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Your Ref: ERC0247
Contact Officer: Matt Lady
Contact Phone: 08 8213 3491
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Mr John Pierce
Chair - Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear Mr Pierce

Draft rule determination—Wholesale demand response mechanism

Thank you for the opportunity to comment on the wholesale demand response mechanism rule change request and related Australian Energy Market Commission (AEMC) draft rule determination.

We welcome the AEMC's work on this rule change request to facilitate wholesale demand response in the National Electricity Market (NEM) to meet the nation's electricity needs through the lowest cost mix of demand response and supply. In our view these aims are in line with, and support the achievement of, the National Electricity Objective.

One of the Australian Energy Regulator's (AER) strategic objectives is to drive effective competition where it is feasible, and to increase competitive pressures by empowering customers to choose the products, services and suppliers they want.¹ In principle, we support the introduction of a wholesale demand response mechanism in the NEM as a further tool to help achieve these objectives.

We consider a well-designed and carefully implemented wholesale demand response mechanism can have a range of benefits, including:

- enhancing consumer participation by allowing consumers to participate directly in the wholesale market and be rewarded for this;
- giving consumers the ability to save on their electricity costs by choosing to adjust their energy consumption in response to market price signals;
- facilitating competition and new entry, and encouraging alternatives to the construction of new generating capacity;
- contributing to promoting reliability and security by improving demand forecasting and the effective integration of variable generation into the NEM; and
- avoiding load curtailment at times of peak demand and the use of costly out-of-market measures, such as the Reliability and Emergency Reserve Trader provisions or the Retailer Reliability Obligation.

¹ AER Strategic Statement.

Demand response participation in the NEM is limited today, but the potential economic and resource planning benefits are growing and considerable.² The AER considers that wholesale demand response can become a critical resource to achieve a more efficient and reliable NEM and help to minimise costs for consumers.

We note the AEMC's proposed wholesale demand response mechanism, and its settlement model, is intended to reduce costs for consumers and market participants by:

- allowing retailers to continue to bill customers based on actual consumption, thereby significantly reducing changes to retailer billing systems and associated implementation costs; and
- reducing the scope of the changes to AEMO's settlement systems.

We consider the AEMC's efforts to minimise the implementation costs associated with the proposed wholesale demand response mechanism have contributed significantly to the feasibility of the proposed rule. We also note that the implementation costs of the 2015 Demand Response Mechanism and Ancillary Services Unbundling rule change request were cited by the AEMC as a significant reason not to make a final rule to implement a demand response mechanism at that time.³

The AER considers that the draft rule determination to introduce a wholesale demand response mechanism in the NEM represents an important and timely development in Australia's energy markets. We appreciate the challenges involved in making and implementing major changes to the NEM, and in balancing stakeholders' preferences while promoting the National Electricity Objective.

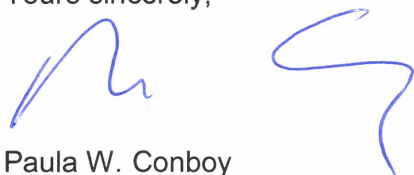
Attachment A (below) sets out further comments on the following matters:

- objectives and efficiency of the wholesale demand response reimbursement rate;
- objectives of the wholesale demand response monitoring guidelines;
- scope of the wholesale demand response mechanism, and consumer engagement with the market; and
- proposed changes to the Energy Made Easy comparator tool.

We thank the AEMC for the opportunity to submit on this process and look forward to ongoing involvement in the assessment of this rule change request.

If you have any questions about our submission, please feel free to contact Matt Lady on (08) 8213 3491.

Yours sincerely,



Paula W. Conboy

Chair

² See, *Independent Review into the Future Security of the National Electricity Market: Blueprint for the Future*, Chapter 6: "Demand response by consumers plays a relatively small role in the NEM when compared with a number of other countries. New mechanisms could unlock the value of demand response actions by commercial and industrial consumers to the wholesale market."

³ Final Rule Determination, National Electricity Amendment (Demand Response Mechanism and Ancillary Services Unbundling) Rule 2016 (24 November 2016).

