SA Power Networks

12 October 2017

Mr Warwick Anderson
General Manager, Network Finance and Reporting
Australian Energy Regulator
Canberra ACT 2601

Dear Mr Anderson

AER draft decisions – demand management incentives and innovation allowance

SA Power Networks welcomes the opportunity to comment on the AER's draft decisions on a new Demand Management Incentive Scheme (DMIS) and Demand Management Innovation Allowance Mechanism (DMIAM), as well as its proposed rule change permitting early application of the DMIS.

The AER has engaged thoroughly and transparently with stakeholders over a considerable period of time in arriving at its draft decisions. We particularly valued the opportunity to provide several rounds of input, visibility on the AER's likely approach to its draft decisions, and the time afforded stakeholders with respect to formal submissions.

We support the AER's draft decisions and in particular the approach to the design of a new DMIS and DMIAM as being appropriately focussed to matters influencing the potential for demand management where it can deliver benefits to customers and the market more broadly. Our submissions on the following pages make suggested improvements only with respect to matters of application, including:

- Specific drafting aspects of the DMIS project eligibility criteria, minimum project evaluation requirements, and the annual reporting requirements;
- The magnitude of the total DMIS incentive and DMIAM allowance; and
- DMIS interactions with the Efficiency Benefit Sharing Scheme (EBSS) and AER benchmarking.

If you wish to discuss any of our comments further, please contact Bruno Coelho on 08 8404 5676.

Yours sincerely

Wayne Lissner

A/General Manager Corporate Strategy

SA Power Networks

Demand Management Incentive Scheme (DMIS)

We support the draft proposal to introduce a new and higher powered DMIS and in particular the following design aspects of the draft scheme:

- A financial incentive of 50 percent of demand management project costs (subject to constraints), as a reasonable level of incentive for pursuing demand management;
- Application of the financial incentive as a simple notional cost uplift onto demand management projects identified by DNSPs and verified through AER processes (and the DMIS' net benefit constraint), as being efficient and valuable for customers and the market more broadly. The DMIS avoids arbitrarily set targets or other measures which might have over or under-incentivised demand management and also focusses on core underlying issues affecting demand management, being the trade-offs relevant to capital expenditure (capex) and operating expenditure (opex);
- Neutrality with respect to demand management that might be either delivered in-house by DNSPs, fully outsourced, or undertaken in partnership with third parties. This avoids bias in the scheme and ensures only the most efficient options will receive incentive payments;
- Inclusion of all forms of demand management (not only peak demand management) within the scope of potentially eligible projects. This ensures that the scheme will remain relevant to challenges that DNSPs are currently and increasingly likely to confront in an environment of high Distributed Energy Resource penetration; and
- The application of financial incentives on an ex-ante basis.
- Avoidance of prescription as to how option value benefits of demand management are quantified by DNSPs in applying the DMIS. We welcome the analysis by Oakley Greenwood[1] on behalf of the AER as assisting DNSPs but consider that a non-prescriptive approach is prudent on this theoretical and technical aspect of project evaluation.

However, we propose that the AER consider the following matters concerning the DMIS' application:

- Increasing the draft proposed total financial incentive available over the five-year regulatory control period—from one percent of a DNSP's Annual Revenue Requirement (AAR) to at least 1.5 percent of AAR, noting that:
  - This would make the DMIS equivalent in scale to the network capability incentive allowance available to transmission network service providers.[2] Demand management is equally or if not more relevant to distribution as opposed to transmission networks, particularly given the dramatic transformation currently underway in the industry whereby the majority of energy generated connects to distribution rather than transmission networks; and
  - An increase in the amount of total financial incentive would not present risks for customers. The net-benefit constraint in the draft DMIS ensures that incentive payments will only be provided where there are benefits to customers and the market.
- Excluding DMIS financial incentive payments awarded to DNSPs from the EBSS and the AER's operating expenditure benchmarking, noting that:
  - While the AER's draft explanatory statement comments on its intent not to exclude demand management project opex from the EBSS[3], there is no comment on how DMIS incentive

1 Oakley Greenwood, *Advice on the DMIS Incentive – prepared for the AER*, 23 June 2017.

2 AER, *STPIS version 5 (corrected),* October 2015, clause 5.3(a).

3 AER, *Explanatory statement – Draft Demand Management Incentive Scheme*, 28 August 2017, p.30.

payments will be treated. While DNSPs should evaluate the trade-offs between CESS benefits and EBSS penalties arising from undertaking demand management that lowers capex and increases opex, it is unreasonable to subject DMIS incentive payments to EBSS penalties; and

    - Including demand management opex and DMIS incentive payments in opex-specific benchmarking would generate misleading information on efficiency, as demand management typically relates to trade-offs between capex and opex. As noted in an earlier submission we made to the AER, the treatment of these trade-offs in the AER's benchmarking requires consideration, particularly as demand management opportunities continue to increase.[4]

