

Mr John Pierce
Chair, Australian Energy Market Commission
Level 6, 201 Elizabeth Street
Sydney NSW 2000



10 December 2015

Re: ERC0186 National Electricity Amendment (Demand Response Mechanism and Ancillary Services Unbundling) Rule 2016

Dear Mr Pierce

The Energy Efficiency Council (EEC) welcomes the opportunity to comment on the rule-change proposal – *ERC0186 National Electricity Amendment (Demand Response Mechanism and Ancillary Services Unbundling) Rule 2016*.

The EEC strongly supports the introduction of a Demand Response Mechanism (DRM) and Ancillary Services Unbundling. Specifically, we support the following features of the rule-change:

- The establishment of Demand Response Aggregators (DRAs) as a new class of market participant;
- AEMO implements a baseline calculation methodology (BCM) to calculate the consumption that would have occurred in the absence of demand response;
- The retailer would be settled and charged for the baseline energy consumption during a demand response event;
- The DRA would be settled and paid the spot price for demand response, and would pay the spot price for any metered energy consumption that exceeds the baseline;
- DRAs would also be able to aggregate loads and offer them into Frequency Control and Ancillary Services (FCAS) markets; and
- DRAs must comply with existing FCAS procedures.

However, the EEC recommends that the staged implementation approach for the DRM should be amended and clarified in two ways:

- Firstly, while it is reasonable that retailers should have some initial flexibility about when they allow their customers to participate in the DRM, there must be a clear date after which it becomes mandatory for retailers to allow their customers to participate in the DRM, even if a manual 'work around' is used. We recommend that this be no later than 1 Jan 2018. If it does not become mandatory for retailers to allow their customers to participate in the DRM the rule-change will be pointless.
- Secondly, while it is reasonable to start the DRM with a smaller number of large energy users, a date should be set after which aggregated loads of smaller energy users are allowed to participate in the DRM. We recommend this be no later than 1 Jan 2018.

Need for the DRM

The AEMC's 2012 Power of Choice Review concluded that:

"While there is some evidence of uptake of DSP [Demand Side Participation] in the NEM over recent years, the efficiency of the electricity market can be improved by more active participation by the demand side." (page i)

Numerous reviews have concluded that there are substantial barriers to DSP. The 2002 COAG Energy Market Review succinctly identified a number of barriers:

"The Panel 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; and residential consumers do not face price signals." (page 174)

There are a number of specific barriers that impede DSP that are relevant to this proposed rule-change, specifically that energy consumers currently can't sell DSP into the wholesale energy market unless they make an arrangement with a retailer or face the complexity of the spot-market. The DRM will address this issue.

The recent review by Oakley Greenwood confirmed that, even if you take a negative set of assumptions and a short-term horizon, the cost of the DRM would be lower than the benefits and the DRM would increase competition and choice in the energy market.

While enabling DRM will deliver benefits in the short-term, the potential benefits will increase dramatically over time, as generation technologies change and the over-supply of capacity in both generation and network infrastructure ameliorates. However, it is critical to introduce the DRM immediately so that the market for DSP can grow and mature over the next decade.

Summary

We urge the Australian Energy Market Commission (AEMC) to expedite this rule change process. The DRM Rule Change was originally proposed by the AEMC in 2012, and it has still not been passed. No further work needs to be undertaken to know that the DRM is necessary.

Responses to the questions in the Consultation Paper are set out on the following pages.

We look forward to continuing to engage with the AEMC on this matter. For further information please contact me on rob.murray-leach@eec.org.au or 0414 065 556.

Yours sincerely



Rob Murray-Leach
Executive, Policy and Advocacy
Energy Efficiency Council

Question 1 Assessment Framework

1.1 Would the proposed framework allow the Commission to appropriately assess whether the rule change request can meet the rule making test?

The proposed framework is broadly appropriate but needs clarification (see below).

