Energy Retailers Association of Australia Incorporated

20 June 2008

Dr John Tamblyn
Chairman
Australian Energy Market Commission
PO Box A2449
SOUTH SYDNEY NSW 1235

By email: submissions@aemc.com.au

Dear Dr Tamblyn,

Review of demand-side participation in the National Electricity Market – Issues Paper

The Energy Retailers Association of Australia (ERAA)[1] is pleased to have the opportunity to comment on the issues paper related to the Review of demand-side participation in the National Electricity Market (NEM).

Our comments on the issues paper focus on areas that we see as primarily impacting on retailers. We address them under the headings provided in the issues paper summary as follows.

The Structure and Components of tariffs may not provide customers with efficient signals about electricity use

If efficient demand side management is to be achieved, it is essential that cost reflective pricing is allowed to reach the consumer. Network tariffs around the NEM attempt to implement various degrees of reflectivity – which is consistent with efficient demand management.

However for many small customers around the NEM, these signals are removed by the ongoing imposition of retail price caps by jurisdictions. In order for full demand side efficiency to emerge it is important that these regulated price caps are eliminated and the market can move to competitively determined tariffs.

[1] The ERAA is an independent association representing twelve retailers of electricity and gas throughout the National Electricity Market **(NEM)** and the jurisdictional gas markets. ERAA members collectively provide electricity to 11 million customers in the NEM and are the first point of contact for end use customers for both gas and electricity.

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The regulatory test threshold may be limiting the ability for alternatives to smaller network augmentations to be considered.

The need for improved transparency around network business operations, particularly in areas that impact on the competitive market, has been a consistent theme in our submissions over recent years. We support investigation over whether current information provision for small projects is as effective as it could be.

In our recent submission related to changing regulatory test thresholds, we expressed a view that these thresholds should not be increased, precisely as they are a key point at which market solutions (both supply and demand) to network needs can be injected into the planning process. While we remain of this view under existing arrangements, we note that there may be value in further exploring if this is the best means of identifying market based options, or if other approaches may be even more effective – particularly for network augmentations below of lower value. (This position is not held by Ergon Energy or Energy Australia – see ERAA submission on ETNOF Rule change proposal.)

Arrangements for avoided TUOS and DUOS may under / over value demand management options

As a matter of principle, the ERAA supports the idea of providing access to avoided TUOS and DUOS to market based (supply / or demand side) investments that create network investment deferral benefits.

We note that the current implementation of this principle actually only provides a benefit where the use of the existing transmission network is reduced and not where actual transmission investment is deferred. This means that no true benefit exists for the TNSP and also can result in the benefits to the embedded generator or DSR provider being only transitory in nature. In some cases, such as SA, the benefit is not available at all since the TNSP charging is based on forecast not actual demand.

The issues paper notes further problems, such as potential double payments, and that distributors are not making benefits available because of this risk.

The ERAA therefore considers that an implementation needs to be found that allows demand side or supply side providers to set up a bankable revenue stream that reflects the full amount of cost savings related to deferred investment. The review should explore this area.

Wholesale market processes may exclude potential demand-side resources from efficiently participating

This issue deals with costs of direct NEM participation. ERAA members believe that general principles that should be considered here include:

- Competitive neutrality – demand and supply resources should face the same requirements for participating in the NEM.

- Participation costs should be as low as possible to minimise entry barriers.

With this in mind it would be appropriate to reviewing all costs imposed on NEM participants (supply or demand), and size thresholds related to when these costs increase. Such a review could aim to review if the basis on which these costs and thresholds where determines remains current.

While such a review may reduce costs for direct participation in some cases, the ERAA notes that in most instances the costs of direct participation (as opposed to indirect participation through a retailer or other intermediary) will continue to outweigh the benefits.

The costs of involvement in the wholesale market and in financial contracting may be unnecessarily high

In our view, the transaction costs of direct market participation are likely to remain uncompetitive for smaller participants, even if set up cost and registration fees could be completely eliminated. For customers who can offer a degree of demand management, bi-lateral arrangements with retailers or other intermediaries are likely to remain the most attractive route to monetising their capability.

