19 March 2015

Australian Energy Market Commission
PO Box A2249
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Via online lodgement.

Consultation Paper – National Electricity Amendment (Demand Management Incentive Scheme) Rule 2015 (ERC0177)

Origin Energy (Origin) welcomes the opportunity to respond to the Australian Energy Market Commission's (AEMC) Consultation Paper in relation to rule change requests from the Total Environment Centre (TEC) and the Council of Australian Governments' Energy Council (COAG Energy Council) for reforming the Demand Management and Embedded Generation Connection Incentive Scheme (DMEGCIS).

The AER has established a DMEGCIS under the National Electricity Rules (NER) to provide incentives for distribution network service providers (DNSPs) to implement efficient non-network alternatives or to manage expected demand in some other way. However, as part of the Power of Choice Review, the AEMC considered that this scheme may not be properly incentivising DNSPs to explore and develop demand side participation options as an alternative to capital investment.

To address this, the Power of Choice Review recommended a more comprehensive demand management incentive scheme to be applied and implemented through a rule change. Our responses to certain matters raised by the rule change proponents and the AEMC are set out below.

The Proposed DMEGCIS

Origin considers that the regulatory framework should be structured in such a way that it promotes the efficient long term delivery of reliability, safety, security performance of the distribution networks. All supporting schemes must be consistent and complementary and no one scheme or form of investment should be promoted over another. Specifically, the regulatory framework should promote the lowest cost combination of demand and supply side options to deliver services that are in the long term interest of consumers.

The NER allows the AER to develop an incentive scheme to provide incentives for DNSPs to implement efficient non-network alternatives through the DMEGCIS. The performance of the DMEGCIS has resulted in only a modest uptake of non-network solutions. In an environment where there has been rapid network expansion this would indicate that incentives are skewed in favour of capital investment.

The rule proponents have put forward a number of suggested rule changes to codify shortfalls in the current scheme and to strengthen the incentives for DNSPs to pursue non-network solutions. We consider many of the proposed enhancements are already implicit in the NER and that the AER has not used its full discretion in the design of the current DMEGCIS. We consider that many of the objectives could be addressed under the existing NER.

However, the AEMC found in its Power of Choice Review that the current scheme has been applied in a very limited manner and, to date, the AER has not made any material changes from its initial

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design. For this reason, we agree that there would be benefit in codifying specific objectives to provide the AER greater guidance in enhancing the operational effectiveness of the current scheme or developing a replacement scheme.

In doing so, the codified changes should retain sufficient flexibility for the AER to adapt and improve the scheme in response to changing and evolving market conditions and the availability of technology, information and knowledge. This should include a requirement for the AER to undertake periodic reviews on the effectiveness of the scheme to mitigate the risk of the scheme staying static in a dynamic environment.

We agree that one way to strengthen the scheme would be to make explicit that the DMEGCIS objective is to capture benefits beyond the distribution system. We also consider that the explicit separation into a demand management incentive scheme (DMIS) and a demand management and embedded generation connection and innovation allowance (Innovation Allowance) would provide greater clarity regarding how the scheme should operate.

We also endorse the requirement for the AER to develop guidelines that: (1) set out the methodology for determining incentive payments; and (2) codify the scheme's administration. These guidelines should be developed consistent with the NER consultation requirements.

Strengthening financial rewards

The rule proponents have suggested that a major shortcoming of the current DMEGCIS is the lack of a sufficient financial incentive for DNSPs to undertake demand management projects as an alternative to capital expenditure. In response, the proposed rule change would allow DNSPs to retain a share of the market benefits delivered across the supply chain by an approved demand management project.

We agree that demand side participation should have direct financial incentives that are comparable to those associated with network investment and that supply chain benefits should be taken into account when allocating rewards. Supply chain benefits would involve a payment based on a proportion of the market benefits and avoided or deferred network costs as well as compensation for any foregone profit due to a reduction in throughput volumes.

The rule change proposes that the AER develop a methodology to determining supply chain benefits consistent with the regulatory investment test for distribution and the AEMO methodology for calculating market benefits in relation to the wholesale demand response mechanism.

We agree, in principle, with the desirability of consistency across regulatory methods and look forward to actively participating in the AER's consultation process to develop its methodology.

In terms of financial compensation, Origin notes that revenue compensation would not apply to DNSPs subject to a revenue cap form of regulation. Origin also considers that the impact of volume reductions on future network prices (i.e. through the unders- and overs- mechanism) should be considered when determining the net benefits to customers from demand side participation.

We consider that the impacts of different sharing levels and the duration of financial benefits needs to be rigorously tested before committing to both a threshold and benefit duration. This testing should also extend to different scenarios to understand fully the implications of committing to such a mechanism.

We also consider it is essential for net benefits to be demonstrated and validated before they are allocated by way of reward. The demonstration, validation and payment of rewards should be included in the AER's annual compliance report.

Reporting Requirements

Origin strongly supports the requirement for the DNSPs to share the data, results and learnings gained from the use of the innovation allowance, especially with respect to any pilot studies testing the effectiveness of network tariff structures as part of the implementation of the network tariff reform agenda. Sharing data and results in this regard is critical to the success of other complementary Power of Choice Review recommendations, particular with respect to network pricing. In addition, we also support the requirement for the AER to monitor and report annually on the performance and compliance of the scheme.

Further information

Origin would be pleased to discuss any matters raised within this response with the Commission. Please contact Sean Greenup in the first instance on (07) 3867 0620.

Yours sincerely

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