

Mr Warwick Anderson
General Manager, Network Finance and Reporting
Australian Energy Regulator
Email: DM@aer.gov.au

October 2017

Re. Consultation Paper – Proposed Demand Management Incentive Scheme and Innovation Allowance Mechanism

Dear Mr Anderson

This submission sets out the Energy Efficiency Council's (EEC) positions on the Proposed Demand Management Incentive Scheme (Scheme) and Innovation Allowance Mechanism (Allowance Mechanism).

The EEC is the peak body for energy efficiency, demand management and cogeneration in Australia. The Council is a not-for-profit membership association, and its goal is to make sensible, cost-effective energy management measures standard practice across the Australian economy. Our members include independent experts, energy efficiency providers and various levels of government.

The EEC strongly supports the development of an effective Scheme and Allowance Mechanism. An effective Scheme and Allowance Mechanism are essential to improve energy affordability, energy security, competition and facilitate transition to a range of new forms of generation and consumer choices.

As noted in our submission in March 2017, excessive expenditure by Network Service Providers (NSPs) resulted in networks costs rising faster in Australia than any other country in the period 2007-13. Much of this expenditure could have been avoided if demand management had been effectively utilised.

In relation to the proposed Scheme, the EEC:

- Supports the proposal to increase incentives for NSPs to invest in demand management, but recommends the Australian Energy Regulator (AER) review the design and raise the caps.
- Supports early implementation of revisions to the Scheme
- Strongly supports the proposed Scheme requirement for NSPs to undertake competitive procurement under the demand management scheme.
- Recommends that the AER adopt global best practice by requiring NSPs to follow an 'Efficiency First' process in designing their investment plans.
- Continues to recommend both minimum targets and reporting for investment in demand management.

The EEC does not have substantive comments on the proposed Allowance Mechanism.

The attached submission discusses these issues in more detail. Your office can contact me on 0414 065 556 or via rob.murray-leach@eec.org.au.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Rob Murray-Leach', is centered on the page.

Rob Murray-Leach

Head of Policy

Energy Efficiency Council



energy efficiency
COUNCIL

**Energy Efficiency Council submission on the
Proposed Demand Management Incentive
Scheme and Innovation Allowance Mechanism**

Scheme Incentive

The EEC supports the proposal to increase the incentive for NSPs to undertake demand management. This will reflect part of both the wider market benefits and options value of demand management investments. However, there are two issues that we encourage the AER to consider before finalising the scheme:

- Scaling the incentive based on a NSP's expenditure on demand management, rather than the outcomes of that expenditure (e.g. reduced demand), creates an incentive for an NSP to undertake less cost-effective projects. The proposed competitive process and assessment process should reduce the impact of this distortionary incentive but, in an ideal world, the incentive structure should also encourage cost-effectiveness.
- While the proposed mechanism will create an incentive for some investment in demand management, the proposed caps on the incentive may prevent NSPs from investing in the full economic potential for demand management. The proposed cap on an incentive at an uplift of 50 per cent of a project's cost may not reflect the full market benefits of some projects, resulting in some projects being undersized. The proposed cap on incentive payments at 1 per cent of a NSP's revenue will limit total expenditure on demand management, potentially below the economic potential.

Early Implementation

- The EEC supports the proposal for early implementation of revisions to the Scheme. This will provide more certainty to NSPs and non-network service providers, earlier investment in demand management and therefore potentially a greater reduction in energy consumers' bills.

Promoting Competition through the Scheme

The EEC strongly supports the proposal to require NSPs to use a competitive procurement process for the provision of non-network services. This proposal will increase competition and cost-effectiveness in the market for demand-management services. However, we seek to engage with the AER to ensure that this requirement is designed to minimize the rise that NSPs circumvent it and unfairly preference in-house providers or partners.

Efficiency First

The EEC has serious concerns about the tacit approach in the proposed Scheme, whereby NSPs are required to demonstrate that non-network solutions are more cost effective than network solutions. This proposal is the opposite of global best-practice in electricity regulation.

The European Union and many other jurisdictions have adopted a principle of *'Efficiency First'*, which requires utilities to consider demand-side investments to address capacity constraints, before they consider supply-side investments. The EEC strongly recommends that the AER move to align Australia with global best practice by requiring NSPs to consider demand-side investments before any investments in network infrastructure.

Assessing Cost-Effectiveness in the Scheme

The EEC endorses the broad approach of requiring NSPs to demonstrate the cost-effectiveness of their expenditure, whether for network or non-network solutions. However, the Regulatory Investment Test for Distribution (RIT-D) is generally only applied to network investments over \$5 million and would therefore be an onerous framework for assessing smaller demand-management projects. Therefore, we recommend a more streamlined approach to assessment of demand management projects, at least for projects worth less than \$5 million.

Minimum Targets and Reporting in the Scheme

The EEC continues to recommend that the AER set NSPs targets for minimum levels of investment in demand management. The EEC's position was not reflected in the Consultation Paper. The EEC has not argued that targets should be set to drive NSPs to undertake the economically efficient level of demand-side investment. Rather, we have argued for minimum targets that require every NSP to undertake some level of demand management, with the expectation that NSPs should invest well above this level.

Minimum targets are appropriate as there is some potential in every region and minimum targets would require each NSP to build their capabilities in the use of demand management. While it would be challenging to set accurate targets if they aimed to drive the optimum level of investment in demand management, it is a much simpler exercise to set minimum targets, and a wide range of metrics could be used.

The EEC particularly objects to the statement on page 58 of the Consultation Paper:

“While some stakeholders supported demand management targets in their submissions to our Consultation Paper, this position appeared to fall away in the Options Day and the following consultation steps.”

This statement does not reflect the content of discussions and appears to have been included in the Consultation Document to support the AER's preferred position. This undermines stakeholders' confidence in engaging with the AER and we recommend that, in future, the AER more accurately report the outcomes of consultations.

The EEC has also proposed that, at a minimum, NSPs be required to report on a few metrics on their overall level of demand-side investment. This would allow comparison between NSPs and identify any NSPs that are potentially under-investing in demand management. While there may be sound reasons for an individual NSP to make low-levels of investment in demand management, this approach would encourage a discussion about the relative levels of demand management undertaken by various NSPs.

The EEC continues to argue for minimum targets for NSP demand management activities and, at a minimum, requirements for NSPs to report on their overall demand management activities. Potential metrics for targets and reporting could include:

- Annual investment in demand management;
- Annual outcomes of demand management (e.g. kW_{peak} reduction, MWh energy saved); and
- Annual value of supply-side augmentation avoided or deferred through demand management, including upstream (net market) benefits.