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Mr Eamonn Corrigan
Australian Energy Market Commission
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4 May 2012

Dear Eamonn,

Directions Paper: Demand Side Participation Review

TRUenergy welcomes the opportunity to provide the following comments in relation to the Australian Energy Market Commission's consultation on the Directions Paper: "Power of Choice – giving consumers options in the way they use electricity".

TRUenergy has a portfolio of approximately $8 billion of generation and retail assets and employs around 1,600 employees and contractors through major operational partnerships across South East Australia. TRUenergy provides gas and electricity to approximately 2.8 million household and business accounts in New South Wales, Victoria, South Australia, Queensland and the ACT.

Overview

TRUenergy agrees with the AEMC that demand side participation (DSP) can provide to benefits to customers but believes there are a number of barriers to these being realised. As such, TRUenergy considers that DSP is unlikely to be delivered simply and will be an iterative process over a number of years. One of the specific issues with the delivery of DSP currently is the significant political focus on keeping energy prices low and the belief that DSP will reduce the impact of higher tariffs for household customers. Unfortunately this sentiment is misguided as it fails to realise that prices may need to rise throughout the day, and even though customers are spending more on energy than they were in previous, it remains a low interest product and therefore customer participation is likely to be low without financial incentives and consumer education.

Price signals represent an important tool for retailers to incentivise customers to reduce their consumption during peak periods. TRUenergy maintains that price regulation remains an impediment to the development of DSP to the mass market as it inhibits competition and stifles innovation. Along with price signals, smart meters represent an important enabling technology for greater DSP by allowing retailers to offer adjust the price of electricity across the day to account for

peak periods and through devises such as in home displays provide customers with visibility of their usage. Given the large number of meters which have been deployed in Victoria, New South Wales and Queensland they currently represent the most practical method of wide scale DSP. However, it is important to recognise that smart metering without comprehensive consumer education is unlikely to achieve significant DSP. TRUenergy believes that further customer education about smart metering would help reduce some of the privacy, accuracy and safety concerns which some customers have been raised by customers where smart meters are rolled out.

TRUenergy believes in order to maximise the benefit of smart meters they must be deployed in a manner which supports competition and customer choice. Simply allocating parts of the markets to distribution business to install smart metering is unlikely to result in the most cost effective roll-out and may restrict product innovation and customer choice which will encourage greater DSP.

Likewise in the wholesale market, the delivery of DSP is complex and requires significant coordination in order to deliver a financial benefit. TRUenergy would caution the AEMC in recommending any amendments to the rules to facilitate specific DSP initiatives, and believes such reforms to the NEM should be progressed outside the scope of this review.

Background

The National Electricity Market (NEM) is intended to provide a framework to support a competitive market based on tensions between the demand and supply side to produce efficient prices.

Historically, relative cost structures in the industry have meant it has been more efficient to develop new generation, transmission and distribution capacity, than to develop demand side solutions.
As a consequence investment in demand side participation has not been viable in most instances.

The historical focus on supply side solutions may now be changing due to the increasing cost of fuels, the impact of carbon pricing and the exhaustion of excess capacity in the grid causing increasing cost to meet peak demand.

The increasing costs for both energy (GWh) and capacity (MW) are coalescing into higher energy bills for consumers. We note that this is focusing the political lens on rising energy prices in relation to increasing cost of living pressures, forcing governments to investigate options to assist small customers to reduce their consumption. In those markets where prices are regulated, there is an added pressure on these governments to demonstrate how they are reigning in the industry and keeping prices low. While price regulation may be perceived to assisting the needs of the consumer in such circumstances, it remains a fundamental impediment to wide scale DSP, as it stifles product innovation, such as critical peak pricing and other time of use tariffs. Furthermore, the incentive to keep prices low and retain tight regulatory controls on retail pricing and tariff options creates winners and losers. Customers who are prepared to commit to behavioural changes that support energy efficiency outcomes and peak demand reduction are not rewarded for doing so and in turn subsidise customers who are not prepared to make behavioural changes.

Value of reliability

Customers derive benefit from utilising energy consumption. Several questions now arise in the context of higher prices: Does the cost paid now exceed the derived benefits for each customer? Are demand side options now becoming more competitive than supply side approaches to meeting future energy needs? One of the key challenges from our internal projects on developing demand side options is how to commercialise the options. This is partly due to the very high value of lost load experienced by customers, as noted in the Direction paper. The value of foregoing consumption simply does not equate to any financial upside.

Customers have the ability to maximise the utility of their consumption subject to minimising cost. For some customers, potentially larger industrial and commercial sites, there may be value in participating in demand side. Ensuring that these customers effectively participate by making informed choices is a crucial component of a competitive electricity market.

Role of competitive markets and stable regulatory environment

The key is to provide a competitive electricity market for both the wholesale and retail elements. While regulated retail prices and terms deliver controlled lower prices in the short term, to ensure long-term benefits it is essential that market structures support development of strong retail competition to drive improvements in efficiency and innovation, leading ultimately to retail price deregulation.

Demand side solutions are examples of exactly the type of innovation a competitive and deregulated market that can rapidly respond to technology development can be expected to deliver.

Along with a de-regulated retail environment, a stable and consistent set of regulatory requirements is another key requirement to support demand side innovation. While in some cases regulatory intervention may be justifiable to address a proven market failure, such measures should only be considered after the full identification of the costs and benefits of the interventions and any associated wealth transfers have been clearly quantified.

