NATIONAL GENERATORS FORUM

19 October 2012

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Reference: EPR0022

Dear Mr Pierce

The National Generators Forum welcomes the opportunity to comment on the Commission's, Draft Report, *Power of Choice,* dated 6 September 2012.

The NGF is the national industry association representing private and government owned electricity generators. NGF members operate all generation technologies, including coal-fired plant, gas-fired plant, hydroelectric plant and wind farms. Members have businesses in all States.

The Power of Choice review aims to identify opportunities for consumers to make informed choices about the way they use electricity. The Draft report sets out the Commission's recommendations for supporting the market conditions necessary to facilitate efficient Demand Side Participation (DSP). Improved consumer information and technology can assist in achieving more efficient market outcomes. In moving toward this outcome an underlying policy objective should be to reduce regulatory intervention and costs.

Of particular interest to the NGF is the Draft Report recommendation in relation to the Demand Response Mechanism (DRM). The DRM aims to allow consumers to directly participate in the wholesale market by receiving the spot price for a demand side response.

The NGF is supportive of improved market signals however, we do not believe that the costs and benefits of this proposal are sufficiently reliable at this stage to justify the Draft Report's recommendations to facilitate demand side response through the proposed DRM.

Benefits of DRM

The benefits of the proposed DRM are overstated as there are existing commercial arrangements in place that allow a demand side response. These include arrangements such as interruptible tariffs, scheduled and unscheduled demand response, and spot pass-through.

Importantly, due to the highly opaque nature of these arrangements the true level of DSP currently in the NEM is not fully reflected in the AEMC analysis.

International comparisons also overestimate the potential benefits of DRM due to the complexity distinguishing between reliability and economic DSP.

To explore this concern the NGF and ESAA have jointly commissioned SFS Economics to perform an analysis of the proposed Demand Response Mechanism. A copy of this report is attached to this submission.

In a number of overseas electricity markets reliability DSP is explicitly procured for managing system security and reliability. These markets are however, fundamentally different to that of the NEM's 'energy only' market. The NEM uses a number of alternative arrangements such as Reserve Trader and Directions to achieve similar system security and reliability objectives.

Hence a key conclusion from the SFS analysis is that comparisons across markets overstated the response due to the complexity of distinguishing between economic demand response and a reliability demand response.

Costs of DRM

The introduction of the DRM would not reduce wholesale and retail market prices as set out in the draft Report. The contracts market is dynamic and buyers and sellers would adjust hedging prices to account for exposure to the demand side response quantity. The net effect of the proposed arrangements would lead to an increase in wholesale cost of electricity which would lead to increases in the retail price for electricity.

The implementation costs of the DRM are potentially significant. Duplicate metering, increased regulatory oversight and working groups to establish the baseline methodology are a number of tangible costs that will be incurred to establish the DRM.

Additionally, if the DRM increases participation of unscheduled demand there will be adverse consequences to the efficiency of central dispatch as scheduled generators face increasingly non transparent market conditions in which to try are optimise their dispatch.

Unintended Consequences of DRM

The proposed DRM will present the DRM recipient with a free option that could be exploited. The DRM recipient is incentivised to maximise the difference between the baseline and their actual consumption. The disputes between DRM respondents and Regulators in the USA energy markets that use a similar DRM provides a case in point.

The NGF is also increasingly concerned by claims that any action that reduces short term spot prices must be in the overall interest of consumers. Current market prices are already providing little incentive for new investment in the NEM. The Commission would be aware that longer term customer outcomes are best protected by ongoing investment in new generation assets.

Finally, rather than reducing regulation within the industry the proposed DRM is likely to increase regulation costs. The DRM would impose significant implementation costs, distort the contracts market and benefit a small group of large consumers at the expense of a much broader group of consumers.

It is the NGF's preference that the objective of transparent pricing signals be delivered by removing the current regulations that restrict this outcome rather than the introduction of an additional regulatory framework.

I will be in contact with your office to arrange to discuss these issues further.

Yours sincerely

Tim Reardon
Executive Director