1.2 What changes to the proposed assessment framework would stakeholders' consider appropriate, if any?

The proposed framework is reasonable, but we believe it should be clarified on a number of fronts:

- The assessment should take into account the full range of costs and benefits. Specifically, while the focus should be on the matters set out explicitly in the National Electricity Objective (NEO) (such as price, quality and reliability of electricity supply) it must also take into account factors that include, but are not limited to:
 - The benefits of greater customer choice and competition particularly in an energy market that is under transition; and
 - The potential benefits of the DRM in developing a market for demand-side participation that provides other services, such as reduced expenditure on network infrastructure and low-cost FCAS.
- The assessment should use a time frame to 2050 for assessing costs and benefits. We believe that the DRM will deliver modest benefits in the short-term, but much more substantial benefits as the mix of generation in the market changes (e.g. more intermittent generation) and the current excess capacity in both generation and network infrastructure is reduced. However, the rule change is required immediately as the DRM market will take some time to grow and mature.

Question 2 Potential barriers to demand side participation relevant to this rule change request

2.1 What are stakeholders' views on the potential barriers to demand side participation that have been set out in this consultation document? How relevant might they be? Should they be considered in the Commission's assessment?

The EEC broadly agrees with the AEMC's analysis of the barriers set out in the consultation document and the 2012 Power of Choice review, and agrees that they should be considered in the AEMC's assessment. In summary, the DRM would enable consumers to respond to wholesale electricity prices by addressing the following barriers to DSP:

- Exposure to the wholesale market price is too complex for most energy users.
- Mandatorily bundling demand-response and retail services has led to sub-optimal provision of demand-response services, as:
 - This reduces competition for demand-response services; and
 - Some retailers may face conflicting incentives in providing demand-response services.
- Load reduction cannot be packaged up in a way that enables it to compete with supply in the wholesale energy market.

2.2 Have stakeholders identified other barriers to DSP that should be considered in the Commission's assessment? Please, explain and provide evidence where possible

See above.

2.3 What are the costs and benefits of removing the barriers that are identified as significant to this rule change request? Which barriers are the most problematic and/or more cost-effective to remove?

The AEMC identified some of the benefits of removing these barriers in the Power of Choice in 2012, specifically:

"[The DRM] would give large customers more competitive options to reduce energy costs in response to high spot price events in the wholesale market, resulting in lower generation and network costs which would benefit all consumers."

The costs of removing these barriers are minimal. In 2013, one industry body provided governments and market bodies with estimates of the cost of IT changes required for the DRM that industry experts widely believed were inflated. Oakley Greenwood's review into the DRM found that, even if these inflated costs are accounted for, the benefits of the DRM outweigh the costs.

2.4 Are there any current or upcoming changes in the market that would mitigate or address any of the identified barriers?

No.

2.5 Might there be any unintended consequences from addressing such barriers?

The impacts of the DRM have been thoroughly assessed and do not need to be further analysed. We anticipate that a number of companies will submit unfounded claims about potential negative impacts DRM to this review, because the DRM will increase competition for their services. We encourage the AEMC to assess these claims with scepticism.

Question 3 Questions on the overall DRM design proposal

3.1 Would the proposed DRM generate useful demand-side information in relation to improving wholesale pre-dispatch and dispatch prices? How significant would this improvement be?

The DRM design will significantly improve understanding of demand-side behaviour in a low-cost way. The EEC has not undertaken modelling on the significance of this improvement for wholesale pre-dispatch and dispatch prices.

3.2 Would the proposed DRM generate useful demand-side information in relation to improving the management of transmission constraints through the dispatch process? How significant would this improvement be?

The DRM will generate useful information for managing transmission constraints, but the EEC hasn't estimated the significance of this improvement.

3.3 Would the proposed DRM generate useful demand-side information in relation to improving the provision or procurement of ancillary services? How significant would this improvement be?

The DRM will generate useful information for procurement of FCAS, but the EEC hasn't estimated the significance of this improvement.

3.4 Would the proposed DRM operation result in a technology neutral approach between demand response and generation resources?

The DRM would reduce the relative bias towards generation resources, but on its own it would not eliminate this bias. Numerous factors create the supply-side bias in the electricity sector, including the incentives faced by Network Service Providers.

3.5 Do stakeholders think that there exist any relevant gaming risks or unintended consequences from implementing the overall proposed DRM operation? If so, how could they be mitigated in a cost-effective way?

