AUSTRALIAN ENERGY COUNCIL

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23rd April 2020

Submitted online to: https://www.aemc.gov.au/rule-changes/wholesale-demand-response-mechanism

Dear Mr Kelly,

Wholesale Demand Response Mechanism
Reference: ERC0247

The Australian Energy Council (the "**Energy Council**") welcomes the opportunity to make a submission in response to the Australian Energy Market Commission's ("**AEMC**'s") *Wholesale Demand Response Mechanism Second Draft Rule Determination*.

The Energy Council is the industry body representing 23 electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. These businesses collectively generate the overwhelming majority of electricity in Australia, sell gas and electricity to over ten million homes and businesses, and are major investors in renewable energy generation.

Introduction

The Energy Council appreciates the effort the AEMC has made to revise the first draft rule determination following stakeholder feedback. The revised draft determination has improved the draft rules, and the Energy Council is generally supportive of its findings and recommendations.

The AEMC considered that the revisions permitted an accelerated implementation by over eight months to 24th October 2021. This was however prior to the occurrence of the COVID-19 pandemic. The shutdown has had a significant impact on the ability of industry to implement significant reform projects, and the Energy Council has written to National Electricity Market jurisdictions requesting delays in a number of implementation programmes for rule changes already made. Given the exceptional circumstances, and the backlog of other programmes that are now ahead of it, the Energy Council was prepared to recommend that the implementation date remain as originally scheduled, i.e. 1st July 2022.

However it is noted that the Australian Energy Market Operator ("**AEMO**") has submitted a rule change request for Five Minute Settlement to be delayed by one year to 1st July 2022, and the associated change of Global Settlement delayed to 5th February 2023.[1] This suggests that the implementation of Wholesale Demand Response should be delayed even further, to ensure that system changes and preparations do not conflict with, or cause unwelcome resource constraints for, the implementation of Five Minute Settlement and Global Settlement. (Leaving the Wholesale Demand Response implementation at the accelerated time of 24th October 2021 is even more problematic, since it would require retailers' systems to be amended twice, once for 30 minute settlement and later for 5 minute settlement, effectively duplicating implementation costs.)

Discussion

The Energy Council is supportive of more involvement of demand-side participation, and endorses the broad concept of a two-sided market, but considers this is better achieved within the existing retailer-customer relationship, and has therefore consistently advocated that this mechanism is unnecessary whilst also creating new costs and retailer risks.

[1] See https://www.aemc.gov.au/rule-changes/delayed-implementation-five-minute-and-global-settlement

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Given the AEMC has chosen to introduce the scheme nevertheless, the Energy Council believes that expanding the proposed demand-side arrangements to include smaller customers is premature, in terms of the necessary technology available to provide and verify the response. In addition, it is likely that the costs of developing a robust framework and its associated systems would outweigh the benefits from having smaller customers providing demand response through this mechanism, as opposed to the conventional retailer approach. The Energy Council therefore supports the AEMC not opening up the mechanism to those customers at this time, and instead using the understanding gained from the implementation of this rule to inform the design of a framework which can encompass smaller customers.

To that end, it is important for wholesale demand response units to be treated as similarly to other market participants as possible. To the Energy Council's mind, this means that rule asymmetries should be minimised and therefore treatments, such as compliance with dispatch targets and causer pays exposure as applies to other scheduled participants, should be applicable to wholesale demand response units as well.

Aggregation of Wholesale Demand Response Units

Aggregation of Wholesale Demand Response Units is an important means by which additional demand response can participate in the market, but this participation must be on a similar footing to the supply side. The Energy Council therefore supports AEMO imposing limitations on the capacity of non-SCADA demand response which is able to participate in each region.

MTPASA Participation

Existing scheduled generators are obliged to submit information to AEMO for the purposes of the Medium Term Projected Assessment of System Adequacy ("**MTPASA**"), pursuant to National Electricity Rule 3.7.2. The Energy Council appreciates that Demand Response Service Providers ("**DRSPs**") have less certainty on their availability in the future, but submits that in order to participate in the market on an equal footing, and so as not to distort the associated contract market, it is a necessity for DRSPs to make their information available to the broader market, and for them to be subject to the same rigour and obligations as scheduled generation.

