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Dear Mr Anderson,

Submission on the Proposed Demand Management and Embedded Generation Connection Incentive Scheme (DMEGCIS)

Thank you for the opportunity to comment on the proposed DMEGCIS. We note that the AER intends to "consider its position" after the AEMC's Power of Choice review has concluded. This consultation may therefore be redundant. Nevertheless, we are making this submission now because we believe it is important that the AER understands the harm that the current proposals could cause.

EnerNOC is an independent aggregator of demand response, currently managing 8,000 MW of dispatchable demand response sourced from over 12,500 commercial and industrial sites across markets in the US, UK, Canada, Australia and New Zealand.

Procuring an efficient level of demand response, so as to avoid unnecessary network expenditure, should become part of the normal business practices of Distribution Network Service Providers (DNSPs). The Demand Management Incentive Scheme (DMIS) in place in most jurisdictions has failed to bring this about. The proposed DMEGCIS is almost identical to the DMIS.

The right thing to do when a scheme fails is to scrap it, not to commit to another five years of the same approach.

It is not surprising that it has failed, because it is not an incentive scheme. Rather, it is a small cash hand-out with some associated reporting obligations, combined with a process which partly neutralises a disincentive. It does not result in a positive incentive that can motivate DNSPs to change their business practices to foster something nearer to an efficient level of demand response.

The dangers of perpetuating such a flawed scheme are:

1. It provides false comfort to DNSPs, regulators, and policymakers that something is being done to foster demand response. They may not realise that the scheme is ineffectual. This risks reducing the focus on introducing the fundamental reforms necessary to fix the underlying problems so as to avoid perpetuating the profligate over-expenditure on network infrastructure.

2. It reinforces the idea that demand response is a separate activity, in its own silo, carried out to take advantage of hand-outs and to appease regulators, rather

than part of business-as-usual. For this reason alone, EnerNOC believes that stand-alone incentive schemes are the wrong approach.

3. It is a waste of money. It is entirely possible that the administrative overheads of the DMIS/DMEGCIS (both for the AER and for DNSPs) exceed any actual benefits.

The current regulatory framework provides a strong incentive for capital expenditure by most DNSPs. Given a choice between solving a particular issue through capital works or through demand-side activities, it is generally more profitable for DNSPs to carry out the capital works, as this increases their regulated asset base, on which they will earn a predictable return. Although in principle DNSPs can profit from temporarily deferring approved capital expenditure, the strength of this incentive depends on the position in the 5 year regulatory cycle, and does not cause DNSPs to make efficient investment decisions.

Building new network infrastructure is a core business of DNSPs, which they hence perceive as much less risky than any alternative solutions. As a result, even if the regulatory regime were fixed such that network and efficient non-network solutions would be equally profitable, DNSPs would be likely still to choose to build infrastructure, even when that is not the most efficient solution.

To solve this problem, we will need to give the management of DNSPs strong motivation to change their business practices. This is most likely to be achieved by a combination of two mechanisms:

1. Making efficient non-network solutions more profitable for DNSPs than the alternative conventional capital works. Since non-network solutions are usually significantly cheaper than the alternative capital works, there is the potential to make them much more profitable for DNSPs, so as to provide a strong driver for change, while still greatly reducing the total costs borne by consumers.

2. Setting mandatory minimum targets for the proportion of peak demand growth met through efficient non-network solutions, with meaningful financial penalties if these targets are not met. The usual criticism of mandatory minimum targets is that they may be set too high, leading to inefficient expenditure. In this case, however, the current levels of use of non-network solutions by DNSPs are so far below best practice that it should be easy to set a target which is above current practice but still very low compared to the economically efficient level.

I would be happy to discuss these issues in further detail.

Yours sincerely,

Dr Paul Troughton
Manager of Regulatory Affairs
EnerNOC Pty Ltd