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19 March 2015

John Pierce
Chairman
Australian Energy Markets Commission
PO BOX A2449
SYDNEY SOUTH, NSW 1235



Dear Mr Pierce

Re: Submission on demand management incentive scheme rule changes

Please find attached our submission regarding the AEMC's consultation paper on the National Electricity Amendment (Demand Management Incentive Scheme) Rule 2015.

We would be pleased to provide further assistance to the Commission on this area of reform. If you would like to discuss any aspect of this submission, please contact Bruno Coelho on 08 8213 3435.

Yours sincerely


Chris Pattas
General Manager
Networks

Sent by email on: 19.03.2015



Rule changes – Demand management incentive scheme

**AER submission to AEMC
consultation paper**

March 2015

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1 Introduction

The AER welcomes the opportunity to respond to the AEMC's consultation paper on changes proposed to the National Electricity Rules (NER) concerning the demand management incentive scheme. This paper consolidates proposals from the Council of Australian Governments Energy Council and the Total Environment Centre (TEC).

We strongly support the goal of creating an environment where physical investments in distribution networks are made only because they are the most efficient, considering all alternatives. The promotion of efficient investment in and use of the network is at the core of the regulatory framework that we administer.

Achieving this goal will partly relate to how the framework either requires or motivates regulated distributors to consider network and non-network options equally. Creating a balanced value proposition appears the focus of the rule changes. However, this is a timely opportunity to re-examine the need for additional financial incentives for demand management by distributors, in the context of other means by which efficient investment and use of networks might also be promoted. There have been a number of regulatory framework changes and continuing market developments, including for example, reforms to require efficient pricing and to expand competition in metering, and emerging competition in demand-side services. These developments suggest that a few preliminary questions need exploring to clarify the following:

- If efficient pricing could materially reduce the need for explicit demand management incentives for distributors — to indicate if these incentives are to operate only on an interim basis, and have greater merit than pursuing more cost reflectivity in prices.
- If regulated distributors are best placed to manage and interact with the market's demand side — and how to maintain appropriate separation of monopoly and competitive services. Demand management could be provided competitively. Third party service providers and retailers operating across the supply chain might derive benefits additional to those achievable by distributors. Clarifying the distributor's role will indicate the type of behaviour that might be encouraged via the proposed incentives.

In assessing the role of distributor demand management (alongside competitive providers of such services), there is still merit in exploring framework gaps leading to imbalanced decision making and the nature of incentives to address these gaps. Our submission suggests that various improvements have recently been made to the framework and our regulatory approaches. However, we support exploring further potential gaps, including:

- If the Regulatory Investment Test for Distribution should extend to network replacements — requiring balanced option consideration, and allowing public scrutiny and third party involvement in addressing this important aspect of network planning and capital investment.
- Aspects that the rule proponents suggest be addressed in a scheme, including paying distributors for broader market benefits of their demand management. Regard is needed on implementation costs and if a distributor's inability to capture market benefits is a

genuine market failure. This might instead be an opportunity for service providers with a focus broader than network businesses to negotiate across the supply chain to manage demand.

Our submission focusses on raising these broader considerations about the role of distributor demand management and related incentives. We have not commented on specific or detailed scheme design mechanics at this time, which can be covered at a later stage. However, our preference is to have discretion to consider the need for a scheme, its longevity, and the merit of specific elements such as market benefits payments via a guideline and framework and approach process. This is to allow flexible consideration of these matters alongside market and framework developments.

2 Regulatory objectives

The rule changes have the underlying goal of achieving efficient network investment. They propose new rules and guiding objectives for us to consider in designing incentives for regulated distributors to undertake demand management, if less costly than building more network.¹ We consider that a broader focus is required as there are other relevant factors in achieving efficient investment. The AEMC's consultation paper outlines various regulatory framework and market changes. We see these as relevant to how regulated distributors might be required or motivated to undertake balanced option considerations, discussed in Section 3 below. However, these changes also appear to raise broader questions given that:

- The objective of pricing reform is to provide signals to unlock greater demand-side participation by various market participants with the view to then achieving efficient network investment. Consideration is needed on why pricing alone might be insufficient, such that additional incentives on distributors to pursue demand management would be required and if these initiatives are needed only on an interim basis until pricing evolves or operate together with pricing.
- The regulatory framework seeks structural separation between monopoly and competitive services. It is unclear what role for distributors might be encouraged by specific incentive schemes and how this role is to interact with the apparent potential for demand management to be provided on a competitive basis by other service providers.

