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Dr John Tamblyn
Chairman
Australian Energy Market Commission
PO Box A2449
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Ref: 237698
Your Ref: N/A
Contact: Franc Cavoli
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Dear John

Re: Review of the role of demand side participation in the National Electricity Market

Thank you for the opportunity to respond to the Australian Energy Market Commission ("AEMC") in relation to its review of the role of demand side participation in the NEM ("Review") conducted by NERA in its Draft Report dated 20 February 2008 ("Draft Report"). VENCORP sets out its comments in relation to the Review and the recommendations proposed in the Draft Report. In general, VENCORP supports measures that encourage Demand Side Response ("DSR") for the reason that DSR has the potential to avoid or defer potentially costly network solutions.

1. Publication of certain information

(a) Seek information from DSR proponents on an annual basis

VENCORP agrees with the recommendation that NSPs seek information from demand side proponents for non-network solutions (presumably including DSR) on an annual basis outside the regulatory test process. We assume that in the case of TNSPs, the constraint information would be described in the TNSP's Annual Planning Report ("APR").

(b) Transfer capability data

NERA recommended that the national transmission planning function of the AEMO, develop a methodology for the inclusion of DSR within expected load forecasts by exit point published in the NTNDP (National Transmission Network Development Plan). VENCORP concurs with the suggested role of the AEMO in this recommendation but contends that load forecasts of themselves will not be sufficient to allow a potential DSR provider to make an assessment in relation to a potential service even if it is broken down by exit point. In addition to transfer capability at each exit point, if information is to be of any use:

- the AEMO would need to prepare data that is forward looking, identify areas of congestion (including near congestion) and estimate the amount of DSR needed and the timing of when the DSR would be required;



- the AEMO would also need to obtain standing offers to assess the viability of DSR in terms of those offers; and
- if the above cannot be achieved, DSR should be assessed on an augmentation case by case basis through the Request for Information ("RFI") process.

2. The RFI and the reliability limb of the Regulatory Test

We note that NERA affirmed the use of the RFI process in disseminating and obtaining DSR information from potential providers. VENCORP has already raised the view that there is an inconsistency relating to the application of the RFI when it responded to the Total Environment Centre's Rule Change Proposal. In its submission, VENCORP pointed out that a TNSP that uses the reliability limb of the Regulatory Test for a proposed augmentation has no obligation to issue a RFI.

In VENCORP's view, restricting the application of the RFI process to the market benefits limb of the regulatory test represents a limitation in the regulatory test's ability to select the optimal solution for a given constraint both in terms of type of solution (network or non-network) and timing. Having said this, VENCORP believes that if the new Regulatory Investment Test ("RIT") proceeds as proposed, and the existing regulatory test limbs are combined, then the RFI process should apply to all augmentations requiring RIT justification.

None of this is to say that DSR information should not also be made available in each TNSP's APR (or eventually made available in the NTNDP as proposed). There is certainly a place for such information and indeed the type of information would necessarily be different from that obtained by a RFI. However, by the time the regulatory test is applied to a particular augmentation, the scope of the constraint, its location and its proposed solution is much more clearly defined and the solutions' scope much more detailed such that a potential DSR provider is in a much better position to be able to formulate an appropriate DSR solution. Accordingly, the RFI is a superior tool for determining the scope of the eventual proposed non-network solution.

3. The Regulatory Test and its application to DSR options

NERA proposes that in applying the regulatory test to DSR and its alternatives, the option that has the highest net benefit or least negative net market benefit should be the successful option. Where a TNSP relies on the reliability limb to justify an augmentation, this type of analysis could still be effected by using the market benefits limb test setting market benefits for all options to zero and in the case of the DSP option, adding the market benefits of DSR while subtracting its costs. The option with the least negative net market benefit is the successful option.

This approach seems to have picked up on discussions in relation to the AEMO's national transmission planning function and the RIT where there is an existing proposal to adopt the current market benefits test provided that if there is a statutory obligation to comply by with certain standards by a particular date, the statutory obligation would dictate the timing of the option over any timing outcome determined by the RIT.

VENCORP believes that NERA's interpretation of the RIT is inaccurate. In VENCORP's view, the new RIT would be developed so that a market benefit is calculated for all options regardless of whether it is a network option or otherwise. However, if statutory requirements dictate a particular implementation date of the best option, then the statutory requirement prevails. Table 1 details a worked example based upon NERA's example.



Table 1:

Options	Cost	Statutorily mandated build date to address constraint
Option 1 - Network	\$500m	2010
Option 2 - DSR	\$100m	2010

Scenario 1	Capital cost	Market benefit	Net market benefit
1	-500	400	-100
2	-100	50	-50

Scenario 2	Capital cost	Market benefit	Net market benefit
1	-500	450	-50
2	-100	40	-60

VENCORP believes that the RIT requires a market benefit to be calculated for all options. In applying the RIT, market benefits should be set to a reasonable assessment of the benefits that each option is likely to contribute to the market (e.g. avoided unserved energy or deferred generation) and subtracting the costs of the option. In the example in Table 1, for given capital costs of implementing a network option and a DSR option, market benefits of each option is varied in each scenario (scenarios 1 and 2). In both scenarios, the market benefits of the network option is greater than that achievable by DSR. The statutory requirement to address a constraint dictates the implementation date and not the point at which the RIT shows a positive net market benefit (as would be the case if there were no statutory obligation) and therefore the option with the least negative net market benefit would be the successful option in each scenario.

In the above example, the statutory obligation to address a constraint by 2010 dictates that in scenario 1, option 2 (DSR) with the least net negative market benefit at 2010 would be the successful one. In scenario 2, option 1 (network) would be successful. Accordingly, the correct result can be achieved without having to set market benefits to zero as NERA has suggested.

4. DSR driven by direct exposure to transmission costs

NERA commented that greater direct exposure to transmission pricing (as the new pricing rules have provided) have improved pricing signals for use of the transmission network. While VENCORP agrees with the new pricing rules and shift to more locational pricing, it believes that the effectiveness of locational pricing in transmission can tend to be overstated.

Transmission costs are relatively stable and represent approximately 10% of the total costs to consumers. At this low rate of contribution to end use electricity prices, the cost of an augmentation would need to be extremely large before there is any perceptible difference in the end electricity cost let alone one that would cause consumers to change behaviour in order to avoid the augmentation.



In conclusion, VENCORP believes that as a tool to raise efficiency in relation to where investments are made on the network, locational pricing is an appropriate tool. However, as a tool to encourage DSR, it has some shortcomings.

5. Other comments

VENCORP at this stage has no comments to make on the balance of the recommendations made in the Draft Report until they are fleshed out in greater detail. VENCORP reserves its right to disagree or make further comments and representations in respect of them at a later stage. For instance the proposals to apply differing discount rates to options in order to reflect their risk adjusted costs seems to, without further clarification, contravene the principle of cost neutrality in the regulatory test. Similarly, the concept of option value benefit requires further explanation and demonstration by example before VENCORP could comment further. Lastly, like NERA, VENCORP, is having difficulty assessing the meaning of 'wider national benefits'. Perhaps this could be clarified in the next step. We await with interest the future stages of the AEMC's review.

Should you have any questions please do not hesitate to contact Franc Cavoli on (03) 8664 6616 or Louis Tirpcou on (03) 8664 6615.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'M. Zema', is written over a light blue circular background.

Matt Zema
Chief Executive Officer