Power of choice review –
Synopsis of the fourth Stakeholder Reference Group meeting

The fourth meeting of the Stakeholder Reference Group (SRG) was held on Monday 28 May 2012. The purpose of the meeting was to continue discussing potential solutions to issues identified in the Power of choice directions paper.

Presentations by the AEMC, ENA and EnerNOC, referred to in this synopsis, can be found on the AEMC's website.

Power of choice review - submissions

The Chair opened the meeting and outlined the topics for discussion. AEMC staff then provided an overview of submissions received to date on the directions paper. The following points were made:

Cost-reflective pricing: Stakeholder submissions generally supported moving to more cost-reflective pricing. Noted that other factors are needed to successfully make this happen including metering and technology, information provisions and vulnerable consumer protections. Some stakeholders noted that pricing is not a "silver bullet" solution to DSP.

Consumer participation: Stakeholders had differing views on each of the issues raised in this area of the directions paper:

<u>Consumer education:</u> Most stakeholders agreed that consumer education is needed to raise understanding of the rationale and benefits of cost-reflective pricing. Informed consumers are essential to effective DSP.

<u>Consumer engagement:</u> Stakeholders were divided on this issue. Some considered that there is scope for network businesses to directly provide information and services to customers. Retailers considered that they were the appropriate conduit for information provision to consumers.

<u>Role of third parties:</u> There was generally support for third parties playing a role in the market to provide DSP options. Retailers considered that any third party should be subject to elements of the National Energy Customer Framework.

<u>Metering:</u> Some stakeholders viewed that metering service provision should be open to competition. Network businesses considered they were best placed to roll-out smart metering technology and to manage metering infrastructure.

<u>Wholesale and ancillary services markets:</u> Small consumer advocates, environmental groups and commercial and industrial users were supportive of demand side response in the wholesale market.

Networks: There were varying perspectives what types of reforms, if any, are needed to incentivise networks to use DSP options:

<u>Distributed generation:</u> Stakeholders were divided on whether additional incentives were needed to increase the uptake of distributed generation.

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Network incentives: DNSPs were of the view that stronger incentive mechanisms are needed to promote investment in risky and uncertain DSP. The AER considered that there is a need to clarify the scope of DSP market benefits in the regulatory process and how these benefits are valued. Environmental groups consider that network revenue should be decoupled from throughput.

Supply chain: Some stakeholders consider that the market will be able to resolve supply chain issues, given sufficient time. In other submissions, stakeholders noted that because of diverse commercial interests participants were not coordinated across the supply chain. Many stakeholders agreed that methods should be developed to value and forecast DSP across the supply chain and plan accordingly.

Session 1: Network regulation and incentives

AEMC staff presented potential solutions to network regulation and incentives. The following points were made:

- How to remove the profit disincentives to do a DSP project instead of a capital asset project. Also if incentives are equalised should DNSPs receive any extra reward?
- Other issues considered include what should be the profit signal for DNSPs to do DSP, and will DSP impact on the network profits through other avenues?

ENA presentation: Ms Tanya Barden from the Energy Networks Association (ENA) gave a presentation on options for improving the Demand Management Incentive Scheme (DMIS). The following points were made:

- Incentive regulation is a preferable approach than regulations or obligations to enable networks to engage with DSP.
- Networks require predictable and reliable DSP to use it to improve efficiency and network operations and investments.
- ENA recommends the DMIS should be revised to include the following elements:
    - Positive incentive payment, reflecting share of benefits;
    - Method or deemed value for benefits;
    - Revenue adjustment for price capped businesses (like d-factor); and
    - Innovation allowance.
- Other changes recommended by ENA include:
    - Balancing the incentives between capital and operating expenditure;
    - Balance incentives to undertake DSP within, rather than the beginning of a regulatory period; and
    - Ensure consistency in arrangements for TNSPs and DNSPs.

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SRG member feedback: SRG members made the following points in response to both presentations:

- A key barrier to efficient DSP is that the rewards for undertaking action do not go to those that provide the outcome (free-rider issue).
- There was some discussion on the perceived/real risks associated with DSP options, and whether these perceptions emerged from the cultural practice of DNSPs. Some noted that the industry had to be mindful to build capability in this area. Other members noted DNSP's perception of the risk associated with DSP products is cultural.
- The regulatory determination cycle may not properly accommodate the benefits of DSP options as it may take longer than the 5 year period to see the benefits. Some DSP options are a long term initiative, and not about the next couple of years.
- Some members raised the option of placing a peak demand reduction target on network businesses. However, it was noted that such an incentive may not be sufficient to overcome the perceived cultural bias in some businesses. Noted that improving incentives under the framework is the right first step.
- Other members commented on whether networks would be offering DSP options as a regulated or as a competitive network service.

