



Department of Primary Industries

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Mr John Pierce
Chair
Australian Energy Market Commission
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Our Ref:

Dear Mr Pierce,

The Victorian Department of Primary Industries (DPI), as the portfolio agency responsible for energy market development in Victoria, is pleased to make this submission in response to the Australian Energy Market Commission's (AEMC) Issues Paper (published 15 July 2011) for Stage 3 of its Review of Demand Side Participation in the National Electricity Market.

Any queries in relation to this submission should be directed to Mark Feather, Acting Executive Director, Energy Sector Development by email at mark.feather@dpi.vic.gov.au or by phone on 03 9658 4793.

Yours sincerely,

Mark Feather
Acting Executive Director
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DPI SUBMISSION TO THE AEMC “POWER OF CHOICE” (DEMAND SIDE PARTICIPATION REVIEW STAGE 3) ISSUES PAPER

The Victorian Department of Primary Industries (DPI), as the portfolio agency responsible for energy policy in Victoria, welcomes the opportunity to comment on the Australian Energy Market Commission’s (AEMC) Issues Paper for Stage 3 of its Review of Demand Side Participation (DSP) in the National Electricity Market (NEM) – “Power of Choice”.

The Role of DSP

DPI considers that the role of DSP in the NEM will become increasingly important as the Australian electricity industry as consumers increasingly seek ways to reduce power costs through reducing or better managing demand.

DPI considers that there is potential to utilise DSP to reduce energy use across the NEM at times of peak demand, thereby reducing or deferring the need to invest in additional peaking generation and network capacity. The costs of providing additional generation and network capacity are largely borne by end-use customers as they are built into higher network charges and consequently into retail pricing. As DSP mechanisms such as peak shifting, distributed generation and energy efficiency measures become more widely employed, all customers should benefit in the long term through sharing in the avoided costs of investment in peak generation and network capacity.

Pre-conditions for effective DSP

DPI agrees with the AEMC assessment that, for DSP to be utilised to its full extent, the network infrastructure must be capable of supporting advanced technologies (including smart meters and other enabling infrastructure) which are capable of providing end-use customers with more accurate information on electricity use to enable them to manage their demand more effectively. The availability of price incentives to end-use customers will also be important to support and encourage changes in electricity use.

DPI further recognises the importance of improved consumer information in assisting customers to understand their electricity usage in order to access the potential benefits of advanced technologies (e.g. electricity usage display devices, and appliances with time delay settings) and price incentives.

DPI notes that the Victorian Government has commissioned an independent cost-benefit analysis to determine whether, and under what circumstances, the Victorian smart meters program can deliver consumers value for money.

It is also noted that the Victorian Government is currently undertaking a study into the potential impact on consumers should time-of-use pricing be made available. This study will consider how such pricing will affect the affordability of electricity for different types of consumers, including disadvantaged members of the community.

Protections for vulnerable customers

While installation of advanced technologies, improved access to information and introduction of price incentive mechanisms will give domestic and small-business consumers the potential to generate significant savings, it is important to recognise that there will be a proportion of customers who cannot alter usage patterns in response to changing price signals. This issue is likely to impact more vulnerable members of society in particular. It will be important to ensure that mechanisms are put in place to protect these consumers in any future changes to pricing and billing arrangements, such as a move to time-of-use pricing. DPI considers that the AEMC should consider this issue in developing its recommendations for this review.

The role of NEM price cap arrangements in limiting DSP

One of the key barriers to DSP in the NEM is the maximum and administered price caps arrangements in the NEM. Whilst these price cap arrangements continue to remain in place in their current form, retailers will have reduced incentives to contract for demand side response to manage the risks associated with supply shortfalls or demand peaks.

More generally, the existing price cap arrangements act as a disincentive for direct involvement of DSP. This is because the presence of market price caps limits the potential profitability of DSP participation, including through direct contractual load control (e.g. from large industrial users), or aggregated load control (managed by specialist providers). It is noted in this respect that industrial customers and commercial customers have a significantly higher Value of Customer Reliability than residential customers¹ and are only likely to make their contracted electricity available at a price well in excess of the present Maximum Price Cap level of \$12,500 per Megawatt hour.

