

28 March 2008



Dr John Tamblyn
Australian Energy Market Commission
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Dear Dr Tamblyn

Response to Review of Demand Side Participation - Stage 1

ENERGEX Limited (ENERGEX) welcomes the opportunity to respond to the review of demand side-participation (DSP) initiated by the Commission and the draft recommendations in the NERA Economic Consulting report *Review of the role of demand side-participation in the National Electricity Market (NEM)*. ENERGEX is providing this response in its capacity as a distribution network service provider (DNSP).

As a general comment, ENERGEX supports the objective of the Commission to identify and remove impediments to achieving efficient DSP. ENERGEX recently responded to the Commission's consultation on the Total Environment Centre's (TEC) proposed rule change and welcomes the Commission's decision to incorporate the consideration of the TEC proposal as part of its wider review of DSP.

What is DSP?

ENERGEX submits that as part of its wider review of DSP that the Commission must be conscious of the different terminology and interpretations that are employed with respect to DSP and demand management and that any Rule change should ensure clear definitions. In the TEC proposal the term 'demand management' referred to demand response, demand side management, demand side response, energy efficiency and non-network solutions. In response to the TEC proposal, ENERGEX argued that this broad categorisation fails to address the most practical solutions required for network constraint problems.

In the NERA report it refers to DSP encompassing actions that might be taken by consumers with the purpose of changing the quantity and timing of their electricity use to deliver both network and wholesale market benefits. However, the wholesale and network interests are not always aligned and demand management activities can be implemented for network, retail or environmental purposes.

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Again stressing that ENERGEX supports the objectives of the Commission for efficient DSP, the structure of the Australian electricity industry with separation between the functions of supply and delivery of electricity (eg the industry is not vertically integrated) means that the 'value of the supply' and 'value of delivery' will also be separate.

Recommendation 1

The Commission must be clear and consistent with definitions and terminology, including the terms demand-side participation, demand management, demand response, demand-side management, energy efficiency and non-network solutions.

Recommendation 2

The Commission must reflect the industry structure separation between the functions of supply of electricity and delivery of electricity. This is particularly important in 'reflecting the value' with regard to quantity and timing of energy consumption.

Electricity Delivery Service Standards and Risk Management

In the NERA report it states that for DSP to be a viable alternative, its characteristics must allow it to be either entirely or partially substitutable for a network investment, to allow the network service provider to rely upon the DSP to satisfy its system reliability requirements.

Importantly, as previously expressed in its TEC response, ENERGEX has concerns that the risks associated with a non-network solution for maintaining system reliability will differ from a network investment and as such DNSPs will be responsible to mitigate the risks which may impact on our ability to meet minimum service standard expectations. There is also the question on how DNSPs will be compensated where asset stranding occurs due to demand management solutions.

Recommendation 3

The Commission must recognise the risks associated with maintaining system reliability and the system reliability risk has a value to all customers. As system reliability risks will remain with the network service providers, so must the value attributed to managing those risks.

Electricity Pricing

The NERA report recommends that for electricity use to be efficient, customers should face the marginal network and generation costs of providing electricity services to them. Customers will then make judgements about whether and how much electricity to consume based on the value obtained relative to its cost.

The definition of DSP and the principles of efficient electricity use outlined in the NERA report are dependent on changing the current pricing tariffs that are charged to consumers ("postage-stamp" network prices) as well as the introduction of smart meters to allow customers to receive pricing signals that better reflect fluctuations in wholesale market prices.

ENERGEX submits that while removing regulatory constraints to efficient pricing is the first step, the process is dependent on retailers passing through cost-reflective price signals. ENERGEX believes that there are other appropriate mechanisms for encouraging optimal DSP for domestic small end-use customers such as promoting the use of direct load control and associated tariffs.

Recommendation 4

The Commission must recognise that wholesale market and network price signals are dependent on retailers passing through cost-reflective price signals.

Recommendation 5

The Commission investigate other mechanisms for encouraging DSP such as promoting the use of direct load control and associated tariffs.