AEMO has proposed mechanisms to minimise the risk of gaming in the DRM, based on decades of collective global experience in demand-response programs. If these mechanisms are adopted the risk of gaming under the DRM will be minimal. More importantly, the DRM will also substantially increase competition in the wholesale market and therefore reduce the existing risk of gaming in the wholesale market.

3.6 Would the DRM result in system-wide benefits and/or costs that might impact the operation and investment in electricity transmission and distribution networks? What aspects of the design would contribute to this?

The DRM would enable demand-side aggregators to develop portfolios of DSP that could be used to reduce further investment in electricity transmission and distribution networks. While there doesn't need to be a specific link between the DRM and other DSP programs for this to occur, the effectiveness of the design of the DRM will determine how successfully DSP can be developed and deployed for other purposes.

3.7 Would the DRM result in improved ability for AEMO to manage system security and reliability? What aspects of the design would contribute to this?

Yes.

Question 4 Accredited baseline consumption methodologies

4.1 In stakeholders' views, are there any alternative demand response mechanism options that would not require the use of baseline consumption methodologies?

Generally, demand-management programs need to be based on an assessment of avoided consumption, which requires a baseline consumption methodology. The only alternative to a baseline methodology for DSP is full exposure to the spot price and, for reasons that the AEMC has set out in its consultation paper, this is not generating desirable levels of DSP.

4.2 What might be the costs, benefits, and consequences from having an administrative baseline developed and then managed by AEMO?

No comment.

4.3 What are stakeholders' views on the proposed baseline methodologies, and the proposed assessment criteria to be applied when assessing baseline consumption methods?

AEMO's proposed baseline methodologies reasonably balance cost and robustness.

Question 5 Restrictions on the provision of demand response

5.1 In stakeholders' views, how effective would the proposed DRM design be in preventing the exercise of potential gaming opportunities?

The proposed DRM methodologies, which are based on extensive global experience, minimise the risk of gaming. The costs for energy users to artificially increase their energy use for large periods would far exceed any benefits from the DRM, minimising the incentive to gaming.

5.2 Are there alternative options to improve upon the current design to manage gaming risks?

No comment

Question 6 Interactions with demand side participation mechanism

No comment.

Question 7 Prudential requirement

No comment.

Question 8 Settlement charge

No comment

Question 9 Implementation issues in relation to the DRM

9.1 The Council proposes a voluntary approach for retailers to enable their customers to participate in the DRM. How effective do stakeholders think this voluntary approach will be in encouraging retailers to enable their customers to opt-in into the DRM?

The EEC believes that the voluntary approach will be ineffective.

9.2 What are stakeholders' views on allowing manual billing as a viable short term solution to encourage retailers to enable their customers to opt-in the DRM?

Manual billing is a viable short-term solution.

Question 10 Voluntary and staged approach

10.1 The Council proposes a voluntary approach for retailers to enable their customers to participate in the DRM. How effective do stakeholders think this voluntary approach will be in encouraging retailers to enable their customers to opt-in into the DRM?

The EEC believes that the voluntary approach will be ineffective.

10.2 What are stakeholders' views on allowing manual billing as a viable short term solution to encourage retailers to enable their customers to opt-in the DRM?

Manual billing is a viable short-term solution.

Question 11 Potential barriers to demand side participation in FCAS markets

11.1 Do stakeholders agree that current market arrangements where only market participants that purchase or sell electricity on the wholesale spot market can participate in FCAS markets are a barrier to entry that restrict DSP in the FCAS markets?

Yes

11.2 Do stakeholders agree that facilitating entry via greater DSP, either as individual or aggregated loads, can result in lower cost and higher quality provision of FCAS services while minimizing the scope to exercising market power in these markets? Do stakeholders have any particular evidence to support their views?

Yes

11.3 In which category ancillary service provision do stakeholders believe that entry will be more likely? Are there any foreseeable future changes that might broaden the scope of entry in markets where demand response has generally not been able to provide ancillary services?

No comment.

Questions 12 and 13

No comment