Whilst the price cap arrangements continue to apply in their current form, the risk is that direct DSP participation in the NEM will be inhibited, creating pressure to address peak demand through higher cost generation or network investment.

Ultimately, whilst wholesale prices are unable to rise above the existing price caps, larger customers will have reduced incentives to participate in the demand side and reduce their consumption.

AEMC assessment of existing energy efficiency arrangements

DPI notes that the review is to consider the effectiveness of current regulatory arrangements for energy efficiency, an important component of DSP. The Victorian Energy Efficiency Target (VEET) is a legislated target introduced through the *Victorian Energy Efficiency Target Act 2007*. VEET is delivered through the Energy Saver Incentive (ESI) scheme, which sets a target for energy savings, initially applied to the residential sector, and requires energy retailers to meet their own targets

¹ 2009 VCR values for Victorian electricity: Residential - \$16.33 / kWh , Industrial - \$45.94 / kWh, Commercial - \$134.15 / kWh. Source: AEMO, Value of Customer Reliability Background Paper, December 2009. <http://www.aemo.com.au/planning/0400-0017.pdf>

through energy efficiency activities (such as providing households with energy saving products and services at no cost or reduced cost).

In recognition of the success and popularity of the ESI scheme, in 2012 the scheme will be expanded to include small to medium enterprises and other businesses. The greenhouse gas abatement target has also been doubled for the period 2012-14 to 5.4 million tonnes per annum. DPI considers that any new arrangements proposed by the AEMC in this review to promote energy efficiency should reflect the success of the VEET scheme in both promoting energy efficiency opportunities amongst customers and ensuring that energy retailers are supporting end-use energy efficiency.

The market structure of ESI is designed to incentivise the deployment of the least-cost abatement measures. A Regulatory Impact Statement (RIS) was prepared recently to examine the impacts of expanding the scheme². The analysis compared the ESI against the use of rebates to deliver energy efficiency outcomes. It found that while rebates can result in many of the same outcomes incentivised under an ESI-style scheme, rebate programs were sub-optimal to ESI in the following areas:

- it may be harder to obtain sufficient take up at a given price to meet a specified target or objective;
- the time and effort involved in clarifying eligibility and then applying for a rebate may mean that households and businesses are not sufficiently incentivised to undertake very low cost activities; and
- government may be less effective than the market in consistently identifying least cost energy efficiency opportunities for a given target.

Furthermore, the ESI is agnostic in terms of which consumers take advantage of the opportunities. This freedom allows for greater efficiency than other similar schemes that mandate targets to consumer sub-groups (such as low-income, residential or business).

Addressing practical limitations to distributed generation

In considering the potential contribution of distributed generation (DG) as a useful DSP mechanism, the AEMC should address the current practical restrictions to the widespread deployment of DG. While the final report to the AEMC Stage 2 DSP review did not identify any major regulatory barriers to connection of DG to distribution networks, DPI engagement with DG proponents and distribution network businesses indicates that there are major practical limitations to widespread deployment of DG. One of the most prevalent of these is the capability of distribution networks to incorporate DG while maintaining local networks within acceptable fault levels.

DPI also has concerns regarding the effectiveness of the current network regulatory incentive arrangements in driving significant network innovation, including increased penetration of DG. In order to drive the growth of DSP, the regulatory system should provide incentives which best balance the need to stimulate network investment (to

² <http://new.dpi.vic.gov.au/energy/environment-and-community/energy-efficiency/energy-saver-incentive-scheme/submissions-to-the-regulatory-impact-statement-veet-regulations>

overcome network barriers to DSP) with the costs consumers are willing to pay to support such incentives.

Further, whilst distribution network businesses may have incentives within each five year regulatory pricing period to deliver cost savings by utilising demand side services, these incentives do not extend beyond the price period. In addition, as distribution network businesses cannot accurately predict where and when in the network DG will locate in future, they cannot precisely forecast and plan network expenditure to accommodate DG connections as part of the five-yearly pricing review process.

DPI has undertaken some analysis on these issues and would be happy to provide the AEMC with further information on this analysis.