Attachment A

Objectives and efficiency of the wholesale demand response reimbursement rate

Under the draft rule, the AER will be required to calculate a wholesale demand response reimbursement rate (reimbursement rate), which is to be based on the load weighted average spot price for the regional reference node for the previous 12 month period.⁴ For settlement purposes, the AER is to provide to AEMO the reimbursement rate for each region, for each quarter, commencing on 1 January, 1 April, 1 July and 1 October of the relevant year.

We understand the objective of the proposed reimbursement rate is to allow affected retailers to recover the costs they may incur to cover the baseline consumption of their customers that opt to engage in demand response. While these anticipated costs are not characterised precisely, the draft rule determination states that the reimbursement rate “would seek to reflect the average retail rate, excluding the retail margin, for that particular type of customer, excluding network costs and the costs of environmental schemes”.⁵

The AEMC’s draft rule determination recognises that under the draft rule retailers may “over-recover in some cases and under-recover in others and it would be anticipated that these outcomes will approximately balance over time.”⁶ We understand that some stakeholders, particularly retailers, have raised concerns with the proposed approach to setting the reimbursement rate, suggesting that it would not fully compensate them for costs incurred, and have instead argued that this rate be set using the historical 12-month average peak prices in a given region.

We note that doing so would likely increase significantly the reimbursement rate in some instances and regions, and may not best achieve the objectives set out by the AEMC. Given the AER’s proposed role in calculating the reimbursement rate, we are keen to ensure that the AEMC’s approach to setting the reimbursement rate achieves its stated objectives, and should any material changes to this approach be made we would support the opportunity for further consultation on this matter.

In principle, the AER supports the reimbursement rate as proposed by the AEMC. However, we consider there is a lack of clarity relating to the objectives of the reimbursement rate and the rationale for identifying the AER as the agency that should be responsible for determining and publishing this information.

We question whether the AER is the most appropriate agency to be responsible for setting and publishing the reimbursement rate. Given this task would rely on data sourced from the Australian Energy Market Operator (AEMO), and setting the reimbursement rate would not involve the exercise of discretion, we encourage the AEMC to consider whether AEMO may be better suited to undertake this role.

The AER appreciates the challenges the AEMC has sought to overcome in proposing the reimbursement rate in the settlement model, including the issues and complexities associated with the alternative approach requiring retailers to provide the actual retail tariffs

⁴ AEMC, Draft National Electricity Amendment (Wholesale demand response mechanism) Rule 2019, clauses 3.15.6B(e) and (f).

⁵ AEMC, Wholesale demand response mechanism, Draft Rule determination, 18 July 2019, p. 156.

⁶ AEMC, Wholesale demand response mechanism, Draft Rule determination, 18 July 2019, p. 157.

of customers engaged in wholesale demand response. We note these retail tariffs are also considered confidential and vary across classes of customer and retailers.

We consider it is important that the reimbursement rate:

- provides for an appropriate level of compensation for retailers that reflects the costs that a prudent, efficient retailer has incurred; and
- is clear and easy for market participants to understand, as well as practical to calculate and administer; and
- does not act as a barrier to entry for market participants engaged in wholesale demand response or a barrier to consumer participation in wholesale demand response.

Objectives of the wholesale demand response monitoring guidelines

The draft rule determination proposes that the AER will have a role in assessing whether wholesale demand response participants are manipulating baselines inefficiently to increase the amount of demand response credited. The draft rule therefore requires the AER to develop and publish wholesale demand response monitoring guidelines that are intended to provide guidance to Demand Response Service Providers (DRSP) about:

- how the AER intends to monitor compliance by DRSPs with regard to providing wholesale demand response that is only the result of action taken by the DRSP in response to dispatch instructions;
- what information DRSPs must retain to assist the AER with its compliance monitoring.

Although the AER has no concerns about specifying information retention requirements in the proposed guideline concerning DRSP participation in central dispatch, we are not clear as to the purpose of this guideline as it relates to monitoring compliance. In particular, we are unclear whether the intent is that the guideline:

- sets out the process by which the AER will monitor for and detect potential non-compliance; and/or
- provides guidance as to what type of conduct constitutes non-compliance with the relevant NER obligations and when the AER is likely to take enforcement action.