Baselines

The proper treatment of baselines is a vexed subject, and the Energy Council appreciates the comprehensive consideration the AEMC has undertaken on this matter. Of particular concern is the determination of appropriate baselines under different market and climatic conditions. For example, generators are derated during times of extreme temperature, and it may be appropriate for wholesale demand response units' ability to be similarly adjusted during particular conditions. It will be important for AEMO's baseline methodology metrics to accommodate such expected variations.

In addition, it will be important for AEMO to be open to alternative baseline methodologies. The Energy Council notes that proposed Rule 3.10.1 obliges AEMO to develop wholesale demand response guidelines, which will include information about the process for the development of baseline methodologies, and it may be appropriate for the Rules to consider some timeframes for AEMO to consider requests for alternative methodologies.

Payment from the DRSP to the Retailer

The Energy Council understands the difficulty in striking an appropriate reimbursement rate which is simple and not affected by confidentiality and competition issues, and notes the AEMC's argument that it "does not consider that methodologies which are based on average peak spot prices … better reflect what the retailer would otherwise have recovered from the customer through the customer's retail tariff than methodologies based on average spot prices".[2]

The difficulty lies in how the retailer would have used financial derivatives to mitigate its risk, which is not included in Figures G.3*ff*. Further, retailers manage risk using a prospective estimate for prices, but the reimbursement rate is retrospective. This means that retailers have an exposure for the difference between the amounts which they pay to AEMO based on customers' baseline consumption, and the amounts which they receive in return from generators and other market participants, since these amounts are based on *actual* consumption. Reimbursement of the loss that the retailer suffers cannot be accurately based on average spot prices, since these differ from the contract market, upon which retailers' costs are based. Thus there is a shortfall because retailers will have paid another market participant for contract cover for baseline consumption, but will only recover for customers' actual consumption. The Energy Council therefore maintains

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[2] p.218

its position that the reimbursement rate, despite the difficulty in derivation, should be more reflective of the cost of products used to ameliorate prices during times of extreme demand (which is when demand response is most likely to be used) and using average spot prices provides inadequate compensation, and could lead to significant retailer exposure.

Regular Reviews

Reporting on the efficacy of the wholesale demand response mechanism is an important component in ensuring the rules are fit for purpose and baseline methodologies are appropriate, therefore the Energy Council is particularly supportive of the requirement under proposed Rule 3.10.6 for AEMO to report annually on outcomes relating to baselines used under the mechanism, and how AEMO proposes to improve the accuracy and reduce the bias of these over time.

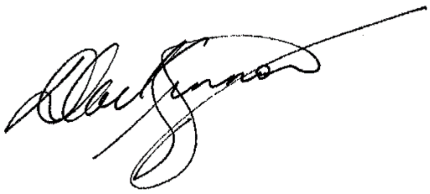
As an adjunct to this, the Energy Council supports a proposed wholesale demand response review being conducted three years after the commencement of the substantive portions of the proposed rule change, in accordance with proposed Rule 3.10.7, although it is noted that this may coincide with the introduction of a new market design pursuant to the Energy Security Board's work for the COAG Energy Council.[3]

Conclusion

The Energy Council is broadly supportive of the AEMC's proposed draft rule, however takes issue with the timetable set down for its implementation, given the disruption currently being caused by COVID-19, and likely to continue for some time to come, and recommends that the AEMC reviews its consideration of the reimbursement rate to consider retailers' use of the financial derivatives market to manage risk.

Any questions about this submission should be addressed to the writer, by e-mail to Duncan.MacKinnon@energycouncil.com.au or by telephone on (03) 9205 3103.

Yours sincerely,



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[3] http://www.coagenergycouncil.gov.au/energy-security-board/post-2025

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