



Submission to the Australian Energy Market Commission

Demand Management Incentive Scheme rule
change request

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About CHOICE

Set up by consumers for consumers, CHOICE is the consumer advocate that provides Australians with information and advice, free from commercial bias. By mobilising Australia's largest and loudest consumer movement, CHOICE fights to hold industry and government accountable and achieve real change on the issues that matter most.

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Introduction

CHOICE is very pleased to offer this submission in support of the Demand Management Incentive Scheme Rule Change as proposed by the COAG Energy Council and the Total Environment Centre. We see this rule change as a rare opportunity to make a major reform for a more affordable electricity industry that better serves the medium and long term interests of Australian energy consumers.

Electricity is an essential service and constitutes a significant share of the household budget. For this reason, CHOICE has for decades advocated for consumer friendly electricity.

Unfortunately, the National Electricity Market (NEM) has recently not served consumers well. Electricity prices have more than doubled in nominal terms between 2007 and 2014 and this has had a major adverse impact on consumers' bills. Much of the responsibility for this pressure on electricity consumers can be attributed to deficient National Electricity Rules and to poor regulations.

To its credit, the AEMC has recognised many of these deficiencies and has sought to address them. One of the key flaws in the NEM has been the neglect of the potential for cost effective Demand Management (DM). CHOICE supports the AEMC's conclusions in its 2012 Power of Choice Report that DM needs to be taken seriously by the AER and the network service providers (NSPs). CHOICE therefore endorses the AEMC's recommended Rule change to strengthen the Demand Management Incentive Scheme (DMIS) and welcomes the proposed DMIS rule changes from the COAG Energy Council and the Total Environment Centre.

DM, a history of neglect

In 1989, the first issue of the Australian National Grid Protocol stated: "*Demand management and renewable energy options are intended to have equal opportunity alongside conventional supply options to satisfy future requirements. Indeed, such options may have advantages in meeting short lead-time requirements...*".

However after more than a decade of relative neglect the 2002 Australian Governments' Independent Review of Energy Market Directions (the Parer Review) found that:

"there is a relatively low demand side involvement in the NEM because:

- the NEM systems are supply side focussed
- the demand side cannot gain the full value of what it brings to the market
- residential consumers do not face price signals."¹

¹ Parer W et al. Towards a truly national and efficient energy market Council of Australian Governments' Independent Review of Energy Market Directions 2002 pg.174

http://www.ret.gov.au/Documents/mce/_documents/FinalReport20December200220050602124631.pdf

In the same year, the NSW Independent Pricing and Regulatory Tribunal's *Inquiry into the Role of Demand Management and Other Options in the Provision of Energy Services* went further.² It said,

"It is the Tribunal's strong view that there is significant untapped potential for efficient demand management. To a large extent, one of the major obstacles continues to be a culture which favours traditional 'build' engineering solutions and which pays little more than lip service to alternative options."

This report was quite explicit in its warnings:

"The Tribunal is very concerned about the potential for substantial increases in capital expenditure and worsening asset utilisation, with adverse consequences for costs faced by end-users. Already, 10 per cent of network capacity is required for less than 1 per cent of the year. This will worsen if demand continues to get peakier and networks have to invest in new network capacity to meet this demand. Potentially massive increases in network expenditure to meet demand growth highlight the importance of getting demand management right."

The primary recommendation of this Inquiry was the establishment of a Demand Management incentive fund.

Unfortunately, these warnings and recommendations and many others from other reports were not heeded and consumers are now suffering the consequences.

Instead, since 2008, the AER has given network businesses strong regulatory incentives to build network infrastructure. The more poles, wires and substations they built, the bigger their "asset base", and the bigger their profits. It is no surprise then, that in the past few years, Australian network business have spent more than ever on network infrastructure, leading to unprecedented electricity prices increases.

The electricity industry is changing rapidly.

The urgency of acting on DM is not just a matter of learning the lessons of history. It is also about responding to current trends and anticipating the challenges of tomorrow. Lights, appliances and buildings are becoming more efficient. Household electricity is trending down. Generation from large, coal fired power stations is declining. Solar power is increasing steadily. Battery energy storage and electric vehicles are expected to become widespread in the near future. In short, centralised power is declining and smarter, more affordable decentralised energy is rising.

This DMIS rule change would give network businesses a chance to work with consumers to respond to these trends and develop new business models and practices to deliver a more affordable energy future.

² IPART, *Inquiry into the Role of Demand Management and Other Options in the Provision of Energy Services: Final Report October 2002*

