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Submission to AER demand management incentive scheme for Victorian Distribution Businesses

This submission has been prepared by the Consumer Utilities Advocacy Centre Ltd (CUAC), an independent consumer advocacy organisation, established to ensure the interests of Victorian consumers, especially low-income, disadvantaged, rural, regional and indigenous consumers are effectively represented in the policy and regulatory debate on electricity, gas and water.

This submission evaluates the demand management incentive scheme (DMIS) proposed by the Australian Energy Regulator (AER) against its objectives, and the process by which the scheme is being developed

In principle, the scheme appears as though it may help uncover some information on non network solutions that can be used by Distribution Businesses (DBs) and the AER alike. However, the extent to which it does this, the extent to which it is necessary or efficient, and the extent to which it will result in solutions being implemented, appears less certain.

To ensure effective efforts are made to address an apparent lack of investment in, and understanding of implementing non network solutions, we would like to see more open and transparent regulatory development processes. We note that the AER has not made public submissions to the Australian Energy Market Commission (AEMC) as part of its review of barriers to demand side participation and no analysis has been presented by the AER on why a DMIS is deemed necessary for Victorian DBs. The AER has not referred to work being done by the AEMC in its paper outlining the proposed DMIS. This makes it very difficult for stakeholders to evaluate the proposed DMIS.

We encourage the AER to, wherever possible, ensure it develops and consults on proposed regulatory measures with a view to other relevant policy or regulatory development processes. In this case, it is likely that the outcome of AEMC work on demand side participation will impact on the effectiveness of the DMIS proposed by the AER. This makes it imperative that they are considered together and if necessary, amendments to the DMIS be possible based on work being done through the AEMC process.

By way of previous analysis on barriers to demand management (DM), we note that in its issues paper released April 2008 on a DMIS for Queensland (QLD) and South Australia (SA) the AER states that:

> *"Lack of information regarding demand management is a primary barrier, in particular limited information regarding end-user attitudes and responses to demand management, as well as information about the effectiveness and reliability of demand management projects"*

The other barriers cited in the issues paper were to do with tariff structures, reliability standards, and split incentives. So based on this, we understand the AER is designing the DMIS to reveal information about the value of DM – and it is against this objective that we comment on the DMIS proposed for Victorian distribution businesses.

We contend that regulation of natural monopoly businesses should be such that those businesses face commercial pressures as they exist in a competitive market. For the six months ending June 2008, Cheung Kong Infrastructure[1] reported profit from Australian operations of HK$448M. It is inconceivable to consumers that a company profiting close to HK$1,000,000,000 per annum is allocated additional funding to undertake research and development on DM – essentially so that the regulator ensures network companies meet their obligation to develop the network efficiently.

DBs earn more than sufficient margin to use money already collected in revenues for research and development purposes. Additional funds are not required for research and development (R&D) to take place. We believe that if the AER deems investment in R&D by DBs insufficient, the AER should require DBs to allocate a certain percentage of revenue generated towards R&D. Continual improvement through research and trials should be an expectation of DBs as part of their normal business operation, it should not be an 'add on' requiring additional incentive.

We note that in its submission to the AER on the incentive scheme to be applied to Ergon, Energex and ETSA for the 2010-2015 period ETSA utilities state that:

> *"The costs associated with implementing a DMIS are considered immaterial, particularly when compared to the significant benefits that may be achieved in the future. Every effort should be undertaken to simplify the schemes to reduce administrative costs to the AER and distributors"*

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[1] CKI is a 50% shareholder in Spark Infrastructure which owns 49% Citipower and Powercor and ETSA utilities, and a 51% owner in Citipower and Powercor directly along with Hongkong Electric Holdings – HKH is a also member of the Cheung Kong Group of companies. CKI also owns 51% in ETSA utilities directly

It is not unreasonable for DBs to incur minor costs in the pursuit of significant benefits, particularly then efficient network expansion, including efficient discovery and use of non network alternatives, is a regulatory requirement of DBs.

The AER proposes compensating DBs for foregone revenue due to implementing projects that arise out of R&D efforts. While we understand there may be a perverse incentive for a DB not to implement a project because it may reduce revenue, any lost revenue arising from activity driven by this scheme is likely to be very small. On principle, we call on the AER to ensure that any foregone revenue resulting from the DMIS activity is shared with consumers as cost savings. This is in recognition that ultimately consumers pay for R&D and for projects to be implemented – therefore they should share in any benefits the projects deliver.

While we agree there is a general need to encourage R&D into non network solutions, we have concerns about the approach of the AER. We suggest the approach of the AER will have limited effectiveness and value for two reasons:

1. The AER acknowledges that due to the form of regulation, distribution companies have an incentive to maximise energy throughput on their networks and that they are effectively penalised when forecast load is not consumed. Until this is addressed at a fundamental level either through changing the form of regulation or through far greater compliance requirements on network companies to find efficient non network solutions as part of their planning process, network companies will continue to expand networks without due regard for DM options.
2. A range of organisations and programs already exist both locally and abroad that are involved with developing and testing products and systems to allow better utilisation of network assets through DM. The AER can already access data and information at little or no cost, to test and challenge the efficiency of planned DB spending. For example, current or pending DM trials include:
    a. ETSA utilities DM trial program funded by Essential Services Commissions South Australia (ESCOSA)
        i. It is worth noting ETSA shares common owners with Victorian distribution businesses and so knowledge sharing should naturally occur
    b. Energy Response is actively engaged in local and international markets for DM and has data available highlighting its benefits
    c. Federal Government funding has been granted to solar cities trials which will include measuring the impact of DM technologies
        i. We understand that some Victorian DBs will be engaged in these trials

It is imperative that networks are built to be resilient in the face of future weather events, but that they are not unnecessarily 'gold plated'. Individual consumers, communities and businesses alike have a reasonable expectation that networks will function reliably through expected future weather scenarios. DM has an important role in ensuring this happens.

We believe the following quote from the SPAusnet submission to the DMIS proposal for Energex, Ergon and ETSA goes to the heart of cultural issues in DBs the AER must overcome. SPAusnet state that the proposed DMIS:

> *"does not reward distribution businesses that find new, innovative and least cost ways of delivering demand management solutions"*

The statement is symptomatic of a culture that sees DM as additional to DB operations, a special activity which if done well, should result in additional reward. DM is not seen as an integral part of the DBs regulated requirement to develop networks efficiently. By creating a DMIS, the AER reinforces the perception that DM is an onerous task, as opposed to a requirement. It is essential that the AER, through regulation and its enforcement of regulatory requirements, shapes a culture in DBs that values DM alongside traditional network solutions.

If you have any further queries please contact Tosh Szatow, Policy Officer on (03) 9639 7600.

Yours sincerely

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