2.1 The role of demand management

The rule change proposals see demand management (non-network alternatives) as options that need consideration alongside those of network build in order to achieve efficient investment. This is consistent with current regulatory requirements. The capital (capex) and operating expenditure (opex) and RIT-D provisions in the NER require balanced consideration of network and non-network options. These caution against promoting one of these options over the other.

However, the National Electricity Objective (NEO) refers broadly to the promotion of efficient investment in and use of the network. Examining why the framework might lead to outcomes inconsistent with the NEO would require consideration not only of whether distributors evaluate network and non-network options equally, but also the role of pricing.

The objective of recently introduced reforms to require efficient distribution pricing is to provide signals for efficient investment in and use of consumer side appliances and devices.² This in turn could influence efficient distributor decisions on the size and location of any augmentations or replacements. Pricing appears a first-best option, potentially eliciting responses on both the supply and demand side and from a greater number of market participants. That is, compared with demand management undertaken within the distribution network, which will likely focus on responses from a more limited number of participants.

¹ Demand management can comprise of various types of activities, but essentially involve the procurement of contracts/agreements for demand-side responses and generation options.

² The rules decided on by the AEMC in November 2014 are expected to commence being reflected in prices from 2017.

Further, demand reductions achievable with pricing could exceed those from approaches such as direct load control where these operate independently of price signals.³ Therefore, the following should be considered in deciding on the role for demand management by distributors:

- If pricing alone will be sufficient to lead to efficient investment, or if demand management options such as direct control of consumer appliances might still be required.
- If the need for demand management in addition to pricing is likely to be an interim issue, as pricing evolves to better reflect network costs, and if developing a scheme as an interim measure warrants potentially significant implementation costs. More cost reflective pricing resulting from reforms will in practice take time to transition. This transition and its speed will be affected by the availability of advanced metering and the consideration of customer impacts.⁴ It might therefore be sometime before pricing alone achieves significant peak demand reductions.
- If concerns on the ability of pricing to lead to efficient investment suggest designing specific demand management incentives, rather than pursuing greater time and location cost reflectivity in prices. In recent proposals to us, some distributors discount the ability of pricing to deliver demand response.⁵ This seems at odds with the objectives of the pricing reforms, and suggestions that pricing might deliver superior demand reductions compared with other approaches.⁶ Some distributors therefore propose to entice customers to have their appliances controlled by providing direct financial payments. Given such initiatives are already being proposed does raise queries about the need for additional incentives, but also why network tariffs alone would be insufficient to entice consumer response. In practice if tariffs are too averaged in their reflection of peak demand there might not be strong signals for efficient energy use. However, it should be explored why less averaged tariffs can't be used instead of having to rely on distributor demand management.

³ This suggestion has been made in a report prepared by the Brattle Group for the Federal Energy Regulatory Commission of the United States. FERC, A national assessment of demand response potential - staff report, June 2009, p.28.

⁴ Distributors will now be required to consider the customer impacts of their tariff structures including any need to transition customers onto these structures over a period of time including across regulatory control periods.

⁵ Ausgrid, Attachment 5.14 to revised regulatory proposal - Demand management opex and capex overview, January 2015, p.4.

⁶ FERC, A national assessment of demand response potential - staff report, June 2009, p.28.