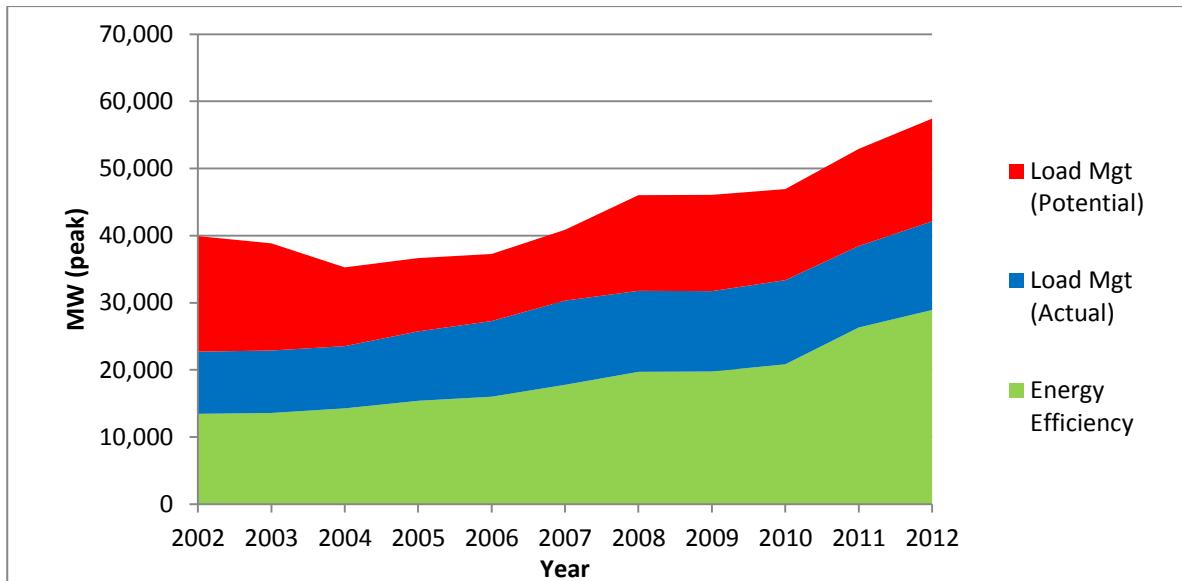
Demand management incentives for network business are crucial

Demand Management is not new. DM, such as in the form of off-peak hot water tariffs, has been practiced in Australia for at least 70 years.

In the United States, as of 2012, utility Demand Management was providing more than 57,000 MW of peak demand capacity, equivalent to meeting 7% of US non-coincident peak demand (see Figure 1). Moreover, it was also providing 139,000 GWh per annum in energy savings, equivalent to 4% of total electricity retail sales. It was doing all of this at an average cost of just (AUD) 5.5 cents per kWh. This compares to an average cost of electricity in Australia of \$27 cents/kWh (excluding GST).

Indeed, it is indicative of the neglect of DM in Australia, that comparable DM data is not even regularly collected and reported in Australia.

Figure 1. Peak Demand reduction provided by DM in the USA³



The above figures are consistent with the findings of research commissioned for the AEMC which estimated the potential consumer savings from DM at between \$4 billion and \$12 billion and bill reductions of between \$120 and \$500 per household per year.

Other examples of demand management include:

- On Queensland's Magnetic Island, network business Ergon Energy has encouraged consumers to install solar panels and smart meters and replace inefficient lights. Peak electricity demand was reduced by 44% and overall energy consumption by 40%. In the process, Ergon Energy has saved millions of dollars by deferring the need to install a new power cable to the island for at least eight years.
- In Southeast Queensland, network business Energex offers the Positive Payback Program which rewards customers for buying and using energy-efficient appliances. More than

³ US Energy Information Administration, *Table 10.2. Demand-Side Management Program Annual Effects by Program*, http://www.eia.gov/electricity/annual/html/epa_10_02.html

40,000 households have connected over 46,000 appliances, like air conditioner and pool pump, to the program. Along with Energex's commercial and industrial Demand Management programs, this has resulted in more than 100 megawatts reduction in Energex's summer peak demand, savings tens of millions of dollars in capital expenditure.

- In New York, the regulator there is supporting local electricity supplier, Consolidated Edison to spend \$200m on batteries and customer energy efficiency and load reduction in order to defer \$1 billion of network upgrades.
- In Ontario, where the Ontario Energy Board has worked with the distribution businesses to set targets for peak demand reduction and energy savings and is providing financial incentives towards meeting and exceeding these DM targets.

There are many other examples around the world but relatively few in Australia.⁴

What if the Rule change is not adopted?

CHOICE is concerned that if the proposed rule change is not adopted, it will send a strong signal to the AER not to provide meaningful incentives for DM. This will mean network businesses will be discouraged from undertaking cost-effective DM to help consumers reduce demand and save energy. Instead network businesses will be encouraged to continue their past practice of building infrastructure and maximising profits from supplying energy.

Fixed charges for network services are likely to be higher and variable charges for energy lower. There will be fewer incentives to support energy efficiency, peak load management and local generation. This will give consumers less control over their energy bills and make energy efficiency, solar PV and batteries less attractive. It will lock Australia into an outmoded, centralised infrastructure regulatory model, just as international technology and market trends towards a decentralised energy are accelerating.

It will also increase the chances of network assets being “stranded” in future, meaning customers and/or shareholders will have to pay for redundant infrastructure.

CHOICE congratulates the AEMC on recommending this rule change. It has the support of consumers with 1,106 CHOICE campaigners taking action within 24 hours in favour of the change.

We strongly encourage you to follow through on this long overdue reform.

⁴ See for example, Crossley, D. 2010, *International Best Practice in Using Energy Efficiency and Demand Management to Support Electricity Networks*. Prepared for the Australian Alliance to Save Energy by Energy Futures Australia.