Retailers, and other intermediaries, who manage broad portfolios of customers and wholesale market positions, are often in a far better position to be able to deal with the often severely limited performance capabilities of demand side options, than NEMMCO could ever be.

By its nature NEMMCO is an exchange that manages a high volume of standardised transactions. To the extent that a demand side proponent is not able to meet this standard transaction form, then they will be unable to participate in the NEM.

Attempting to introduce less standardised products into the NEMMCO exchange would be likely to undermine the efficiencies that the standardisation produces. Therefore we do not see benefit in further exploration of options of this nature.

In contrast to this, when dealing with a retailer (or other intermediary), customers are able to specifically tailor an agreement to meet their needs. This overcomes the lack of standardisation mentioned above. A second benefit is that this process allows a market value for the specifically tailored service to be determined. As the unregulated retail market is highly competitive, customers can seek a wide range of offers for demand services that they can provide. This process allows any non-standardisation, lack of firmness, time delays or other limitations to be priced.

Buyers of such demand side service can then establish the fit of the offer to their portfolios, and establish the value in the wholesale contract market that the customer contract would add. This mechanism is the way in which non-standard market services are converted to wholesale market products.

In conclusion, the ERAA believes the current arrangement appropriately strikes the balance between exchange efficiency and ability to monetise non-standard demand side products.

Demand side participants may not be adequately compensated for providing a demand-side response

The key way in which the NEM rewards the demand side, is through avoided costs (ie. Customers don't have to pay for what they don't take).

However as described in the section above, the secondary market does provide a mechanism for customers with demand side capabilities to monetise the flexibility they offer.

If a particular demand side option is not worth pursuing under these two value propositions, then that option is not competitive against supply or other options being exploited by the market. This does not indicate a market failure; on the contrary it indicates that the market has succeeded in identifying more competitive options. In the absence of market failure, it is not clear why more regulation in this area would be justified.

The issues paper raises options such as increasing Voll, or introducing uplift payments to provide additional incentives for demand participation.

While ERAA members have a range of views on where Voll should be set, we are all of the view that this question should be dealt with via the regular Voll review process, and not through the current demand-side review.

On the issue of uplift payments, retailers are united in their opposition. By their nature uplift payments are not hedgeable by retailers. Where retail price caps are in force, these payments are not recoverable by retailers. For customers not subject to regulated pricing, these costs will be invariably passed through. In either case the outcome is a wealth transfer which could only make sense if overall efficiency was improved. We see no evidence that efficiency would improve by the implementation of such an uplift.

The ERAA does not support further work on either of these two proposed options.

The use of short term emergency Reserve Trader may not facilitate the development and use of efficient demand-side participation for reliability

On this matter the issues paper suggests that a longer reserve trader may help facilitate demand side response.

At a fundamental level, this proposition is not compatible with the NEM design. The reserve trader is by definition a back up plan – and not the primary trigger for long term NEM investment. The real mechanism for NEM investment is the wholesale contract market, which allows proponents to lock in sufficient future revenues to underwrite their investment.

On this basis, the ERAA does not see value in extending the reserve trader mechanism. Rather, the issue to be addressed here is ensuring that the demand-side proponents are able to access the wholesale market over the long term. As this market is unregulated (and should stay that way), we doubt there is anything this review will be able to do in this regard. One exception may be if the review can facilitate a better understanding of how the NEM (and its secondary market) operate to facilitate investment, and how retailers and other intermediaries can act to help demand-side proponents access this contract market.

The use of reserves may not allow demand-side participants to obtain fair market value for their services

The point raised here in the issue paper appears to explore the issue of whether the reserve trader mechanism itself is a barrier to demand-side participation.

This is an interesting point, as it appears to recognise that the presence of a reserve trader may encourage some participants to avoid contracting for sufficient capacity on the assumption that a market invention may occur at lower cost to the retailer.

Broadly the ERAA is not a supporter of the reserve trader mechanism, and believes the market reliability settings should be set at levels that incentivise sufficient investment to ensure reliability. However as with the proposal to alter Voll, we think this issue has recently been dealt with through the review into reliability review mechanisms – and further exploration through this demand side review is not desirable.

Should you require any further information in relation to this matter please feel free to contact me on (02) 9437 6180.

Yours sincerely

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