Australian Energy Regulator

Comments on

AER Preliminary Positions:

Demand Management, etc

by

Energy Markets Reform Forum

January 2008

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The content and conclusions reached are entirely the work of the EMRF and its consultants.

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1. Introduction

IN late December, the Energy Markets Reform Forum (EMRF) and its affiliate, the Major Energy Users Inc (MEU) provided comments on the AER's Issues Paper to apply to the forthcoming NSW/ACT distribution review for the 2009 – 2014 determination. The Issues Paper addressed:-

- A Demand Management Incentive Scheme
- Control Mechanisms for alternative control services
- Approach to determining materiality for possible pass through events.

The EMRF responded in detail to these issues and subsequently the AER has released a Preliminary Positions paper on these self same matters. Ostensibly the AER had integrated comments from the respondents to the Issues Paper – the respondents were predominantly from the supply side entities (especially the four distribution companies) and some consumers and embedded generation proponents.

The EMRF's comments on each of the major matters follow.

2. A Demand Management Incentive Scheme

The main issue addressed by all respondents was that of demand management. All respondents appear to be supportive of demand management approaches, and of the current D-factor scheme.

The EMRF notes that notwithstanding the highly modest (to be excessively generous) achievement of IPART's D-factor incentive scheme, the AER is (courageously) intending to retain the D-factor and as an additional feature implement a somewhat puny 'learning-by-doing' demand management incentive fund on 'a trial basis' for the 2009 – 2014 NSW distribution determinations. In particular, the proposed fund will allow NSW DNSP's to recover revenues of:-

- $1 million for Energy Australia
- $600,000 for Country Energy

- $600,000 for Integral Energy.

This is proposed, against an expectation of some $10 billion to $12 billion in proposed capex that the NSW distributors are reported to be seeking in the 2009 – 2014 revenue determinations.

Against that background, this fund is truly a modest initiative that has a good deal to be modest about.

To State that the EMRF is disappointed with the AER's proposal is not surprising. This is especially given that the EMRF had proposed that a targeted scheme, similar to that used by ESCoSA, be introduced. The AER, whilst acknowledging this suggestion, made no other comment or provide any indication as to its thoughts on the matter.

There is little doubt that a demand management approach is necessary and is considered desirable by all of the respondents. It is of great concern that the AER effectively gave respondents very few options of the myriad of approaches that are available and used in Australia and overseas for demand management. It is small wonder that the majority of respondents, in the absence of any better suggestions from the AER, effectively supported the AER in its clear desire to continue with the under-performing D-factor scheme.

This approach by the AER is in stark contrast to the approach used by ESCoSA when it developed its targeted incentive approach to assessing the best options for implementing demand management, which in SA is much more a needed tool than in NSW due to SA's extreme needle peaks of demand. It is worthy of note that ESCoSA was fully aware of the IPART D-factor approach for encouragement of demand management. After examining it in detail, ESCoSA considered that it was inadequate for the SA needs and implemented its much more targeted approach.

Whilst we acknowledge that the AER is pressed for time, reflecting the very late introduction of the NSW transitional rules and the whole policy and administrative processes associated with the NSW distribution determinations, it is disappointing to seek to introduce such a modest scheme, especially when it is assessed against an expected reported $10 billion to $12 billion capex programme by NSW DNSP's for the 2009 – 2014 distribution determination reviews.

The EMRF sees that the AER has failed NSW consumers by its lacklustre approach to this very real and concerning issue.

The EMRF through its affiliates MEU and the Energy Consumers Coalition of SA (which was heavily involved in the development of the ESCoSA approach to demand management) remains prepared to assist the AER examine much more targeted approaches to demand management then the very modest approaches outlined in the Position Paper.

The EMRF also takes issue with the AER in relation to the throw-away line in the Position Paper, page 13, where the AER states:-

> "The EMRF commented that pricing is the primary tool for getting demand side responses."

The EMRF points out that a major element of the Rule changes for Distribution reviews is the need for the regulator to ensure (especially under price cap regulation) that prices for services are as close to cost reflective as is reasonable. The EMRF has seen in NSW (and also through its affiliates in other jurisdictions) where distribution pricing is not cost reflective then demand management approaches become grossly distorted and quite ineffective.

The EMRF was (and still is) quite sincere in its observation that the first step to adequate and successful demand management is to ensure that prices for services are cost reflective. Because of this, the EMRF recommends to the AER that one of its preconditions for the implementation of whatever demand management scheme is introduced, that it clearly requires the DNSP to implement cost reflective pricing of its services. A statement (and guidelines) to this effect would have been appropriate and welcomed.

The EMRF considers that the AER has failed to address this key issue (by remaining silent on this matter) with sufficient vigour and concern, and as a result will implement what can only be viewed as a notional demand management scheme at best, leaving NSW consumers to the loss of an opportunity to provide a much better outcome.

3. Control Mechanisms for Alternative Control Services

The EMRF supports the AER's proposal to assess the efficient costs of providing public lighting services through a limited building block analysis, because of the short frames available. Also, supported is the inclination to apply a high level evaluation of the existing DNSP regulatory asset bases for public lighting, applying the historical cost approach. **The latter approach is critical and, as necessary, it must be consistent with the approach taken on easements valuation, should this issue emerge in the future.**

4. Guideline on Determining Materiality for Pass Through Events

The EMRF agrees with the AER proposal that an event is material if:-

1. the revenue impact in any one year exceeds 1 per cent of the respective DNSP's revenue for the first year of the regulatory period; or

2. the proposed capex exceeds 5 per cent of the AARR in the first year of the regulatory period.