2.2 Delivering demand management - who and how?

Pricing reform could create uncertainties on the exact role of distributors in undertaking demand management. The uncertainty extends to how efforts to encourage demand management by distributors might coexist with the goal of separation between monopoly and competitive services. This distinction as applied to demand management is currently imprecise⁷ and it is also unclear what the rule proponents envisage. Our initial view is that demand management could potentially be provided competitively and that more definition is required on the limits or scope of the distributor's role. The following could be considered:

- Demand management activities do not appear to share the same natural monopoly characteristics as the building of a poles and wires network. It is difficult to foresee many demand management activities that might not potentially be provided competitively. Activities like controlling appliances, installing embedded generators or battery storage devices could all potentially be provided by parties other than a regulated distributor.
- The potential for competition is also apparent given that other parties might derive additional benefits from providing these services, compared to regulated distributor's:
 - while a distributor could use a load control device to manage network issues, a retailer could also provide this device to procure load control from customers to manage not only network conditions but those in the wholesale market.
 - while a distributor could use battery storage and embedded generators to manage network constraints, a registered third party or retailer could use these devices to sell demand management to a distributor (and to a transmission business) as well as to manage wholesale market risk. This is also relevant to the issue of whether the ability of other parties to capture broader market benefits reduces or negates the need to pay distributors a share of these benefits (discussed in section 3.2.2.1).
- If the distributor's role should be akin to that being envisaged by the metering contestability reforms, being one of procuring services but not delivering the devices to provide these services.⁸ There are similarities between the provision of metering hardware and the provision of devices such as battery storage or embedded generation. The use of these devices could provide distributors with means of achieving operational efficiencies, but at the same time, their provision could be on a competitive basis and achieve superior market benefits. Extending the potential metering framework to the issue of battery storage, might suggest that regulated distributors should pay to access the capacity provided by these devices to manage network conditions, but not provide the battery as a regulated service.

⁷ The exception is where there are jurisdictional based restrictions imposed via ring-fencing guidelines on either the regulated distributors ability to own an embedded generator or to use it to earn revenue from selling energy into the wholesale market.

⁸ The current reform process is envisaging some exceptional circumstances such that regulated distributors could seek waivers from ring-fencing requirements if competition is deemed as unlikely to deliver outcomes in particular locations such as remote regions.

3 Balanced considerations by distributors

If there is a role for distributors in demand management, then we should consider the nature of any gaps in the regulatory framework that might not promote a balanced consideration of network and non-network options. In responding to the AEMC's consultation paper, we think the following potential gaps should be considered:

- The need for firm requirements to consider options equally, and allow public scrutiny and involvement in network planning, given potential contestability. We are exploring improvements to annual planning reports but also suggest considering the merit of extending the RIT-D to cover the increasingly important issue of network replacements.
- The need for distributors to earn a share of market benefits resulting from their demand management. We seek discretion on how to address these specifics of incentive scheme design and whether a scheme should apply and its longevity. This is particularly given the earlier questions on whether such incentives are to be interim measures only and the changing market dynamics of the sector.

3.1 Planning – options, public scrutiny and involvement

The NER capex and opex arrangements require distributors to make provision for efficient non-network alternatives. In practice, it is difficult for us to assess if distributors have in fact allowed for this in their proposed expenditure as it relies on their business practices, meaning it is questionable whether this will actually occur. Arguably, a superior model is to have stronger procedures to require distributors to evaluate options effectively and subject these to public scrutiny and involvement at the planning stage. To this end, we now have new rules governing the RIT-D process and annual planning reporting, the full benefits of which are still to be realised given the recent introduction of these reforms. These procedures are a good way of requiring balanced consideration by distributors while also protecting emerging competition. For example:

- The RIT-D requires distributors to evaluate the costs and benefits of different investment options (network or non-network) to address an identified need, and to only choose the option that maximises benefits. In doing so, distributors are explicitly required to screen for possible non-network options.⁹
- The RIT-D requires distributors to allow other parties to become involved in the process of managing demand on the network by allowing these parties to present efficient alternatives to the distributor's proposals.
- To enable meaningful public involvement, including by third parties, accompanying processes were introduced. There are now more detailed requirements on what distributors are to include in their distribution annual planning reports and requirements to have a demand-side engagement strategy. As flagged in our 2014-15 Statement of Intent, we have now commenced engagement with distributors to improve the quality of

⁹ Further information on the RIT-D process can be found in the RIT-D fact sheet and guideline on our website. [<http://www.aer.gov.au>]

their annual planning reports.¹⁰ One of the areas of focus is whether the information provided meets the NER requirements for third-party involvement in non-network solutions to network constraints. We are keen to observe stakeholder feedback on any compliance issues that might be impeding public involvement and scrutiny. Given these information requirements, it is unclear what additional benefit there would be in separate reporting on distributor's demand management, as suggested by the rule proponents.

