**TOTAL ENVIRONMENT CENTRE INC.**
LEVEL 4, 78 LIVERPOOL STREET, SYDNEY, NSW 2000
PO BOX A176, SYDNEY SOUTH 1235
Ph 02 9261 3437  Fax 02 9261 3990

29 January 2008

Mr Mike Buckley
General Manager
Network Regulation North Branch
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601
Email AERInquiry@aer.gov.au

Dear Mr Buckley,

Re: Preliminary positions paper: Distribution determinations for NSW and ACT

Total Environment Centre (TEC) is pleased to support the Australian Energy Regulator's (AER) recommendation to continue the D-factor mechanism for NSW for the distribution determination for 2009-2014. We have regularly stated our endorsement of the D-factor as a mechanism to promote demand management (DM) by distribution businesses. It is disappointing that the AER does not consider it appropriate for the ACT also.

We would also urge that the D-factor – or an improved version of it – be used in future determinations in the other jurisdictions participating in the national energy market (the NEM).

The learning-by-doing fund is a worthwhile innovation and we support the concept in principle. TEC considers, however, that the allocated sums are grossly inadequate as encouragement to distribution businesses to undertake proper trials for the implementation of DM. Moreover, funds should not be allocated on the basis of a lump sum per business but as a percentage of annual proposed capital expenditure – 2% of each business's expenditure could yield significant benefits.

TEC commissioned the Institute for Sustainable Futures (ISF), with support from the National Electricity Consumers Advocacy Panel, to undertake a review of the D-factor in NSW. They were also requested to make recommendations to further encourage DM. ISF recently finalised their report, *Win, Win, Win: Regulating Electricity Distribution Networks for Reliability, Consumers and Environment*, and a copy of this report is attached.

I also attach a summary of the recommendations made in the ISF report, which are offered in order to maximise DM outcomes from the D-factor mechanism.

Yours faithfully,

Jeff Angel
Executive Director
Total Environment Centre

Summary of recommendations from *Win, Win, Win: Regulating Electricity Distribution Networks for Reliability, Consumers and Environment*

1. **Clarify government policy intent regarding efficient Demand Management.**

   In recognition of the scope of demand management (DM) both to advance the long-term interests of consumers and to enhance environmental sustainability, State, Territory and Federal Governments should ensure that the National Electricity Law and the National Electricity Rules:

   - explicitly require the Australian Energy Regulator (AER) to make efficient regulatory determinations in relation to DM
   - explicitly require Distributors to undertake all cost-effective DM, prior to network augmentation.

2. **Align network incentives with consumer and public interest.**

   In making regulatory determinations, the AER should avoid creating incentives that set the financial interests of the Distributors in conflict with the interest of their customers. In particular, incentives against DM should be avoided in relation to:

   - short-term incentives (within regulatory periods) associated with price/revenue control formulae (see Recommendations 3 to 8)
   - long-term incentives (between regulatory periods) associated with prudence review and the incorporation of capital expenditure into the capital base and mechanisms for sharing efficiency benefits between shareholders and consumers (see Recommendations 9 to 11)
   - network system development and planning requirements (see Recommendations 12 to 14).

3. **"Decouple" Distributor profit from electricity sales.**

   In setting its year-to-year price control formula, the AER should as a key priority, decouple Distributor revenue and profit from electricity sales volume. That is, the AER should ensure that the profitability of a Distributor is not linked to the amount of electricity carried through its network and consumed by its customers.

4. **Use Revenue caps to decouple network profit from electricity sales.**

   In order to decouple electricity consumption and Distributor revenue and profitability, the AER should apply a revenue cap in preference to a price cap in regulating Distributors.

5. **Link revenue cap to economic growth.**

   In applying a revenue cap, the AER should consider applying adjustment factors to insulate Distributors from large divergence of actual peak demand from forecast peak demand. This could, for example, be applied by linking the annual revenue cap to movements in measures of economic activity, such as Gross State Product.

