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**Mr Anthony Bell**

**Australian Energy Market Commission**

**via the AEMC website**

**11 July 2019**

**Submission to Demand Management Incentive Scheme for TNSPs rule change – ERC0266**

AGL Energy (**AGL**) welcomes the opportunity to comment on the Australian Energy Market Commission's (**AEMC**) consultation paper on a demand management incentive scheme (**DMIS**) and innovation allowance (**DMIA**) for transmission network service providers (**TNSPs**) (**Consultation Paper**).

AGL is one of Australia's leading integrated energy companies and the largest ASX listed owner, operator and developer of renewable generation. Our diverse power generation portfolio includes base, peaking and intermediate generation plants, spread across traditional thermal generation as well as renewable sources. AGL is also a significant retailer of energy and provides energy solutions to over 3.5 million customers in New South Wales, Victoria, Queensland, Western Australia and South Australia.

In addition, AGL is continually innovating our suite of distributed energy and demand management services for customers of all sizes. These energy solutions involve new and emerging technologies such as energy storage, electric vehicles, Solar PV systems, digital meters, and home energy management services delivered through digital applications.

**Energy transition must occur at least cost to consumers**

Energy systems are undergoing a transition with greater levels of variable renewable generation across the network and a higher penetration of distributed energy and storage technologies at the customer level. Networks will need to adjust to support these changes while still delivering reliable and secure energy. It will be vital that this transition occurs at the least cost to consumers over the long term. AGL considers that demand management will be an important element of promoting the efficient utilisation of network infrastructure, and thereby minimising the amount of network investment required.

The regulatory framework should encourage networks to investigate a range of network and non-network solutions on equal footing, and on the basis of the most efficient costs to consumers. The consultation paper notes that there are already mechanisms in place to promote this outcome. We trust the AEMC will closely consider whether there is any need for additional incentives.

AGL notes that this rule change was proposed to address the issue that there is a bias towards investment in CAPEX projects instead of non-network options. While we support networks being encouraged to engage efficient non-network options, including demand management, we consider the AEMC should consider the issue more broadly. It would be more cost-effective to address the underlying problem related to incentives rather than introducing a specific incentive mechanism for demand management. Network incentives are being considered by the AEMC as part of the Electricity Networks Economic Regulatory Frameworks

(ENERF) review. We suggest this rule change and the need for a DMIS or DMIA for all network businesses be considered in light of this work.

**Demand management and transmission networks**

There are technical differences between transmission and distribution networks that may affect how demand management will typically be used to address network issues. AGL provides the following observations.

In distribution networks, demand management can be used to address constraints on transformer capacity (typically low voltage) and avoid having to upgrade the transformer. It can also be used alleviate over voltage issues, such as from high penetration of PV. Small volumes of demand management may be sufficient to address an emerging network issue.

Transmission constraints typically occur at high voltage transformers but are unlikely to occur above 220kV. These constraints are more likely to be caused by dynamic voltage instability that is a factor of the local generation mix. However, this means the location of the constraint is not necessarily consistent and can move around depending on the generation flows. While non-network solutions can be valuable to address these constraints (like strategically located batteries or synchronous generators), demand management occurs at a specific connection point and may not necessarily solve the constraint. In these circumstances it may be difficult for a TNSP to define the problem that is to be addressed by demand management, which is necessary under the regulatory framework.

While these examples show some of the differences that may drive the way TNSPs would use demand management, it is clear that certain transmission network issues can be addressed through demand management. Some TNSPs have used demand management options to defer or avoid capital investment under the current regulatory framework. For example, Transgrid's Powering Sydney's Future program includes demand management as a non-network solution to address extreme summer peaks and the risk of equipment failure.

This infers that introducing further incentive mechanisms for demand management may be unnecessary and could add additional costs for consumers.

**Ring fencing arrangements**

The efficient deployment of demand management and distributed energy capability will enable co-optimisation of those technologies across multiple uses and value streams. Competition and innovation in technology and business models is the primary way to maximise the value from this co-optimisation – to achieve efficient 'value stacking' of these services. It is also important that customers have the ultimate choice about how their resources are deployed and the compensation or reward they receive for participating in different service markets (including network services). AGL is concerned that network businesses are being encouraged to engage or provide these services, without effective ring-fencing arrangements in place or without sufficient transparency around decisions to engage their affiliated ring-fenced business to provide the services.

Without appropriate ring-fencing arrangements, and compliance with those arrangements, there is a risk that networks cross-subsidise a competitive service by its regulated activities or restrict competition for the services that should be efficiently value stacked. We note that the AER's most recent compliance report for DNSPs found some significant breaches of the ring-fencing guideline and will be working with individual companies to improve compliance rates. While this is the first year of compliance reporting under the new

DNSP ring-fencing guideline and some breaches are not unexpected, the findings uphold our concerns that the ring-fencing regime needs to be shown to be working effectively to minimise impacts on competition and ultimately consumer costs.

We hold significant concerns with the ring-fencing arrangements for TNSPs. The existing ring-fencing guidelines for TNSPs have not been updated since 2002 and do not consider the provision of new products and services. Should TNSPs be provided with greater incentives to procure demand management services, it will be important that those services are procured in a way that encourages competition. If a TNSP wishes to engage an affiliated business to provide those services, appropriate ring-fencing must apply.

The TNSP ring fencing guidelines are expected to be updated in 2020. AGL strongly suggests that if the AEMC is inclined to apply a DMIS and DMIA to TNSPs, such a rule should not come into effect until after the ring-fencing guidelines are updated and implemented by TNSPs.

**Other suggestions**

AGL considers the following changes are also necessary to encourage appropriate competition for demand management services:

- The Contestability Rule should be applied to TNSPs:

  In 2017 AEMC made the Contestability Rule which prohibited DNSPs from providing services behind the meter, unless this is carried out by a ring-fenced business. A similar requirement should be placed on TNSPs to avoid impacting competition for those services.

- Transparency around decisions to engage the ring-fenced business:

  Currently the DMIS that applies to DNSPs requires a tender process to identify competitive providers for the service. The DNSP is able to engage their affiliated ring-fenced business, but there is little transparency around the decision and whether the DNSP has turned down better offers in favour of the affiliated ring-fenced business.

  AGL strongly suggests there should be more transparency and scrutiny around decisions of networks to engage their ring-fenced business, especially if the tender process has shown another provider can reliably deliver the service at lower cost.

- The DMIA should include a tender process, or something similar:

  While the DMIS currently requires the distribution business to carry out a tender process to identify competitive providers, this is not required of the DMIA. While the nature of the DMIA is slightly different to DMIS (the DMIS involves addressing an identified problem), we consider the DMIA should include a more explicit obligation for networks to partner with competitive providers to investigate demand management ideas and deliver these projects.

**Conclusion**

AGL considers that demand management will be an important tool to help minimise the long-term costs to consumers of network investment. However, we question whether the introduction of an incentive scheme specific to demand management is the best way to address the broader issue related to the incentives on network businesses when making investment decisions. We trust the AEMC will closely consider whether this rule is necessary, or whether there are better, alternative options to address the incentives on networks.

Should the AEMC be persuaded to apply the DMIS and DMIA to TNSPs, we strongly suggest that complementary reforms are implemented to avoid the potential impacts on competition for those services, such as: updating the TNSP ring-fencing guidelines; applying the Contestability rule to TNSPs; improving transparency around the use of the DMIS; and requiring a tender process to encourage competition for projects under the DMIA.

If you have any queries about this submission, please contact Jenessa Rabone on (02) 9921 2323 or JRabone@agl.com.au.

Yours sincerely,

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