However, it appears that there may be a gap in that the RIT-D only applies to network augmentations. Given current declining demand trends, increasingly this process might not capture the main areas of network investment. In recent revenue proposals from distributors, we have observed that as network peak demand declines, there appears to be a greater focus on network replacements. The merits of extending the RIT-D (and likely the RIT-T) to also capture network replacements should be explored as part of any exercise designed to require balanced option consideration by network businesses.

3.2 Value proposition for distributors

3.2.1 Improvements

The regulatory framework has undergone various recent changes that would be expected to gradually improve the consideration of demand-side options. In addition, following the network regulation rule changes, we have made various changes in our regulatory approaches. These should influence or improve the value proposition between network and non-network options. Given their recent introduction, they may take time to impact on demand management. These include:

- Decoupling volumes from profit:
 - our recent framework and approach papers flag our intent to move distributors onto revenue caps. Moving away from price caps will reduce the incentive that was apparent to boost consumption volumes. Further, by moving to revenue caps, distributors will not lose revenue by undertaking more demand management that has the effect of reducing demand. Therefore, in response to the AEMC's question, it will no longer be relevant to apply a foregone revenue component within a scheme, where we apply revenue caps. However, we should maintain discretion on the relevance of applying this component should there be future changes to control mechanisms.
 - We also now have distribution pricing reforms that require price signals to be based on cost. We agree with the AEMC that this reform raises questions on the merit of having incentives to encourage distributors to undertake innovative tariff approaches as proposed by the rule changes.
- Capex/opex sharing schemes: we now have the same retainment period for capex as we do for opex savings. If a distributor undertakes a demand management project during the regulatory period that reduces the need to spend capex on a network option, then it can retain the capex savings for 5 years.

¹⁰ This follows similar work with transmission businesses that commenced in 2013-14.

- Capex/opex overspend treatment: we have effectively lowered the incentive that might exist to only undertake network capex because it adds to the Regulatory Asset Base (RAB). We are now required to undertake ex-post assessments on capex overspends before these are added to the RAB. We also have better tools to assess capex needs.
- Weighted Average Cost of Capital (WACC): we have better rules to improve how we determine a reasonable WACC, effectively lowering incentives to only undertake network options because they add to the RAB and earn a return that may be unreasonably high.
- Efficiency Benefit Sharing Scheme (EBSS): we are able to exclude expenditure on demand management from the operation of the EBSS so that distributors who undertake more demand management in the form of opex are not penalised.

We would add that the value proposition for demand management is also changing as demand becomes more uncertain. For example, as set out in our recent draft decision for Ausgrid, as overall demand and peak demand declines toward an uncertain point, demand management solutions might actually increase in their so-called, 'option value' as follows:

- Demand management can be a less risky and more flexible investment than long-lived network assets in a more uncertain demand environment. Demand management such as load control agreements can be designed with shorter life spans than what would result from building more network and can readily be re-negotiated or re-purposed.
- The demand reductions to achieve capital deferrals are effective for a longer period of time making them more cost effective.

3.2.2 Remaining gaps in the framework

In response to the AEMC's consultation paper, there appear to be two potential gaps in our regulatory framework with respect to the value proposition of demand management that are worth exploring.

