



20 June 2008

By email: submissions@aemc.gov.au

Australian Energy Market Commission
PO Box A2449
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Dear Commissioners

Review of Demand-Side Participation in the National Electricity Market

The Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to comment on the Australian Energy Market Commission's (the **Commission**) *Review of Demand-Side Participation in the National Electricity Market* (the **Review**) which was released for consultation on 16 May 2008.

As an initial comment, we are concerned the emphasis the consultation paper places on price as impacting upon consumption decisions. While price does play a significant role in consumption decisions, it is our view that, particularly for residential consumers, price signals alone will not provide effective incentives to consumers to change demand patterns.

While an increased cost might act as an incentive for some householders to use electricity more efficiently, or make different decisions about their energy consumption and demand, it is our view that overall, the ability of households to do so is limited by a range of structural factors. Barriers to household energy efficiency include the efficiency standards of buildings and appliances, the split incentive that exists between landlords and tenants, and the inability of low-income households to pay more to be efficient. Perhaps the most significant barrier is the cultural change necessary to convince consumers of the need to consume far less. More complex solutions are required to overcome these problems – a mere price signal cannot be the silver bullet for delivering effective demand side participation (**DSP**).

We believe that it should be ensured that actions to promote DSP do not pass on significant additional costs to residential consumers and that the price for non-discretionary use is maintained at an affordable level.

We acknowledge that the AEMC is limited in its review by the requirement that it have regard to the national electricity objective (NEO). The NEO, as it is founded in the concept of

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economic efficiency, does not account for the vagaries of actual consumer behaviour in markets. According to the terms of reference, DSP is the ability of consumers to make decisions regarding the quantity and timing of their energy consumption which reflects their value of the supply and delivery of electricity. It is our view that the ability of consumers to make decisions is not only impacted by price and economic efficiency, but must involve other considerations as well. It is important to note that behavioural economics examines actual consumer behaviour and identifies systematic biases and departures from the perfectly rational consumer that is assumed by our current regulatory framework. These systematic biases or departures need to be considered in determining whether intervention is necessary and in judging the efficacy of proposed DSP. For these reasons, we believe the NEO should be amended to include goals relating to:

- The minimisation of the consumption of electricity;
- The provision of effective consumer protection; and
- The reduction of greenhouse gas emissions.

We also note that while DSP is defined around consumer decision-making, much of the consultation paper relates to opportunities to signal behavioural change to market participants to deflect energy production and network augmentation. In many circumstances market participants have more control over how and when energy is consumed.

International experience of DSP

We believe that currently there are insufficient incentives for network businesses to avoid operational expenditure that would be spent on DSP or to undertake research, development and innovation on DSP initiatives. It is our view that incentives need to be introduced into the regulatory framework before effective DSP will be achieved.

As Australia's networks are regulated monopoly businesses, it is recognised that competitive pressure does not influence the incentive for a network business to innovate. However, an example of how network businesses are incentivised to engage in DSP comes from California USA where DSP is embedded in the state wide policies.

As detailed in the report by NERA Economic Consulting¹, there are various forms of reliability-based demand response programs, in particular direct load control (DLC) and interruptible load (IL) which are used effectively in California:

Direct load control

Direct load control is used by network service providers to directly control the energy use of specific appliances at an end user premises at pre-determined times or based upon 'critical peak' events. Consumers who have subscribed to the program receive incentives, such as rate discounts or credit to their accounts.

Interruptible load

¹ NERA Economic Consulting, Review of the role of demand side participation in the National Electricity Market, Australian Energy Market Commission, May 2008

Interruptible load requires customers to subscribe, as with DLC, for a rate discount or account credit, to a program where their load is curtailed, by a pre-specified amount, during for example, peak network periods. IL is targetted more at large users who can not respond to reduced load with only a short period of notice.

These programs are both effective ways for small consumers to participate in the energy market, particularly when accompanied by consumer protections, and the Californian market has had success with these programs as both voluntary and mandatory measures that reduce energy consumption.

While these programs are effective, it is the combination of demand management initiatives and energy efficiency that produces the largest energy savings and is much cheaper than peaking generation. Within the Californian network, energy efficiency is ranked as a first priority for action, ahead of demand-side response, followed by the development of renewable energy. Only when these initiatives have been explored to their maximum can network augmentation be utilised. Further, 20 years ago they decoupled the incentive to increase sales and are allowed to increase the tariff if consumption drops.

We encourage the AEMC's review to examine the opportunity for similar programs in Australia. We would caution, however, that any introduction of reliability-based demand response programs should be accompanied by a strong consumer protection framework.

Economic regulation of networks

We welcome the review's consideration of whether the economic regulation of networks acts as a barrier to DSP. We note that price caps provide a strong incentive for network businesses to create efficient prices as they are influenced by consumption and risk losing profit, while under revenue caps, network businesses have only a limited incentive to ensure prices are linked to costs. In the case of DSP, revenue caps appear to be slightly more suited to achieving DSP goals.

Despite this, Consumer Action questions the role of either form of regulation to substantively promote DSP. In our view, the choice of form of economic regulation of networks should be based upon what ensures economic efficiency and fair pricing across all classes of consumers. For residential consumers, the requirement to keep network prices as efficient as possible should go some way to ensuring energy is affordable.

We believe effective DSP cannot be ensured through the economic regulation of networks but should be based upon strong external regulation to effectively deliver outcomes for consumers. In particular, we believe that a network should be required to implement projects that promote DSP. We are attracted to ESCoSA's approach which required ETSA to undertake DSP projects as part of its regulatory price set. A regulator must also ensure the achievement of demand management targets for network services providers is efficient and least cost. We would also welcome further consideration of financial incentives and penalties as a means of ensuring demand management targets are reached, as has been implemented in California.

Network Planning

We believe that the key reason that current planning arrangements for network augmentations create a bias against demand side options and under consideration of non-network scenarios is the lack of effective consultation. The timing of existing consultation processes currently occurs after networks have been planned and commenced development. Effective communication, comprising community participation and guidance from regulators will assist networks to improve the efficiency and balance of the planning process and influence outcomes to potentially achieve DSP.

Network access and connection arrangements

We agree that current network access and connection arrangements impede the use of embedded generators and distributed generation (DG). These barriers prevent consumers from actively participating in and contributing to the energy market which also results in reducing the ability to supply energy at a certain amount or at a particular time, as well as avoided losses, improved reliability, avoided network and generation capacity and avoided emissions. We refer to the Consumer utilities Advocacy Centre's paper² for further discussion of the way in which small DG's are limited access and potential means to overcome this. We support initiatives that ensure the network is accessible to DG.

Wholesale markets and financial contracting

We don't see the benefit of small consumers participating in wholesale markets. The market is designed to protect consumers from the volatility of wholesale markets and which is more efficient for other market participants, for example retailers, who play this mediation role.

Should you have any questions about this submission, please contact us on 03 9670 5088.

Yours sincerely

CONSUMER ACTION LAW CENTRE



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² Szatow, T, Beyond Free Market Assumptions: Addressing Barriers to Distributed Generation, Consumer Utilities Advocacy Centre, 2008 pg 23