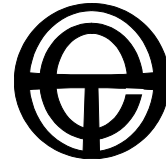


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SUBMISSION

Australian Energy Regulator

Matters relevant to distribution determinations for ACT and NSW DNSPs for 2009-2014

Issues Paper

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AER distribution determinations – ACT and NSW DNSPs Issues Paper

1. Introduction

Although Total Environment Centre (TEC) appreciates the opportunity to comment on the Australian Energy Regulator's (AER) Issues Paper about matters relevant to distribution determinations, we are concerned about the process for consultation. There was a very short turn-around for submissions (22 November to 10 December) and the release of the Issues Paper does not seem to have been widely advertised. This means that many stakeholders may not have been able to allocate resources to commenting on these important matters and our submission too will of necessity be brief. We understand that time is short for the NSW/ACT determinations, but we urge that further consultation be undertaken, particularly on the demand management incentive scheme (since it does not appear to be addressed in the other issues papers on guidelines released in November 2007 by the AER).

This is the first time the notion of a demand management incentive scheme has been explicitly canvassed for the National Electricity Market (the NEM) as the previous reference to such a concept was solely within the terms of changes to Chapter 6 of the Rules (clause 6.6.3). TEC therefore recommends much wider public consultation on this significant mechanism. We note that the new Rule for this only stated that the AER may develop such a scheme, therefore it needs to be properly designed in terms of the whole of the NEM, not just in reference to the ACT and NSW distribution network service providers (DNSPs).

TEC – in conjunction with the Alternative Technology Association (ATA) and the Ethnic Communities Council of NSW (ECC) – covered various matters germane to this Issues Paper earlier this year in submissions to the Ministerial Council on Energy (MCE) on network incentives¹ (particularly pp 4-6) and network planning and connection arrangements² (particularly pp 4-5). We attach copies of these submissions.

TEC also commissioned the Institute for Sustainable Futures (ISF) (with assistance from the Advocacy Panel) to review the NSW D-factor mechanism regarding its success in promoting demand management and to recommend potential alternatives³. We understand that the ISF has sent separately a confidential draft of this report through to the AER for comment – please note that although its contents are pertinent to the Issues Paper and we would urge the AER to take them into consideration, the report has not yet been released publicly and so should not be exposed by the AER at this stage.

¹ TEC, ATA, ECC (2007) *Submission on Network Incentives for Demand Side Response and Distribution Generation*, 30 May 2007

² TEC, ATA, ECC (2007) *Submission on Network Planning and Connection Arrangements – National Frameworks for Distribution Networks*, 5 October 2007

³ Institute for Sustainable Futures (2007) *Draft report: Win, win, win: Regulating Electricity Distribution Networks for Reliability, Consumers and the Environment*, Confidential draft, December 2007.

We have restricted our recommendations here to the demand management incentive scheme (which we strongly support in principle), in particular:

- Mechanisms for promotion and implementation of DM across the NEM need to be properly explored. There are many processes under way at the moment – the AER is only one of a number of them – and they are apparently being independently run with no overarching guidance. The MCE should institute a proper review, to look at potential DM mechanisms for all sectors of the NEM and sectors with which the NEM interacts (such as a potential emissions trading scheme). At the very least it would assist clarity and certainty for all stakeholders if the MCE played a coordinating role and informed stakeholders of how the various processes will interact, not only in terms of rule changes but for other regulations and policies as well.
- It is imperative the D-factor scheme in NSW is not abandoned precipitately as it has been responsible for greater efficiency within the NEM. At the very least it should be continued while further options are widely canvassed for application across the NEM.
- The application of the D-factor method should be given closer consideration for the ACT. The fact that the customer base is largely residential (and revenue caps are in place) does not preclude the potential for DNSP implementation of energy efficiency and other DM methods.
- The ESCOSA “learning-by-doing fund” should be adopted for NSW and the ACT as a supportive mechanism to a D-factor scheme.
- Wider investigation of potential options needs to be undertaken, with the potential for variation in NSW and the ACT before the next determination once NEM-wide approaches are established.
- Promote a revenue cap for distribution networks since they essentially form geographic monopolies. Where a price cap is in place, generous incentives should be developed to encourage cost-effective network DM, at least of the “D” factor system.
- The ISF report, *Win, Win, Win* (referred to above) contains a number of detailed recommendations which would be worth investigation by the AER.

