

18 December 2018

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear Mr Pierce

Wholesale Demand Response Mechanisms – ERC0247

Hydro Tasmania appreciates the opportunity to provide comment on the three rule change requests currently being considered by the Australian Energy Market Commission (AEMC) on wholesale demand response (WDR) mechanisms.

The National Energy Market (NEM) is undergoing an unprecedented period of transition with the rapid uptake of renewable energy resources, and the retirement of ageing thermal generation. It is important that this transition is managed in an orderly fashion to ensure the supply of affordable, reliable and sustainable energy.

While WDR is complex in nature, an appropriate framework successfully implemented, should provide significant benefits to the market as a whole in a cost-effective manner, and could also play an important role in achieving this orderly transition. Most importantly, Hydro Tasmania considers it integral that any framework to facilitate WDR should appropriately balance the interests of consumers with the efficient functioning of the market. Hydro Tasmania welcomes the robust assessment approach of the AEMC to ensure that this fundamental outcome is achieved.

The consultation paper considers three distinct mechanisms to facilitate increased WDR in the NEM. These mechanisms each seek to address the recommendation of the AEMC's Reliability Frameworks Review that *'demand response providers ... should be recognised on equal footing with generators...'*¹ Each of these mechanisms involves third-party demand response aggregators (DRA) engaging customers behind their connection point. Hydro Tasmania has not provided specific comment on each of these mechanisms individually, but would like to highlight some key risks/complexities that must be managed in the event that DRA's can more proactively engage consumers behind their connection point:

- 1. Allocation of market risk(s)** – An enduring principle of the NEM assessment framework is that risks should be allocated to parties best placed to manage those risks. Hydro Tasmania considers that when a third-party DRA engages a customer directly, the retailer will likely lose visibility of that demand response, which will impede the retailer's ability to manage the risk associated with that load through contracting practices. This is particularly the case for hedging in peak periods, when

¹ Pg. 1, Wholesale Demand Response Mechanisms consultation paper, AEMC

demand response is most likely to be triggered. This would create a perverse outcome in the market as retailers would carry the risk associated with that customer's load, whilst DRA's would attain the benefit from the demand response. As such, retailer's revenues will be reduced and they will not have an ability to recover the costs associated with hedging that load. Hydro Tasmania considers it integral that any mechanism to facilitate two parties engaging the one customer behind the connection point must address this anomaly accordingly. Hydro Tasmania proposes that it would be appropriate to consider a framework which allows retailers to pass a proportionate amount of market risk through to DRA's.

2. **Certainty of response** – the 'what if' nature of baselines is inherently uncertain given they attempt to forecast what the prevailing demand profile would have been in the absence of demand response. The application of the baseline methodology is increasingly uncertain when applied to an aggregate customer base, as opposed to a larger load with centralised control, such as an aluminium smelter. Ultimately, there will be varying probabilities of realisation for demand response, dependent on market segments and the maturity of technology utilised to offer that response. Hydro Tasmania considers that this carries a number of risks:

- a. The utilisation of a baseline may create a **perverse incentive to overstate the extent of response** from any given load and potentially introduce the opportunity for gaming.
- b. We consider that there is a **risk of increased errors in forecasting practices**, which could distort market signals for both investment and operational decision-making.
- c. The uncertainty of response **may cause an increase in the risk premium applied by retailers** in the event that consumers do not respond as expected. This risk must also be considered in the context of the Energy Security Board's Retailer Reliability Obligation, as retailers may over contract to ensure compliance.
- d. **Retailer's may lose their ability to optimise spot-market trading practices** without sufficient transparency of DRA's response in real-time.

Where possible, any mechanism that is implemented should be designed to: (i) enhance the certainty of demand response; (ii) identify the extent to which the demand response is being offered; and (iii) ensure the appropriate provision of information between retailers and DRA's as close to real-time as possible.

3. **Customer confusion** – As noted in the AEMC's 2018 Retail Energy Competition Review, there is a high-degree of uncertainty and confusion held by consumers regarding products and pricing in the retail energy market. If DRA's are more proactively engaging consumers behind their connection point, Hydro Tasmania considers that this may risk exacerbating current levels of consumer uncertainty and confusion, particularly in the mass market customer segment. Any mechanism that facilitates WDR in the NEM via two distinct firms engaging one customer behind a connection point must be clear and transparent to ensure the products and services offered are clearly understood.

Hydro Tasmania looks forward to ongoing engagement with the AEMC. If you would like further information on any aspect of this submission, please contact John Cooper (john.cooper@hydro.com.au or (03) 6230 5313).

Yours sincerely



Steve Davy
CEO