Session 2: Wholesale and ancillary services markets

AEMC staff gave a presentation on the potential role of aggregators and other third parties accessing the spot market. The following points were made:

- Under the current arrangements an aggregator needs to effectively register as a retailer and also be responsible for the supply of electricity at a connection point. This results in the demand side response unable to be unbundled from the energy purchase.
- Similar arrangements apply to the ancillary services markets which prevent the supply of electricity being unbundled from the non-energy services, such as ancillary services.
- The option to consider is the creation of a new category of Market Participant to overcome issues associated with having to bundle services.

EnerNOC presentation: Dr Paul Troughton from EnerNoc gave a presentation on a new model for demand side bidding into the wholesale market. The presentation covered the following points:

- A suitable model for demand side bidding in the NEM should incorporate the following principles:
    - Acts like a peaking generator and receives the spot price;

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    - Separately contestable service that is unbundled from retail contracts. Further the retailer should be unaffected by the demand response actions and should be neither worse or better off.
- Such a model would calculate the amount of demand side response delivered by comparing the end-use consumer's baseline consumption with their actual metered consumption.
- Each party involved in the arrangement continues to fulfil their financial liabilities (retailer to the spot market, end-use consumer to the retailer). The market operator then pays the demand response provider the spot price determined during the demand response interval by the deemed demand response quantity.
- The baseline model used to calculate the end-users consumption should be designed to ensure accuracy, simplicity and integrity. Responsibility for calculating the baseline may rest with the market operator, meter data agents or the demand response providers.
- For the model to be implemented, new obligations would be needed on AEMO and retailers plus potentially a new category of market participant. Most of the work will be in developing the baseline consumption methodology.
- The benefits of this model is that it is easily amenable to current market arrangements. In the longer term unbundling electricity services from demand response services will drive competition and investment in DSP.

SRG member feedback: SRG members made the following points in response to both presentations:

- Some members thought that model implementation from a settlement point of view will require relatively straight forward amendments to the rules. Specifically, assigning category 7 type meters to demand response providers may be useful in this context. The rules almost allow demand response to occur now.
- Some discussion on how the model could lead to a pool of DR resources which could also be used for network DSP programs.
- Some discussion on whether it will be necessary for the DR resources to be scheduled or non-scheduled or both.
- For such a model accuracy is paramount in determining an end-use consumers' baseline consumption.
- Some participants noted that this model solves a number of supply chain issues, especially those relating to implementing cost-reflective pricing such as "critical peak pricing". Under the model, a DNSP would buy the required load reduction from the demand side response aggregator.
- In the longer term the model is likely to benefit retailers and the consumer market more generally as it will act to reduce the peak spot price for electricity in the wholesale market. For retailers, a reduction in the spot price reduces the cost of their hedges in the financial markets.

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Session 3: Supply chain interactions

AEMC staff gave a presentation on supply chain interactions, and in particular, whether cost reflective pricing is a strong enough signal to coordinate the different market participants, or whether other tools for coordination are required. The following points were made:

- To what extent will cost reflective price signals align the interest of parties so as to package up a "product" which consumers see value and will take up the DSP option?
- What suite and alternative solution made be needed in the absence of full cost reflective price signals?
- Some constraints on achieving coordination is the complementarity of commercial drivers between network and retail businesses.
- There is a broader issue of trying to achieve coordination in the face of differing network and system peaks. This issue is further complicated as the share of intermittent wind generation increases. Under this circumstance, peak energy prices will be driven by demand (net of wind), while peak energy flows will be driven by demand.
- Improving coordination across the supply chain can occur incrementally and through incentives, or through more fundamental regulatory mechanisms.

SRG member feedback: SRG members made the following points in response to both presentations:

- For the purpose of providing a regulatory incentive to undertake DSP, it is difficult to measure the impact of a 1MW peak load reduction on network investment (i.e. may not translate to a 1MW reduction in network investment).
- Some members noted that aligning incentives and setting up the right conditions for DSP was an important first step before considering more fundamental reform.
- There was consensus around needing to flesh out what is meant by cost-reflective pricing, and whether it can deliver efficient DSP outcomes.
- Some members noted that cost-reflective pricing will have some behavioural influence that will impact on maximum demand. Others considered that exposure to network tariffs will provide a meaningful signal to provide DSP solutions. Cost reflectivity from retailers only represents a portion of this peak demand cost drivers.
- When considering supply chain interactions, policy makers should be very clear as to who they consider to be the buyers and proponents of DSP. Driving change by regulation rather than market based incentives may result in a mixture of outcomes.

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- There needs to be a clear focus on the role that commercial and industrial end-use consumers can play in DSP. Also could be value in assessing how the appliance stock in residentials is changing and what this will mean for future peak demand.

Concluding comments from the Chair

- The Chair reiterated that the review was now moving into the solutions phase, and that the feedback from SRG members and stakeholders to date has been beneficial.
- The Chair noted that the AEMC staff will now focus on narrowing and refining policy options, as well as preparing the draft report. The Chair encouraged stakeholders to continue to discuss the issues and solutions with AEMC staff through the current and next phase of the review.