In this area the subject of ongoing technology and commercial development such as the evolution of the demand side solutions, it is incumbent on regulators and government to avoid picking "winner and loser" technologies. For example, the introduction of Feed in Tariffs(FiTs) and the Small Scale Renewable Energy Scheme(SRES) has encouraged the installation of domestic solar photo voltaic panels. However this technology has not come without a number of significant costs, not just in terms of financing both the FiTs, but the impact on the network where there has been significant installation of solar panels and the boom/bust effect on solar businesses.

Such strategies run the risk of further delaying future beneficial solutions by reducing incentives for investment in innovation.

Role of the Retailer

Retailers play an important role in the market by providing intermediation between end use consumers and the wholesale market. A significant benefit they provide is the taking of spot market risk for end use consumers along with meeting market obligations including credit risk and transaction costs that would be a significant impost that consumer would otherwise have to bear to participate in the market. In exchange for the risk of intermediation retailers earn a return; which is a function of how efficiently they manage the issues above (amongst others). Some large customers may find it more efficient to participate directly. There are cases where some customers are willing to take partial or full spot price pass through. In these instances there still remains a role for a retailer to manage the other market transaction and operational costs.

Our concern is that other parties seek to reduce the benefits that a retailer gains from providing market intermediation yet leave the retailer with some of the risks and costs that being a market participant imposes. Any new participant category should be required to comply with the Rules (as per any other participant) and not impose any costs on existing participants (especially transaction costs), or is used to avoid consumer protection mechanisms in the NERR (National Electricity Retailer Rules).

The AEMC discussed a range of solutions that would seek to provide price certainty and concluded that options such as a day-ahead market would impose significant costs on the entire industry. It was also concluded that short term financial products would provide similar benefits without the costs.

Smart Meter, Time of Use, and Critical Peak Pricing

TRUenergy supports the roll-out of smart metering to facilitate DSP but believes that only way to fully capture the benefits of the technology is to implement them in way which supports competition and customer choice. TRUenergy does not endorse the approach adopted in Victoria to roll them out via the distributor in a non-contestable environment, because it fails to recognise the needs of the customer and is unlikely to result in a least cost approach.

While smart metering alone does have the potential to provide customer with greater information about their consumption through technology such as in home displays, it is important to recognise that they are unlikely to substantially shift consumer behaviour without time of use pricing and consumer educaiton. While there are States which as part of their retail price determination currently set a time of use tariff, given such prices are determined via an artificial process they are unlikely to have a significant impact on changing behaviour. As such, TRUenergy would maintain the abolishing of retail price regulation is a necessary step toward improving the uptake of DSP.

Encouraging Customer Participation in DSP

Customer interest represents a key barrier to DSP. As demonstrated in the AEMC Effectiveness of Competition Reviews energy remains a low interest product within most households and therefore it important to recognise that unless the motivations of customers are fully understood the uptake of DSP may be minimal.

TRUenergy would therefore draw the AEMC's attention to the Office of Gas and Electricity Markets in the UK which undertook an investigation into the decision making process of energy customers. In the 'What can Behavioural Economics say about GB energy consumers?' it identifies the following behaviours[1]:

- Limited consumer capacity
- Status quo bias
- Loss aversion
- Time inconsistency

In light of this report TRUenergy strongly believes consumer education represent an important step to improving DSP. As has been shown with the various roll-out of smart meters around the world the lack of customer understanding about why the meters are being installed has resulted in many customer being distrustful of the technology eventhough they may actually be no worse off or even better off if they had one installed.

Current Wholesale Market Design

We agree with the AEMC's view that major energy market reforms are out-of scope nature and believe these debates, if needed, should focus on overall market outcomes and not specific measures to support DSP.

Furthermore we agree with the AEMC views on other measures that simply seek to cross subsidise and increase complexity are not desirable; ultimately these measures are in effect an externality that undermines the efficient operation of the market.

[1] OFGEM, 'What can Behavioural Economics say about GB energy consumers?' (London 2011), p5

We would also like to note the similarity between DSP and peaking power stations in their effect on the market. Both seek to provide response at high market prices and can be used to place downward price pressure. Both carry similar risks in that they need to be available and respond during high price events and that they also carry a level of sunk-capital costs that need to be recovered in an energy only market. Therefore when assessing obligations and options for DSP, a reasonable counterfactual would assess those same obligations and options for a small peaking power station.

One factor that DSP needs are higher market prices in order to provide the incentive for consumers (or their agents) to react. The failure of DSP to gain traction in the wholesale market is a reflection that prices in the wholesale market are not at levels to provide the incentives for DSP.

The sale of DSP in the financial markets as a call option is possible; it bears the same reward/risk profile that peaking generators face in the market. The revenue from the option premium does provide a steady revenue stream to the seller. A major risk to the sellers of these products is the inability to provide the physical response to offset the financial product when it is needed; thereby leaving them exposed to high spot market prices.

Additionally it would appear that the availability of current financial products are considerably cheaper and provided higher levels of reliability compared to the often non-firm DSP options. In plain English it is cheaper for a participant to purchase a cap or option product to manage high price risk than to invest directly in a DSP solution. This is appropriate as one of the functions of financial markets is to transfer risk to parties better able to manage those risk. In the current environment it would appear that supply side options are more efficient that demand side options – resulting in lower overall costs to consumers.

In any case the Rules should be neutral between demand and supply side to maximise long term customer benefits under the National Electricity Objective (NEO).

TRUenergy thanks AEMC for the opportunity to provide a submission in relation to the Directions paper. Please feel free to contact me on (03) 8628 1185 should you wish to further discuss this submission.

Yours Sincerely,

Alastair Phillips
Regulatory Manager
TRUenergy