AUSTRALIAN ENERGY REGULATOR

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Mr Ed Chan
Director - Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear Mr Chan Ed

Demand management incentive scheme and innovation allowance for transmission network service providers draft determination

Thank you for the opportunity to provide our views on the Australian Energy Market Commission's (AEMC) draft determination on Energy Networks Australia's (ENA's) rule change request for the introduction of a demand management incentive scheme (DMIS) and demand management innovation allowance mechanism (DMIA) for transmission network service providers (TNSPs).

We note that the AEMC's draft determination proposes to introduce a DMIA only. As per our submission to the consultation paper, we consider it useful to have additional tools at our disposal to promote efficient take up of non-network options, and well-designed DMIA for TNSPs could make an important contribution to the existing framework.

We have yet to form a view on the effectiveness of the DMIS and DMIA that has been implemented for distribution network service providers (DNSPs). As the DMIS and DMIA for DNSPs were introduced in December 2017, we have only received one DMIS compliance report to date.[1] Given this, we do not yet have visibility on eligible or committed projects put forward by DNSPs, nor their associated expenditure. Similarly, the updated DMIA, as developed in 2017, only commenced on 1 July 2019.

In principle, we agree with the AEMC that regulated monopolies like DNSPs and TNSPs have less incentive to conduct research and development (R&D) than competitive businesses. This is because, all else equal, they:

- Face lower 'up-side risk'. Competitive businesses may be more likely to profit from R&D than monopolies, as R&D can provide them with a 'competitive advantage'. Moreover, to the extent that R&D results in future cost reductions, NSPs will pass a material portion of these gains onto consumers under the regulatory regime.

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[1] Compliance reports are required within four months of the end of a regulatory year in which the scheme is applied.

- Still face 'down-side risk'. If R&D costs occur significantly before the benefits, NSPs risk being financially penalised from making these decisions under the regulatory regime.

A well-designed DMIA could provide innovation incentives by reducing TNSPs' 'down-side risk' via an allowance for R&D costs.

We also note that while the updated DMIA mechanism for DNSPs has commenced only recently, prior to this there was a similar mechanism under the Demand Management and Embedded Generation Connection Incentive Scheme in Chapter 6 of the National Electricity Rules (NER). In that sense, we consider that a DMIA only approach is a reasonable way to proceed as it will allow a trial of these provisions before considering a move to a higher powered scheme. It could promote opportunities to share and expand knowledge and appears to facilitate many of the objectives of encouraging non-network solutions.

In considering design and implementation, we strongly support the AER having full discretion on whether and how the DMIA should be designed and applied with a view to providing appropriate incentives to reduce a network's downside risk while minimising the tendency for inefficient outcomes. We also consider a 31 March 2021 deadline for the AER to design, consult on, and implement the TNSP DMIA is achievable. We further note that any work we undertake on the DMIA mechanism for TNSPs will need to be reflected in appropriate additional resourcing for this new work.

In considering the need for transitional arrangements, we note early adoption did not apply to the DMIA for DNSPs (although it did for the DMIS). However, AusNet Services and Powerlink are due to lodge their next regulatory proposals by 31 October 2020 and 31 January 2021 respectively, which is prior to the proposed implementation date. As such, we consider there may be rationale for allowing some form of early adoption for only these TNSPs. However, our preliminary views are that this may not require a transitional rule. For example, we could allow these TNSPs to identify their interest in applying the DMIA in their regulatory proposals, and then provide the formal requirements in their revised proposals. This early adoption approach would mean that these TNSPs would not need to seek a re-opener to their existing determinations to apply the scheme, as was the case with DNSPs. We look forward to working through these detailed implementation issues with the AEMC ahead of its final determination.

Should you wish to discuss this further, please contact Nishana Perera (03 9910 9447).

Yours sincerely

Chris Pattas
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Australian Energy Regulator