2. Demand management incentive scheme

Demand management (DM⁴) in all its forms must be recognised as a viable alternative to current attitudes and actions throughout the NEM because of the benefits that it delivers to consumers and to improving efficiency across the whole market. The Objective of the National Electricity Law (NEL) is set up to cater for “the long term interests of consumers”; without effective DM this is not being achieved. The AER paper states that

⁴ DM in this submission can be read to include ‘demand response’, ‘demand side management’, ‘demand side response’, ‘energy efficiency’ and ‘non-network solutions’. In general, DM can include both the management of peak loads and energy efficiency as a way of meeting capacity requirements most cost effectively. It includes a diverse array of activities that meet energy needs, including cogeneration, standby generation, fuel switching, power factor correction, interruptible customer contracts, and other load shifting mechanisms.

DM refers to growth in demand (p 10), which is a limited definition since it can also be used to address baseload requirements (such as through increases in energy efficiency and alternative distributed sources of supply).

It also notes that one consideration is how such a scheme would interact with other schemes. TEC would argue it is not yet possible to assess that interaction since the other schemes (for instance service performance and efficiency benefit) have not yet been settled.

If a price cap methodology is applied to DNSPs, then it must include incentives for DSR and DG to counter the massive incentives and cultural bias for DNSPs to sell more electricity. Such incentives should ensure that networks are able to recoup revenue for both the efficient cost of carrying out a non-network solution as well as for the forgone revenue from sales that would have been raised had the DSR and/or DG not gone ahead. The purpose is to promote consideration of more efficient non-network solutions and, conversely, to reduce the incentive for the networks to encourage excessive consumption (that is, by selling more electricity).

An alternative method to promote DM is for DNSPs to be required to earmark a specific minimum spending level for DM: at least 5% of the projected network capital expenditure could be set aside for cost-effective DM projects, on 'use it or lose it' terms.

Since the requirement for either of these would be to implement DM wherever possible, such incentives in fact 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.

Neglect of demand management is a pervasive problem throughout the National Electricity Rules, despite professed intentions that demand side options should be given "due and reasonable consideration". Consideration of DM, in all its forms including DG, must be embedded in the Rules as a valid approach to increasing efficiency by avoiding unnecessary generation and network investments. In the interests of efficiency, DNSPs should be required to investigate non-network solutions before proceeding with supply-side solutions. We reiterate that this refers to both baseload and peak consumption.

Demand-side opportunities include load shifting, load curtailment and fuel switching and these can represent a low-cost alternative to new generation and transmission investments. DM provides the potential for networks to operate more efficiently by avoiding unnecessary or premature network augmentations, and thereby create savings for consumers. DM therefore meets the efficiency criteria of the NEM Objective, and by relieving constraints it can also bring reliability benefits in the long-term interests of consumers.

In essence, given the uncertainty surrounding future recommendations and the success (even though modest) of the D-factor to date, we would urge the AER to retain the mechanism for NSW, pending further investigation into its application across the NEM. We also consider that the arguments for supporting a price cap rather than a revenue

cap are quite spurious, given the monopoly nature of DNSPs (for instance, there are only four in NSW and they are largely geographically distinct). It is also not demonstrably an effective mechanism in itself for promoting non-network solutions.

The possibility of applying the D-factor scheme in the ACT should be further investigated by the AER since there is potential for its use despite the arguments presented in the Issues Paper. The fact that a revenue cap applies in the Act and the customer base is largely residential does not imply that a similar incentive scheme would not be practicable. A DNSP can still develop energy efficiency schemes of various types, for instance, and there are other DM methods which can be developed. To date the experience has been that DNSPs are less likely to implement these methods without direct incentives to do so. There are supporting measures that are critical to achieve a successful D-factor mechanism, as highlighted in the ISF paper:

- short-term incentives relating to the annual price control formula within regulatory periods should be neutral between DM and network investment options, and should “decouple” DNSP profit and revenue from electricity sales;
- long-term incentives between regulatory periods should be neutral between DM and network investment options in terms of recovery of costs and sharing of efficiency benefits between shareholders and customers;
- planning and development regulations should ensure that there is equal opportunity for DM and network investment options to be both considered and adopted;
- regulation should ensure that network planning and operational decisions take account of the implications of these decisions on the external environmental costs and, in particular, the costs associated with greenhouse gas emissions.

In addition, since there have been positive reports of the ESCOSA scheme – named a “learning-by-doing fund” by the AER – TEC would also support the implementation of such a fund for NSW and the ACT. It would certainly bring benefit, and would act as an additional trial of the measure before potential implementation in other parts of the NEM.

Most importantly, these must be viewed as interim measures while a full range of options for regulations to promote DM by DNSPs are pursued. There are too many ad hoc processes under way at the moment with no clear overarching guidelines for the promotion of DM across the NEM.