- Not requiring DNSPs to report on all demand management projects considered as being potentially eligible—that is, in the proposed Part-B of the annual compliance report. This reporting requirement is excessive. We accept the need to provide good information for the AER and the market on decisions undertaken under the DMIS, and we therefore support requiring annual reporting on projects committed and for which DMIS payments are sought. However, there is no value for the market in annually reporting detailed information on projects that have been considered unsuitable for commitment.
- Further considering the project eligibility criteria to ensure no unintended limitations of the DMIS' application. We would benefit from further AER guidance on general expectations as to the base cases against which demand management projects are to be compared if the identified need is for, or not for, 'reliability corrective action', and how these expectations might differ depending on whether the project seeks to address security, quality or reliability of supply:
    - While the term 'reliability corrective action'[5] applies under the RIT-D, it is not commonly used within the AER's revenue determinations. Our initial view is that if a project pertained to traditional deferral of network augmentation, the comparator would be the least cost option as the project would be addressing a reliability requirement. Alternatively, if the project was to improve state-wide supply security, the comparator might be a do-nothing scenario since the project would not be required to meet regulated service standards.[6]
    - While the draft proposed DMIS criteria provide that an eligible project needs to achieve positive net market benefits, 'reliability corrective actions' might incur net costs as the RIT-D contemplates.[7] We seek AER confirmation of our interpretation that in the case of 'reliability corrective action', the DMIS could apply to the project determined to have the lowest net cost.
- Not requiring DNSPs to include in their requests to third parties, via the "minimum evaluation requirements", a description of DNSPs' preferred option to address an identified need. DNSPs might at the point of issuing the request not have a preferred option, and the purpose of issuing the request is to identify possible projects that can then be evaluated by DNSPs.

Early application rule change

We support the AER's proposal for a rule change to allow early application of the DMIS within DNSPs' current regulatory control periods. However, we wish to confirm that in submitting an application under the amended rule, that DNSPs will not be required to include in their applications, all specific details of the demand management project for which DMIS incentive payments will be sought. We would expect it to be sufficient to only broadly describe the network issue that we are considering as potentially suitable for demand management.

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[4] SAPN, Submission to NSW, ACT and Tas Framework and Approach, 21 April 2017, pp.2-3.

[5] Defined in Part B—Chapter 5 of the NER as meaning: *"investment by a TSNP or a DNSP in respect of its transmission network or distribution network for the purpose of meeting the service standards linked to the technical requirements of schedule 5.1 or in applicable regulatory instruments and which may consist of network options or non-network options*".

[6] The AER may also wish to consider applicability to other possible examples of demand management projects that we consider theoretically feasible including: demand management for network reliability improvement; demand management to avoid network asset replacement; demand management to reduce connection costs.

[7] Clause 5.17.1(b) of the National Electricity Rules.

Demand Management Innovation Allowance Mechanism (DMIAM)

We support the AER's draft proposal to maintain an innovation allowance for demand management as the need for research and development and trials continues to be relevant given the rapidly changing technologies connected to distribution networks.

However, we propose that the AER consider the following DMIAM application matters:

- Slightly amending the project criteria to also include circumstances specific to each DNSP's network infrastructure, in determining whether innovation to be funded is truly innovative. The draft criteria appropriately allow consideration of customer or location specific issues warranting research involving technologies that might have been applied by DNSPs in other jurisdictions. However, there might also be matters particular to the current design of a DNSP's infrastructure, climate or demography that warrant particular research.
- Clarifying the total allowance available under the DMIAM. There is some uncertainty between the drafting of the DMIAM document and AER's explanatory statement. We wish to confirm our interpretation that the total allowance proposed by the AER over the five-year regulatory control period is 0.075 percent of Maximum Allowable Revenue plus $1 million ($200,000 X 5 years).[8]
- Marginally increasing the total allowance available under the DMIAM to 0.075 percent of MAR plus $3 million. SA Power Networks has to date utilised all of its innovation allowance under the current scheme as the current allowance has generally been insufficient to cover the usual cost of running demand management trials. Given the dramatic transformation currently underway in the industry to one whereby the majority of energy is generated in distribution rather than transmission networks, higher allowances would seem appropriate—particularly in the mid-term.
- The requirement for annual compliance reports to include a statement signed by a director of the DNSP is impractical and should be amended to be either a suitably qualified officer of the DNSP or at most the Chief Executive Officer. This amendment would be in keeping with expectations of other regulatory documents such as Regulatory Information Notices.

[8] For example, Table 2 (p.18) of the AER's Explanatory Statement lists SA Power Networks' allowance as being proposed to increase from $0.6m per year ($3 million in total over 5 years) to $0.8 million ($4 million in total over 5 years). However, equation 1 (p.18 and elsewhere) of the AER's Explanatory Statement indicates that the allowance would be 0.075 percent of MAR + $0.2 million with the latter amount being as a single amount over the five years rather than an annual amount.