Power of Choice – Stage 3 DSP Review Submission

Submitted on behalf of:

Lucy Cooper
Tom Dwyer
Martin Timperley

The Power of Choice Review and questions of reform

The purpose of NEM reform

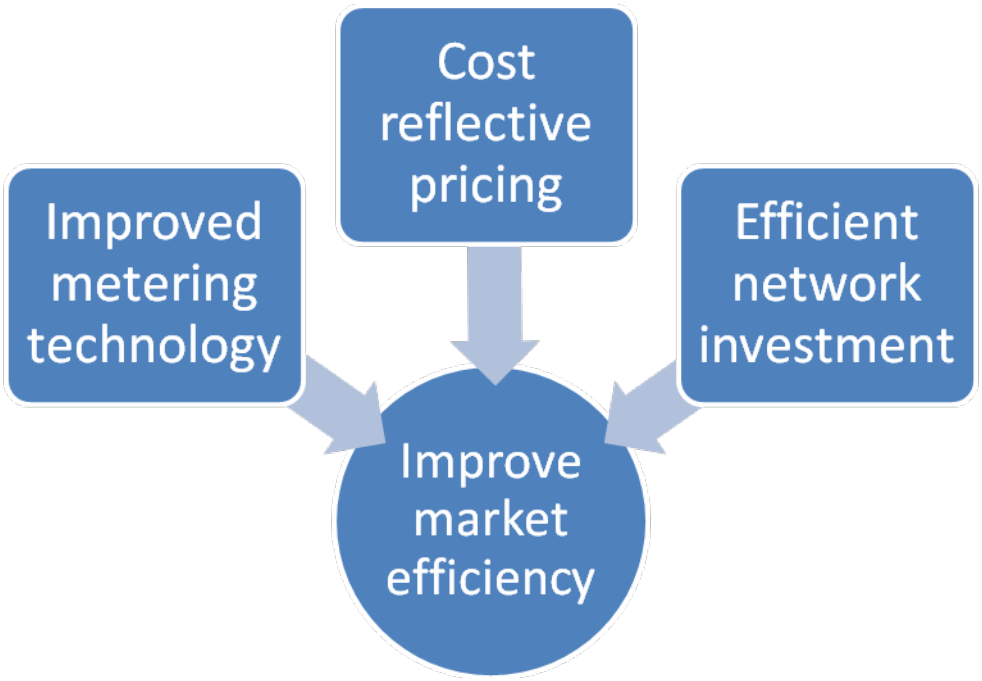
Firstly, any changes to the regulatory framework of the NEM cannot compromise energy reliability and security. With this in mind, market frameworks should be developed to improve NEM efficiency. Any improvement in market efficiency should ultimately result in a lower cost to consumers.

Current market overview

- The market structure dictates that the maximum revenue of a network service provider (NSP) is proportional to the NSP's assets. This has given the NSP's a clear bias toward assets investment (over other potentially more efficient and effective options of meeting their reliability obligations).
- Consumption during times of peak demand or network constraint has a far more significant impact on overall long term system costs than consumption during times of average demand.
- The benefits that result from an individual changing to a consumption profile that is more desirable from an overall system perspective (i.e. less "peaky," more constraint responsive) are for the most part shared amongst all consumers and retailers so there is effectively no incentive for an individual to act in the interest of the system.

NEM reform and the Power of Choice Review

By correctly incentivising and rewarding DSP, the benefits of DSP engagement can be felt across the market. As the PoC review acknowledges, the key to these incentives, is the implementation of cost reflective pricing; however its implementation would require the widespread rollout of smart metering technology.



Questions raised in The Power of Choice Review Draft

The PoC review seeks to mandate changes in the areas of improved metering technology and network investment in addition to investigating the introduction of cost reflective pricing. The review emphasises the capacity of distributors to remain responsible for DSP investment, however it identifies several areas of development that would be required for them to do this including:

- minimum metering specifications
- a mechanism through which a metering rollout would occur
- the reform of rules that govern NSP revenue – in particular, a change in the way DSP technologies are evaluated as assets.

Questions we raise in response

Are NSPs best placed to drive DSP?

First and foremost an NSP must remain responsible for system reliability and security. Given the monopolistic nature of NSPs, is it realistic to rely on these businesses to find the optimal balance between the (potentially conflicting) goals of reliability and efficiency?