Network Planning and Investment

NERA recommends that network service providers be required to seek information from demand side proponents on an annual basis on potential non-network solutions to emerging network constraints, outside of the application of the regulatory investment test.

ENERGEX disagrees with the comment made by NERA as to why network service providers have difficulties in properly evaluating non-network options. In particular, ENERGEX as a DNSP does have a direct physical connection as well as a contractual relationship with its 1.2 million end-use customers and is currently engaging with some of these customers in its 'Cool Change' air-conditioning direct load control project.

In addition, the absence of incentives to consider non-network options is not due to the absence of competition in the provision of network services but rather as a result of the absence of a market for non-network solutions as well as the current regulatory regime, which does not treat the costs of implementing non-network solutions the same as network solutions.

NERA has suggested that in order to enhance information provision, network service providers should publish sufficient information on likely network augmentations with adequate time to allow demand side proponents to identify opportunities.

However, in accordance with the clause 2.3 of the Queensland *Electricity Industry Code*, ENERGEX is required to prepare and publish an Annual Network Management Plan (ANMP), which details how ENERGEX will manage and develop its supply network to deliver an adequate, economic, reliable and safe connection and supply of electricity to its customers over the next five years. ENERGEX must include in its ANMP its demand management strategy, including its existing and planned programs and opportunities for DSP.

Recommendation 6

The Commission should disregard some of the comments by NERA as to why network service providers have difficulty evaluating non-network options.

Regulatory Investment Test

NERA has recommended that to facilitate DSP the regulatory investment test should:

- ensure that the timeframe over which DSP options are required to be presented as alternatives to a network solution is sufficient to allow these options to be considered viable;
- clearly define how 'wider national benefits' should be interpreted for non-network options;
- use risk-adjusted costs and benefits to take into account differences in risk between alternative options; and
- define an option-value benefit associated with an investment that defers a proposed network investment.

ENERGEX has concerns that these recommendations will lead to a reversal of the current perceived bias and believes that any reforms to the regulatory investment test should allow DNSPs to consider network and non-network options on an equal basis and where possible, to take into account each solution's risk profile.

Compared to transmission, there are a larger number of distribution projects driven generally by demand growth, reliability and asset replacement requirements. The first NERA recommendation would make application of the regulatory investment test for DNSPs an onerous requirement given the shorter planning horizon, lack of economically viable alternative options and volume of projects undertaken.

Recommendation 7

The Regulatory Investment Test should provide for both network and non-network options to be considered on an equal basis, allowing each solution's risk profile to be factored.

Recommendation 8

The Commission should take into consideration the specific planning environment and volume of projects undertaken by DNSPs when applying the regulatory investment test to DNSPs.

Summary

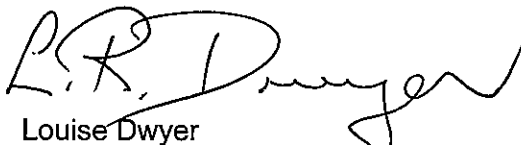
ENERGEX strongly supports the principles and recommendations made by the Energy Networks Association (ENA) in their recently released 'Demand Management – Regulatory and Policy Framework' document.

ENERGEX generally agrees that there are barriers or disincentives for DNSPs within the Rules which are inhibiting DSP in the NEM. Of particular concern for ENERGEX as a DNSP is the ability to identify and manage the reliability risk of non-network investments and the potential corresponding detrimental impact to minimum service standards and customer service. There is also the uncertain regulatory treatment of non-network solutions that defer capital expenditure.

ENERGEX agrees that cost-reflective pricing would improve customer awareness of the true cost of supply and provide the incentive for customers to participate in demand management initiatives. However, ENERGEX is also concerned about the financial impact on customers and believes that education and the promotion of direct load control should be the first steps.

ENERGEX looks forward to participating in the Commission's future reviews of DSP and should you have any questions regarding our response please do not hesitate to contact me directly on (07) 3407 4161.

Yours sincerely



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