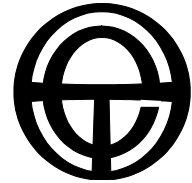


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SUBMISSION

to

Australian Energy Regulator

**NSW/ACT Distribution Demand Management
Incentive Allowance (DMIA)**

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NSW/ACT Distribution Demand Management Incentive Allowance (DMIA)

1. Introduction

The failure of the Ministerial Council on Energy (MCE), the Australian Energy Market Commission (AEMC) and the Australian Energy Regulator (AER) to put in place a regulatory framework that prioritises demand management (DM) above inefficient infrastructure expansion remains a core problem in the National Electricity Market (NEM). The AER's current approach to the NSW/ACT distribution networks determination is another symptom of this failure.

Notwithstanding the inadequacy of the AER's current attempts to grapple with DM, Total Environment Centre (TEC) supports the small steps being taken towards the development of a demand management incentive scheme. These measures are in the right direction but are decidedly inadequate. In principle we fully support the concept of a DM innovation allowance, but the sums allocated for each distribution network service provider (DNSP) are insufficient to stimulate significant new demand management (DM) solutions.

In the absence of more comprehensive and appropriate regulatory DM incentives, we support the overall concepts of the DMIA; allowance for revenue forgone as a result of DM programs; and application of the D-factor to NSW DNSPs. Such incentives promote efficiency within the NEM – in a competitive market, the failure of networks to weigh up non-network and alternative generation options goes against the intentions of the National Electricity Law and adds unnecessary costs for consumers.

Our recommendations in this submission are restricted to the treatment of demand management (DM) in the AER's papers of November 2008 on the *Demand management incentive scheme for the ACT and NSW 2009 distribution determinations – Demand management innovation allowance scheme* and on the *Draft decision – New South Wales: Draft distribution determination 2009-10 to 2013-14*.

- The innovation allowance should be set at 5% of the projected network capital expenditure for each DNSP – the amounts set are far too low to promote the utilisation of the vast amount of DM available.
- The innovation allowance should operate on a “use it or lose it” basis. The ability to defer DM spending could continue indefinitely and would therefore negate the whole intent of the allowance, which is to stimulate development of new DM projects.
- The D-factor mechanism, under which the DNSP can pass through any costs to customers when its DM implementation costs are less or equal to the avoided distribution costs, should be retained until a more effective DM incentive is established.

- The ability to pass through costs from revenue forgone as a result of DM actions should apply to all DM in jurisdictions with the price cap form of regulation, not just for actions taken under the innovation allowance.
- The AER should develop a Demand Management (DM) Code of Practice for distribution networks, with the NSW model to be adopted as a minimum (including the protocol for disclosure of information).

2. Demand management innovation allowances

2.1 Allocated sum

We are disappointed that the AER is being so intractable on the sums allocated to each DNSP as a DM innovation allowance. As the AER recognises, DM can bring wide-ranging benefits to the electricity market, the electricity system as a whole and consumers.

To allocate such paltry sums negates proper recognition of these benefits. Even the DNSPs have requested an increase in the proposed sums (as reported in the *Draft decision*) and this goodwill on their part urgently needs substantial encouragement. Moreover, as TEC has submitted, the sums should be based on a percentage of the projected network capital expenditure – and we strongly recommend 5% as an appropriate figure – rather than a fixed sum (and therefore would still be different for each DNSP).

TEC nonetheless fully supports the principle of “use it or lose it” as proposed by the AER (and opposed by at least one DNSP). The whole purpose of a DMIA is to encourage new investigation and implementation of DM programs, so if DNSPs were able to defer spending then this would be an incentive to defer action on DM. It would make the DMIA pointless.

2.2 Reporting

2.2.1 Lack of clarity

Reporting of DM programs has not been clarified sufficiently. DNSPs do undertake some DM, and they are currently proposing more such projects (although minimal) for this determination period. It is not clear, however, in what way the DNSPs will distinguish between DM done as normal practice, and DM investigated and/or undertaken under the DMIA.