3.2.2.1 Non-network / market benefits

Both rule proponents seek to provide for the possibility of distributors earning a financial payment as a share of the broader market / non-network benefits resulting from their demand management. Further, they both propose to fix the sharing percentage directly into the NER. The treatment of market benefits is currently uncertain and we therefore welcome greater clarity in the NER on this point. We also accept that there appears to be some merit in aligning the distributors profit function with that of the market for the following reasons:

- There might be situations where a demand management option that presents a net benefit to the market might not proceed because distributors are unable to place a value on those benefits. This is the so-called, 'split incentives' problem.
- There could be 'free-rider' problems such that other participants like transmission businesses or generators can benefit from demand reductions resulting from a distributor's actions but do not share in the costs of these actions.

However, the AEMC should also explore how these split incentives and free-rider issues could be addressed in a different and potentially less costly way, given the following:

- It could be administratively costly and subjective to quantify market benefits precisely enough to decide upon a financial payment. This includes whether the benefits would be calculated on an ex-ante or ex-post basis. Consideration of market benefits is a current requirement in evaluating projects under the RIT-D. However, allocating an actual portion of these benefits into a payment is likely to be more complex.
- The magnitude of potential market benefits is unclear, and if these outweigh administrative costs. Quantifying market benefits of distributor demand management would involve considering the directly related reductions in investment needs in transmission networks and wholesale market generation.¹¹ This would need to consider the likely need for investment in these sectors prior to any distributor demand management.¹²
- It is unclear if the split incentives problem naturally leads to the need for expanding the role of regulated distributors. This could be a function of the concern we outlined earlier that competitive service providers might derive benefits additional to those possible by distributors. Distributors can only place a value on projects affecting their network given their specific role in managing this part of the electricity supply chain. For others, the split incentives problem might actually be a market opportunity for these parties to negotiate across the supply chain and deliver demand management benefiting the whole market.
- It is unclear if a payment for broader market benefits might equalise incentives or tip these too far in favour of demand management by distributors. This is particularly in light of the improvements made to the regulatory framework and other developments such as the changing option value of demand management in the face of demand uncertainty.

3.2.2.2 Demand management in revenue proposals

The TEC's proposal also appears to use a calculation of market benefits as a means of providing a bonus if distributors undertake the demand management set out in their revenue proposals. This would serve as a self-imposed target on distributors. We consider such matters as the nature of targets and other scheme design issues should be left with the regulator in developing a scheme rather than prescribed in the Rules. Our initial view is that there is in-principle merit in motivating distributors to include demand management in their five yearly revenue proposals, avoiding the possibility of over-inflated capex allowances. However, in deciding whether providing a financial bonus is the best means of achieving this, the following needs evaluating:

- On the operation of a target and bonus scheme, consideration would be needed on whether the demand management undertaken by distributors actually deferred/negated

¹¹ Ausgrid's latest regulatory proposal suggests that these market benefits would be by way of reduced capex requirements in transmission and generation. Ausgrid, Attachment 6.12 to regulatory proposal - Demand management operating expenditure plan, May 2014, p.31.

¹² For example, AEMO's latest Electricity Statement of Opportunities suggests that there will be no need for generation investment in any region for at least the next 10 years.

the need for network investment. That is, the demand management should not only reduce demand but these demand reductions need to have an effect on network spend.

- Including demand management in the revenue proposals could avoid the potential perception that these options are less favourable as distributors are unable to seek additional opex during the regulatory period. However, this concern might be exaggerated as distributors could in practice re-allocate any capex savings resulting from their demand management to fund these projects.
- It might be difficult for distributors to forecast specific demand management projects for the majority of needs, given low demand growth rates and that for the foreseeable future most augmentation is at the tail-end of the network and hard to predict.
- Stronger and more transparent planning requirements including by considering extending the RIT-D to replacement would increase the likelihood that projects submitted to us are properly evaluated. An aim of improving the quality of annual planning reports is to create a clear lineage between the RIT-D, annual planning and revenue determinations.
- What other aspect of the value proposition is the financial bonus trying to address? That is, beyond the split-incentives/free-rider concern or that of motivating distributors to include demand management in their proposals.

4 Promoting innovation

The rule proponents seek to distinguish between the application of a demand management incentive scheme and any innovation allowance. This provides greater clarity to the NER. Additional specification is also proposed to be added to these rules relating to the innovation allowance. The AEMC queries if these changes are likely to achieve materially different outcomes and what level of flexibility the AER should have in applying these rules?

