through the DMEGCIS required?

The rule changes concerning connections for embedded generation have been made to address the barriers in this process. They are not a financial incentive - they simply try to create a less onerous connection requirement and so remove a barrier to a practice likely to result in cost reduction for consumers. A DMIS is a separate requirement addressing a separate policy issue.

3. Demand management innovation allowance (DMIA)

3.1 Codification and size of the DMIA

Issue 3

1. Given that the proposed amendments in relation to the innovation allowance are largely reflective of existing AER practice, what additional benefits are likely to be gained by codifying these in the NER?
2. What impact, if any, will the proposed amendments have on distribution businesses incentives to utilise a greater proportion of their allocated allowances on innovative demand management projects, relative to current practice? For example, would greater certainty increase the likelihood of distribution businesses participating in this scheme?
3. Are the proposed amendments likely to address concerns raised by stakeholders around the size of the innovation allowances allocated by the AER to the distribution businesses (noting that, to date, these amounts have been considered to be modest)?

PIAC supports the AEMC's characterisation of the DMIA as essentially an R&D fund for network businesses - not available for business as usual DM projects. PIAC's view is that it is useful for consumers to have clarity about the existence, role and reporting requirements for the DMIA in the rules. While the AER might be clear about the scope of acceptable DMIA projects, it is not clear that this is well understood by network businesses. As such, greater certainty may increase the likelihood of distribution businesses participating in the scheme.

A relatively small DMIA is appropriate if there is an effective DMIS alongside it. The size of the DMIA should be determined by appropriate R&D-type criteria for project inclusion, rather than a total quantum. It is the quality of the innovative projects that is important to future-proof the network businesses, especially given the nature of the transformation underway in the energy market.

3.2 Reporting requirements

Issue 3

4. Given the new DAPR and DSES arrangements are now in place, what additional benefits will the proposed annual reporting requirements deliver to the market? Is there a risk of duplication in reporting for the distribution businesses?

PIAC has been concerned about the lack of accountability for outcomes and sharing of outcomes in the current DM arrangements. The proposed rule changes around reporting provide some additional procedures to address this concern—and should definitely be required as part of the AER implementing more DM (under either component of the scheme) even before the AEMC's review is completed.

The clear, consistent, regular, public and transparent reporting of expenditure and outcomes should be applied to both the DMIA and DMIS as a matter of good practice and accountability. Currently the DAPRs do not require breakdowns of spending or metrics on outcomes, such as MVA saved or the benefit to cost ratio of DM spending. There is an overdue need for a much higher standard of accountability and transparency from networks, and for better oversight of DMIA spending by the AER.

3.3 Time limitation

Issue 3

5.Should the innovation allowance be a time-limited measure? If so, should the AER be given the flexibility and discretion to determine the appropriate timeframe?

Given the DMIA is effectively an R&D fund, PIAC sees no reason why it would be time-limited. If it is to cease, that would imply network businesses were able to fully fund innovation from profits or elsewhere which would be ideal, but unlikely, given experience to date.

4. Demand management incentive scheme (DMIS)

4.1 Payment based on market benefits

Issue 4

1. If distribution businesses are able to receive a payment based on a proportion of the market benefits produced by a demand management project, is this likely to increase investment in projects that will deliver broader market benefits that are in the long term interests of consumers?

As mentioned, the PC recommended the introduction of an efficiency benefits sharing scheme ‘to ensure that network businesses earn an equal return from reductions in capital or in operating expenditure’.[8] A well defined Demand Management Incentive Scheme (with an objective, set of principles and additional criteria) as proposed in the consolidated rule change requests is a starting point to try and restore the balance towards non-network solutions. Ideally, the NER would be amended to redress the inherent capex-bias and prioritise DM and energy efficiency as the first options networks should consider, but in the meantime, an incentive scheme as has been applied to other areas such as capex (CESS) and opex (EBSS) seems a partial solution to increase investment in projects that will support the long term interests of consumers.

PIAC is comfortable with a 30 per cent benefit capture share as proposed by the COAG Energy Council, consistent with other benefit-sharing schemes.

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8 Productivity Commission, ‘Electricity Network Regulatory Frameworks’, (Report No. 62, Productivity Commission, 2013), 481.

4.2 Foregone revenue

Issue 4

2. Given that the majority of distribution businesses are expected to be regulated under a revenue cap in the near future, is there value in amending the rules to explicitly require the inclusion of a payment for any foregone revenue resulting from implementing a demand management project approved under the innovation allowance? Should the AER retain discretion as to whether this component is appropriate?

Given all businesses are under or about to be under a revenue cap, PIAC is not certain this provision is necessary in the rules. With a revenue cap, the issue of foregone revenue does not arise and there does not seem to be any likelihood of a return to profit caps.

4.3 Tariff-based DM

Issue 4

3. In light of the recent changes to the distribution network pricing arrangements, what are the potential benefits of requiring that the DMEGCIS include tariff based demand management options, in addition to non tariff based options?

As discussed above, the benefits of cost-reflective tariffs are uncertain and so further investigation under the DMEGCIS would appear to be reasonable. PIAC supports making the option of tariff based DM available via the rule change and does not see any benefit in excluding this option. Its inclusion will allow for further innovation (including of tariffs that are not based on long run marginal cost) and testing, likely in conjunction with other forms of DM.