This further leads to an implied risk that the DNSP could declare a program which they were planning to undertake as part of their normal business as being part of their DMIA – which would lead to no increase in DM activity.

TEC therefore urges the AER to require more detail in the reports from DNSPs.

Apart from this lack of clarity, the reporting regimes for DM activity seem to be worthwhile and TEC is particularly in favour of annual reporting about this important activity.

2.2.2 Scope

The proposed scope for the annual reports appears useful and clear (p. 6), but falls short. We recommend adding “the value of capital and operating expenditure avoided or deferred” to the list.

2.3 Forgone revenue

In the absence of a more responsible and appropriate regulatory framework that sends strong signals that make utilisation of DM obvious for networks, we support the principle of the recovery of revenue forgone as a result of programs under the DMIS. It is also consistent with the principles of the D-factor mechanism, under which DNSPs can claim for forgone revenue.

We urge the AER to instate a similar principle regarding forgone revenue for all DNSPs operating in the NEM under a price cap form of regulation. This would be more equitable, since otherwise DNSPs in other jurisdictions would be missing out on an incentive granted to those operating in NSW.

2.4 DM Code of Practice

The NSW DM Code of Practice is a worthwhile initiative that seems to have been lost under the shift to national regulation, which is unfortunate because it was a useful guide and part of the supportive structure for the D-factor. In the absence of more appropriate regulatory architecture that properly prioritises DM, it is a key component of the development of DM solutions, and should be adopted and further developed by the AER. It could then be applied to all DNSPs, not just those in NSW. South Australia also has a code of sorts – Guideline No 12 – which sets out requirements for DM obligations under the licensing system.

TEC therefore again urges the AER to develop a DM Code of Practice for application at a national level, which DNSPs would be obliged to follow. The NSW and SA versions at least would serve as starting points for such a national code. A Code would not only set out requirements that DNSPs must follow, but would serve as guidelines for them to remove uncertainty. For instance, it allows for definition of terminology that the AER would follow in consideration of allowed expenditure.

3. NSW determination – DM

3.1 D-factor

In the absence of the proper incentivisation of DM by regulators, TEC supports the application of the D-factor in NSW. Although uptake to date has been small, it is providing DNSPs with experience in applying DM solutions. Successful programs can also serve as models for other distribution businesses.

3.2 DM reporting

There is a lack of consistent and transparent ex post reporting on DM efforts by DNSPs including:

- efforts to identify and procure cost-effective DM;
- expenditure on DM;
- peak demand and energy consumption reductions;
- the value of electricity sales forgone; and

- the value of capital and operating expenditure avoided or deferred.

This makes it impossible for regulators and consumers to assess the degree to which networks are utilising an adequate level of DM. We would urge the AER to develop coherent and thorough annual reporting models for all DNSPs (not just those in NSW) as well as for TNSPs, along the lines of that proposed for the DMIA (see also 2.2.1 above). These annual reports should be made publicly available. This will benefit the AER and consumers, as well as promoting information across the NEM about potential non-network solutions.

We also recommend that the AER issues consolidated reports annually on non-network solutions investigated and implemented, including those that were unsuccessful (in the spirit of building up a knowledge bank). TEC has found it very difficult in the past to develop a clear picture of DM actions across the NEM, and it would be no easier in the current situation for others to do the same.

3.3 DM aggregators

The AER makes a curious statement in the *Draft decision* that, “the AER understands that there are a number of demand-side aggregators operating in NSW.” (p. 267) TEC conversely understands that there are very few indeed (certainly less than five). This lack of such aggregators is exacerbated by poor uptake of DM by DNSPs, lack of regulatory incentives for DM, and numerous barriers still existing within the Rules. Many of TEC’s arguments about the need for acceleration of DM actions and removal of barriers are based on the difficulties faced by aggregators attempting to operate within the NEM.