To date there has been limited take-up of our current innovation allowance.¹³ It is doubtful if the additional specifications proposed to the rules would promote further innovation. As the AEMC notes, these changes are merely formalising current AER practice in applying the innovation allowance.¹⁴ It is unclear if the limited take up to-date of this allowance is a product of the regulatory framework historically not presenting a balanced value proposition for distributors to progress from trials to actual implementation. As noted earlier in this submission, we have only recently made various improvements to our regulatory approaches in this regard.

However, we prefer discretion to consider the issue of innovation broadly, including the continued relevance of providing specific allowances, noting the following:

- As discussed earlier, there are questions about whether regulated distributors will be best placed to deliver demand management, compared to other service providers. These points need to be explored so that funds are not put to innovation in services which regulated distributors might or should not be providing. For example, as mentioned earlier, the role of the regulated distributor could be akin to that being considered in the metering framework — not providing devices to deliver demand management but paying to access demand management delivered by competitive players. If so, then there would be limited benefit in providing funds for distributors to innovate with respect to these devices at the exclusion of other parties.
- The possible need to encourage innovation in demand management appears best described as either a 'need to learn' or 'value' argument. Earlier sections of this submission discussed the value proposition. On the second argument, it does not appear immediately apparent that demand management presents particular peculiarities such that distributors need to learn how these options might be utilised. The uptake of our current innovation allowance has been minimal. However most distributors have trialled various forms of demand management for some years now, either through our modest innovation allowance, capex/opex allowances or previous jurisdictional schemes.

¹³ As outlined in our latest annual report on Demand Management Innovation Allowance expenditure, distributors have on average spent less than one quarter of their allowances. AER, Decision - Applications by DNSPs for Demand Management Innovation Allowance, March 2015.

¹⁴ For example, we already do the following: check if distributors can seek other funding for projects; request and publish information on distributor activity under the innovation allowance.

While demand management technologies are fast evolving, it is unclear exactly which issues a distributor might seek to experiment. The following should be explored:

- A potential area could be trialling different network tariff options, but it's unclear if these trials are likely to require much by way of cost to the distributor.
- Currently the rules explicitly refer to innovation with respect to the connection of embedded generators onto the distribution network. The AEMC has queried the continued relevance of allowing innovation funds for this issue. Its specific inclusion was initially seen as desirable to remove potential barriers to the uptake of these units. These barriers in part appeared to relate to the less than transparent technical requirements for how generators are to be connected to the grid. As the AEMC identifies, changes have now been made to Chapter 5 of the NER, helping to improve technical transparency on generator connections. However, it is still worth exploring if the connection of generators presents particular technical challenges to distributors such that there would be merit in continued research and innovation in this regard. In general though we suggest that the Rules should be neutral on particular technologies.