6. **Use D-factor if revenue cap precluded.**

   In circumstances where it is not possible to apply a revenue cap (for example, where a commitment to a price cap has already been made, as in NSW for the forthcoming regulatory period), other revenue decoupling or "lost revenue adjustment" mechanisms should be applied (such as the NSW D-factor).

7. **Create a “use it or lose it” component in the D-factor.**

   Where a “lost revenue adjustment” mechanism (such as the D-factor) is established, it should be applied with a default ex ante allocation on a “use it or lose it” basis that assumes some (non-trivial) level of DM will be undertaken by the Distributor. A D-factor of at least 2% of annual proposed capital expenditure could provide a reasonable default ex ante allocation.

8. **Allow recovery of long-term DM costs in D-factor.**

   Distributors should be permitted to recover, through the D-factor, costs associated with low cost “long-term DM” opportunities that would otherwise be lost if they are delayed until a local network capacity constraint emerges.

9. **Allow Distributor savings from DM to be carried forward.**

   The AER should ensure that Distributors are permitted to carry over efficiency benefits from DM, such as deferral or avoidance of capital expenditure, from one regulatory period to the next, on no less favourable terms than they are able to continue to earn a return on network capital investment from one period to the next.

10. **Ensure balanced prudence review of capital expenditure.**

    Recognising that short-term incentives are likely to have little impact unless complemented by longer-term incentives, the AER should ensure that the review of prudence of past and projected capital expenditure involves a thorough all-sources assessment of the opportunities for deferring capital expenditure through DM, conducted by experts with a demonstrated balanced understanding of the theory and practice of DM.

11. **Require Distributors to demonstrate efforts to procure DM.**

    The AER should require Distributors to demonstrate that they have undertaken reasonable efforts to identify and procure cost effective DM, particularly in the context of anticipated network constraints and proposed new network investment. Such efforts should include DM direct offers to consumers, DM programs developed by the Distributor and DM proposals solicited from other parties.

12. **Inform the DM market.**

    The AER should seek to inform the market for DM options by requiring Distributors to publish detailed information annually about the current capacity of the distribution network, current and projected demand and possible options to address any emerging constraints. (The NSW DM Code of Practice for Distributors and the South Australian Guideline 12 provide sound precedents for such information disclosure.)

13. **Ensure consistent Distributor DM performance reporting.**

    The AER should require Distributors to report annually on DM activities undertaken in relation to: expenditure, peak demand and energy consumption reductions, value of electricity sales foregone, value of capital and operating expenditure avoided or deferred, and efforts to identify and procure cost effective DM. Such reports should be publicly available. The AER should issue a pro forma to encourage consistency in DM reporting. Reporting to the AER should be harmonised with any other DM reporting requirements.

14. **Conduct and publish annual AER DM Reviews.**

    In recognition of the relatively underdeveloped state of DM in Australia, the AER should monitor DM data provided by Distributors and publish a consolidated annual review to encourage mutual learning and allow comparison of different policies and approaches between jurisdictions. (This will also assist in building understanding of DM potential within the regulatory community and among stakeholders.)

15. **Apply complementary transitional measures to accelerate DM.**

    Recognising that the above measures are designed simply to address existing barriers to efficient DM in the economic regulatory environment, and that the DM market in Australia is currently underdeveloped, Federal, State and Territory Governments should establish complementary transitional measures to create positive incentives to develop DM quickly.

16. **Put an appropriate price on greenhouse gas emissions.**

    In the interests of economic efficiency, and in recognition of the high economic cost that climate change is expected to impose on the Australian and global community, the Australian Government should ensure that the price of greenhouse gas polluting activities, such as fossil fuel-based electricity generation, includes the full cost of the associated greenhouse gas emissions. This could be achieved by introducing an emissions trading scheme or a carbon tax. (Recommendations 1 to 15 would be complementary to such action.)