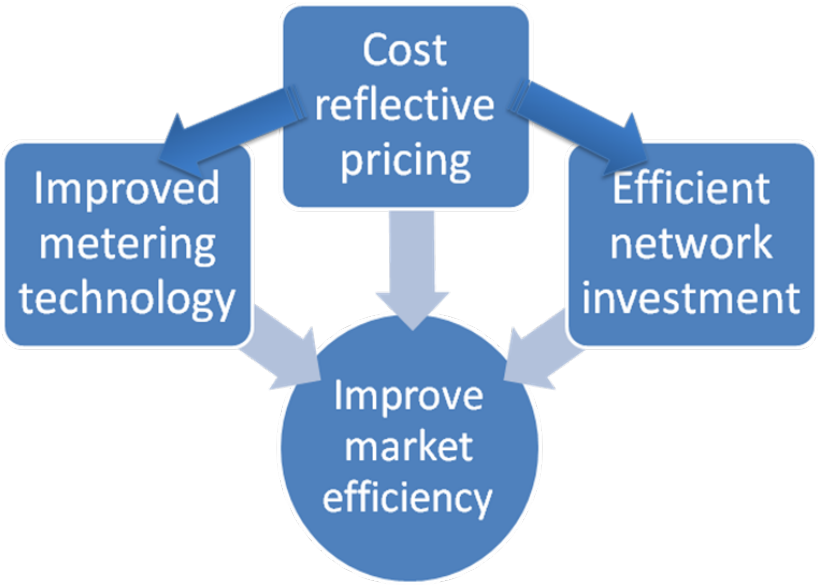
Is it necessary for NSPs to drive DSP investment?

If cost reflective pricing was implemented in such a way that the long term value of a particular demand profile was reflected in the way a NSP passed on network charges to a retailer, that retailer would be incentivised to improve the overall load profile of its consumers and to install technology that verified this change (a smart meter). The problem is not that the NSPs cannot derive such a pricing mechanism, but that they have no incentive to – why would they initiate a change aimed at reducing the need for investment when their profit remained (at least partly) proportional to such investment?

NEM reform - an alternative approach

We suggest an alternative approach that removes the need for direct distributor involvement whilst achieving the aims of wider DSP response and a more efficient market. Many of these suggestions are in response to unanswered questions present in the Draft Report but in general they are to:

- Engage a third-party to determine the pricing mechanism to be used by the NSP in order to provide *long term* cost reflection.
- Mandate the NSPs use of such a mechanism
- Lower Barriers to entry into the retail market
- Keep distributors responsible solely for reliability as under existing regulations
- Keep mandatory smart meter specifications to a functional minimum
- Reconsider "baseline" pricing mechanism



Firstly, we support the implementation of cost-reflective pricing as suggested in the PoC draft review. Assuming at least a minimal level of smart meter rollout, we see little difficulty in implementing such a pricing mechanism in relation generation costs as the spot market already efficiently prices these services. However, in relation to network costs there is currently no obvious pricing structure that would encourage demand to behave in a way that would reduce long term costs – the network is either there or it is not (the marginal cost of delivering an additional unit of electricity is effectively zero). In order to effectively price this network component, we would suggest enlisting an unbiased third party to explore the options available and mandating that NSPs implement the pricing scheme suggested by their findings.

In order for the long term benefits of DSP to be realised, the presence of a competitive retail market is essential. For this reason we would suggest lowering the barriers to entry into this market to promote competition. Such a competitive retail market would be naturally incentivised to install smart meters on behalf of their "good" consumers – those of which once monitored individually, would improve the retailers overall load profile. The *new* "average system profile" (which would be the old *total* system profile minus the profile of consumers with smart meters) would be attributed to the remaining unmetered consumers – as would be the associated costs. This in turn would increase the incentive of the retailer to install meters for those remaining "good" consumers. Such a rollout would not provide meters to all consumers but would continue to provide them up to the point at which the cost of provision was equal to the potential savings (plus, invariably some risk component).

Such a rollout would also encourage the development of innovative DSP technologies (either directly via the retailer and consumer or indirectly via a third party).This would in turn incentivise the distribution of meters with a level of technical capability geared toward what would in theory be the most efficient outcome – the market preference.

Finally we would question the use of a "base-line" referencing scheme, as we feel this could have undesirable consequences. Given consumers with an easy to change, "peaky" profile are in the best position to alter their profiles, it would seem unwise to implement a program that actively rewards such customers for maintaining such a profile in all but a few "response events." Further, we imagine that this scheme would effectively subsidise unnecessary energy consumption in all but the defined "response events" and therefore discourage overall energy efficiency.

It is important to note that all of these proposed changes must still be considered bearing in mind the effect they might have on those consumers with little capacity for change and without the ability to bear the full costs of their use (such as pensioners). In such cases subsidies may need to be made available; however as pointed out in the PoC review such consumers are likely to enjoy both short and long term benefits from the implementation of such reforms, as they generally consumer less total power and have a more desirable load profile.