Appendix 1: Overview of AER responses

Issue	AEMC question	AER response	Response location
(1) Issues the rule changes seek to address	1. Given current / potential future market conditions, and recent changes to the regulatory framework for distributors, is there a framework gap which may be discouraging distributors from pursuing demand management projects as an efficient alternative to network investment?	It is appropriate to consider how changing market and regulatory conditions might affect balanced consideration of network and non-network options by distributors. However, these changes also raise broader questions about the role of distributor demand management. This role should be considered alongside the purpose of reforms for efficient pricing, and the need to protect emerging competition.	Sections 1 & Section 2
	2. If a gap does exist, where does it lie? Is it a product of the provisions in the NER or as a result of the current design of the DMEGCIS applied by the AER.	Various changes have been made to our regulatory approaches which might help achieve balanced consideration of network and non-network options by distributors. We identify further potential gaps worth exploring: <ol style="list-style-type: none"> 1. Expanding measures that require distributors to consider options equally and allow other service providers to offer alternatives — we think the RIT-D could also cover network replacements. 2. Issues the rule proponents seek to address via a specific incentive scheme, including market benefits payments and a target and bonus scheme. We suggest some aspects of these proposals need further consideration. 	Section 3.2.1 & section 3.2.2
(2) Proposed DMEGCIS	1. What is the appropriate level of prescription to include in the NER to enable the AER to develop and apply an effective DMEGCIS.	Our preference is to have discretion to consider the need for a scheme and innovation allowance, their longevity, and the merit of specific elements such as market benefits payments via a guideline and Framework and Approach process. This is to allow flexible consideration of these matters alongside market and framework developments.	Section 1, Section 3 intro & Section 3.2.2.2.
	2. Given recent AEMC changes to Chapter 5 and 5A of the NER in relation to arrangements for connecting embedded generators, are additional financial incentives for innovation in the connection of embedded generators required?	Changes have been made to Chapter 5 to improve technical transparency on generator connections. This might not diminish any need to research and innovate with respect to generator connections. However, this will need to be considered alongside the appropriate role of the distributor in demand management.	Section 4.
(3) Demand management innovation allowance	1. Given the proposed amendments in relation to the innovation allowance largely reflect existing AER practice, what additional benefits are likely to be gained by codifying these in the NER?	We agree that the additional proposed specifications would merely be formalising current AER practice and are themselves unlikely to increase uptake of the innovation allowance.	Section 4.

	<p>2. What impact, if any, will the proposed amendments have on distributor 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 distributors participating in the scheme?</p>	<p>There has been minimal uptake of the innovation allowance. It is unclear if this has been a product of the regulatory framework historically not presenting a balanced value proposition to implement non-network projects beyond the trial stage. As mentioned in response to Issue 2 question 1, we prefer discretion to consider the continued relevance of the innovation allowance. Any allowance for distributor innovation in non-network activity needs to be cognisant of whether these activities are to be the sole responsibility of the regulated distributor.</p>	<p>Section 4 & context in section 2.</p>
	<p>3. Are the proposed amendments likely to address stakeholder concerns on the size of the innovation allowance allocated by the AER to the distributors?</p>	<p>We do not comment specifically on this issue, but highlight that current uptake of the innovation allowance has been minimal.</p>	<p>Section 4.</p>
	<p>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 distributors?</p>	<p>There is questionable merit in requiring distributors to publish further information on demand management activity. We have commenced consultation to improve the information that distributors provide via their annual planning reports — information that might be used by other demand-side service providers.</p>	<p>Section 3.1 & section 4.</p>
	<p>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?</p>	<p>We prefer discretion to flexibly consider this issue in the context of market and framework changes. Consideration of this point will depend on the appropriate role of distributor demand management.</p>	<p>Section 4.</p>
<p>(4) Demand management incentive scheme</p>	<p>1. If distributors are able to receive a payment based on a proportion of market benefits produced by demand management projects, is this likely to increase investment in projects that will deliver broader market benefits that are in the long term interests of consumers?</p>	<p>We note in-principle reasons for why market benefits payments for distributors might be explored, including the ‘split incentives’ issue. However, potential concerns need exploring, in particular:</p> <ol style="list-style-type: none"> 3. potential quantification challenges 4. whether the split incentives issue is best characterised as a market failure needing additional incentives for distributors. This might be a market opportunity for other demand-side service providers operating across the supply chain. 	<p>Section 3.2.2.1</p>
	<p>2. Given the majority of distributors are to be 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 allowances? Should the AER maintain discretion as to whether this component is appropriate?</p>	<p>The application of revenue caps means that foregone revenue measures are no longer required. We prefer discretion to consider the appropriateness of these matters should there be any future changes to control mechanisms.</p>	<p>Section 3.2.1</p>
	<p>3. Given recent changes to the distribution pricing arrangements, what are the potential benefits of requiring the DMEGCIS to include tariff based demand management options, in addition to non-tariff options?</p>	<p>There is limited merit in additional incentives to motivate distributors to undertake something that the new efficient pricing reforms will require. Further, in querying what purpose an innovation allowance might be put to, there might be a case for distributors trialling innovative pricing options. However, it’s unclear how costly these trials could be.</p>	<p>Section 3.2.1 & Section 4.</p>