Policy analysis of electricity demand flexibility

The large-scale development of variable renewable energy sources, like wind and solar power, increases the demand for flexibility in power systems. At the same time, their electricity production replaces that of conventional power plants – the traditional suppliers of flexibility, and consequently, a new flexible infrastructure needs to be established. This thesis addresses the policy dimension of the flexibility challenge with a focus on Denmark, a country committed politically in two ways that make it particularly interesting: first, a commitment to renewable energy formulated as a long-term vision of becoming independent of fossil fuels; and second, a commitment to liberalised energy sectors with a notably progressive approach to market-based operations. The crucial question of how it will be possible to balance the Danish electricity system with large amounts of variable renewable production, primarily wind power, is still under debate. To maintain reliability in the most cost-efficient way, a policy strategy aiming at flexibility needs to be developed. Technologically, several different options are available to fulfill the requirement. A part of the solution may be to make use of idle flexibility on the demand side. Its potential could be substantial and technical solutions are available. Still, demand flexibility is largely unutilised and establishing an enabling policy and regulatory framework has been identified as one of the major challenges. While the latest Danish energy policies include a clear commitment to develop an “intelligent” energy system that utilises the flexibility potential of the demand side, a coherent policy strategy covering all aspects of the flexibility challenge has not yet been defined. By use of economic models and concepts of policy analysis, this thesis considers several policy options aiming at demand flexibility in terms of their effectiveness to induce adoption and their efficiency in creating system value while accounting for the specific characteristics of the demand side. The thesis suggests barriers relevant to be addressed due to either market failures in the classic economic sense or systemic failures founded in market design, rules and regulations. The analysis covers impacts of failures stemming from incomplete markets for flexibility and inappropriate regulation that distort the observed value or risks of demand flexibility. Furthermore, it considers various types of transaction costs related to adopting a demand response contract (switching costs) and to activation (monitoring and decision costs). The thesis develops methods to quantify the impacts of these failures and applies them in relation to the Danish case.

Switching costs are estimated and found to be a major barrier to the adoption of dynamic pricing schemes in spite of the benefits that could be achieved. As the cost of adoption may be difficult to influence directly, policies may aim at increasing the benefits of flexible demand. One suggested option is to address the issue of incomplete markets and expand market access of flexible demand in the spatial and time dimensions. The value of improving the access of the demand side to intra-hourly reserve markets is found to be substantial. Quantitative findings of the thesis suggest that the reserve value of flexible demand may be significantly higher than the value in hourly spot markets. Another improvement might be achieved by adjusting distortional electricity price elements. It can be shown that value-based taxation, even if applied to smaller portions of the electricity taxes and levies, generates benefits sufficient to exceed switching cost estimates. Monitoring and decision costs can be caused by the complexity of pricing schemes and hamper efficient response. Even though real-time pricing generates the highest benefits in theory, results of the thesis suggest that simplified schemes with minimal monitoring and decision costs would generate around half of the ideal gains and could be deemed sufficiently beneficial during an initial phase. After consumers gained experience with dynamic pricing, they should be transferred to the more complex and efficient schemes, though. Focussing on the installation of automation equipment could be another way to improve the efficiency of response. As this would require investments, the question of risk involved in generating benefits from demand response becomes more relevant. Using a stochastic price model the thesis shows that risk-averse investors might require a significant cost reduction, resulting in lower levels of investment in automation than what could be expected based on average prices. A policy intervention could be considered to initialise adoption, depending on the further technology cost development. Overall, the thesis improves the understanding of the specific challenges that policymaking faces when aiming at better utilisation of demand-side flexibility. It includes aspects that often would remain unaddressed in the evaluation of policies. On that basis, it provides support to the development of a coherent policy strategy for flexibility that is required for the successful transition to a fossil-free energy system.

General information
State: Published
Organisations: Department of Management Engineering, Systems Analysis
Contributors: Katz, J.
Number of pages: 208
Publication date: 2016

Publication information
Publisher: DTU Management
Original language: English
Electronic versions:
PhD_Thesis_toOrbit.pdf
Source: PublicationPreSubmission
Source-ID: 131802261
Research output: Research › Ph.D. thesis – Annual report year: 2017