As an enforcement agency, we consider the proposed provision of guidance relating to the AER's approach to enforcement to be potentially problematic for the integrity of the proposed wholesale demand response mechanism and the efficacy of the AER's market monitoring regime. The AER's approach to enforcement action is detailed in our Compliance and Enforcement policy, which sets out the principles we apply to drive compliance with energy legislation, including our enforcement powers, functions and strategies.

The AER has and will continue to publish guidance for participants on compliance best practice where, based on our experience, we consider it assists businesses to understand their obligations under the energy laws. This guidance does not seek to describe what conduct would or would not constitute non-compliance (which, by its nature, cannot be definitive). We also note that the draft rule is intended to treat DRSPs in the same way as generators, and similar guidance is not provided for these market participants.

Nonetheless, if the AEMC considers that the proposed monitoring guidance is required under any final rule, the AER recommends the AEMC consider closely the rationale and objectives of these guidelines. Any potential benefits of these guidelines must be weighed carefully against the impacts they are likely to have on the ability of the AER to conduct its

essential market monitoring and surveillance activities in accordance with its legislative responsibilities.

Scope of the wholesale demand response mechanism and customer engagement with the market

The draft rule limits the scope of the proposed wholesale demand response mechanism to exclude small customers. The AER understands the AEMC has made this decision due to the need to consider further the relevant consumer protections and to ensure an appropriate consumer protection regime is in place for small customers who may choose to engage in wholesale demand response.

Given the potential benefits of wholesale demand response to the NEM, and the benefits that customers providing demand response may accrue, the AER encourages the AEMC to prioritise its planned review of energy-specific consumer legislation to enable the expansion in scope of the wholesale demand response mechanism to small customers.

We note the AEMC has committed to undertaking this review of energy-specific consumer legislation from the end of 2019, and has not ruled out the potential for small customers to be able to access the wholesale demand response mechanism upon its proposed implementation on 1 July 2022.

The AER also encourages the AEMC to consider how best to mitigate conduct by market participants that may create a barrier to consumer and DRSP participation in demand response. For example, it will be important to understand how market participants respond to the introduction of the mechanism, and whether customers who engage in wholesale demand response experience any subsequent issues with their retailers, such as difficulty re-contracting or accessing competitive offers.

Similarly, the AER considers there is a risk that discriminatory technical and administrative requirements, procedures and charges could be imposed on the basis of a customer's agreement with a DRSP, thereby undermining the objectives of the proposed rule.

In this vein, we encourage the AEMC to consider closely whether existing laws and the proposed rule sufficiently discourage market participants from engaging in conduct that may frustrate the objectives of the proposed rule.

Proposed changes to Energy Made Easy

In the draft rule determination, the AEMC considers that changes to the Energy Made Easy comparator tool may need to be made so that:

- demand response services offered by retailers are represented on Energy Made Easy, and that their cost and competitiveness is accurately portrayed to users of the tool; and
- retailers provide easy access to information related to the risks and requirements involved with retailer-led demand response arrangements, particularly where customers are materially exposed to the wholesale market price.

The AEMC has suggested the AER should explore when and how the above proposed changes may be made to the Energy Made Easy comparator tool, as well as an equivalent to include DRSP demand response offers for small customers.⁷

⁷ AEMC, Wholesale demand response mechanism, Draft Rule determination, 18 July 2019, p. 176.

We agree with the Commission that such changes may increase the awareness and transparency of retailer-led demand response products and allow consumers to make more informed choices when considering such products.⁸

However, any changes to Energy Made Easy must be informed by consultation, consumer testing, and evidence about how best to incorporate these offers so that consumers can readily understand and compare them. Further exploration of the nature and extent of changes required, and how best they can be implemented, is required before any changes are made.

Care should be taken to ensure proposed changes to consumer information meet known and evidenced consumer needs (taking into account differing circumstances, including comprehension and time availability), and avoid a temptation to present more information to consumers about an already complex market.

We are currently undertaking a major redevelopment of the Energy Made Easy website and changes such as those proposed in the draft rule determination are beyond the agreed scope of this work.

Any new or additional requirements for Energy Made Easy will need to be prioritised, together with our ongoing work program, and funded accordingly. In determining the timing for the proposed changes, it will be important to consider resourcing and funding available to the AER, and the need for this to occur ahead of future financial years.

⁸ AEMC, Wholesale demand response mechanism, Draft Rule determination, 18 July 2019, p. 175.