



06 September 2019

Mr John Pierce
Australian Energy Market Commission
PO Box A2449
Sydney South NSW, 1235

Dear Mr Pierce,

Re: ERC0247 Wholesale Demand Response Mechanism – Draft Determination

Flow Power welcomes the opportunity to make a submission in response to the Wholesale Demand Response Mechanism – Draft Determination (**Draft Determination**).

Flow Power is a licenced wholesale electricity retailer that works with business customers throughout the NEM. Our model is to partner with our customers to provide value by giving them control over their energy costs. Demand response (**DR**) is a crucial tool utilised by many of our customers to hedge their exposure to spot prices.

Flow Power has been providing services to our customers to enable them to undertake DR for over 10 years. We fully understand the essential role DR plays in the market, and the value it brings to customers. We appreciate the work done by the Commission in preparing the Draft Determination.

We are supportive of the policy intent and a demand response mechanism that is simple to operate, compatible with current market arrangements and places risks with those best positioned to manage them – the demand response service provider (**DRSP**).

We believe the Draft Determination proposes a mechanism that does not satisfy any of these criteria. Our key concerns relate to:

1. The use of baselines;
2. The process of load classification into wholesale demand response (**WDR**) units;
3. The settlement model and reimbursement rate; and
4. The potential risk of inconsistencies with the Retailer Reliability Obligation (**RRO**) arising from the application of different approaches to the same set of customer's data.

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We have discussed these concerns within Appendix 1.

An alternative approach

In its WDR Consultation Paper, the Commission discussed a proposal of setting out an obligation on retailers to offer a spot price pass through tariff to customers wishing to participate in DR. We note the Commission was silent on its assessment of this approach when making the Draft Determination.

We support this alternative approach based on the following grounds:

- Many retailers provide spot price pass through tariff to their customers therefore we expect the implementation cost to be minimal;
- Based on our over 10-year experience in providing spot price pass through pricing to customers, the arrangement is easily understood by customers, therefore participation is likely to be high;
- It is compatible with existing market arrangements;
- The cost of implementation will be lower as there is no need for AEMO to make changes to its systems and processes including MSATS, nor is the need to develop, maintain or operate baseline methodologies and secondary settlement mechanisms;
- The speed of implementation will be faster as there is no need to make major changes to systems and processes, including to retailer systems;
- Customers can choose to contract with a DRSP in order to undertake DR and settle based on a commercial arrangement reflective of the savings made, negotiated between both parties without involving or affecting a third party (retailer);
- Risks rest with those parties best placed to manage them, i.e. the customer wishing to provide DR and the DRSP providing the service;
- The DRSP can also provide the customer risk management services during times when the customer is not willing to provide DR;
- Any large customer can participate as there will be no need to set thresholds, such as the proposed 5 MW for Scheduled WDRUs; and
- AEMO will have visibility of quantities of DR provided through the Demand Side Participation Portal.

We encourage the Commission to consider this alternative approach, not only from the perspective of addressing the issues we highlighted in this submission but also from cost effectiveness.

Implementation Date

At the public forum held on 16 August 2019 in Sydney, the Commission sought feedback on the implementation date. Flow Power supports the Commission's proposed implementation date of 1 July 2022. We do not support an earlier implementation date as our resources are currently focused on the implementation of the 5-minute settlement rule change.

If you have any queries about this submission, please contact me on 0417 971 032 or nabil.chemali@flowpower.com.au

Yours sincerely

A handwritten signature in black ink, appearing to read 'Nabil Chemali', with a stylized flourish at the end.

Nabil Chemali
Regulatory & Compliance Manager
Flow Power

Appendix 1

The use of baselines is inappropriate

The Draft Determination¹ recognised and discussed the challenges in setting baselines but failed to offer a solution. Instead, the responsibility of developing baseline methodologies and addressing those challenges is left with AEMO to resolve and creates a situation where a third party (retailer) bears the risk.

We are disappointed that despite recognising the issues of utilising baselines the Commission went one step further and proposed the application of baselines at NMI levels, ignoring what has been written and experienced both in Australia and overseas about the shortcomings of such approach. Not only does this produce inaccurate results, but it is also susceptible to manipulation and gaming by the customer, the DRSP, or both.

An effective demand response mechanism provides a system that facilitates negotiations between affected parties, the buyer (DRSP) and the seller (customer), to agree on a baseline balancing the risk/return expectation sought by each party. We believe the Draft Determination will not establish such a mechanism since both parties will be incentivised to manipulate and game baselines because the outcome of such behaviour lies with a third party (retailer) who will foot the bill.

Applying the baseline methodology at NMI levels creates another issue; under the Draft Determination AEMO is required to develop a series of methodologies and produce a guideline setting out, amongst other things, the thresholds for an acceptable baseline methodology. For these methodologies to produce a 'good baseline'², we suspect AEMO will either:

- Have to develop, maintain and operate a large number of methodologies to accommodate the diverse load profiles of large customers, the cost of which will be borne by consumers; or
- Set thresholds that limit participation to a few large customers, possibly with predictable or flat loads, raising the question of how effective the WDR mechanism is, especially when considering that currently there is nothing stopping these customers from participating in DR.

The process of load classification as wholesale demand response units lacks input from those bearing the risks

The Draft Determination proposes that a DRSP wishing to classify a load as WDR unit must:

- Apply to AEMO for classification;
- Identify the load by NMI;
- Demonstrate how the load will provide WDR;
- Nominate a baseline methodology; and
- Provide all other information required as set out in the WDR guidelines.

AEMO is responsible for approving the classification.

This proposed process involves AEMO and the DRSP, however it does not allow input from the retailer – the party bearing the risk from the choice of baseline methodology.

¹ Draft Determination, Appendix E, section E.2.3, page 115

² *ibid*

We submit that the AEMC should revisit the process and provide the customer's retailer the opportunity to object on the baseline methodology proposed by the DRSP and include provision for dispute resolution.

The settlement model and reimbursement rate will not make retailers whole

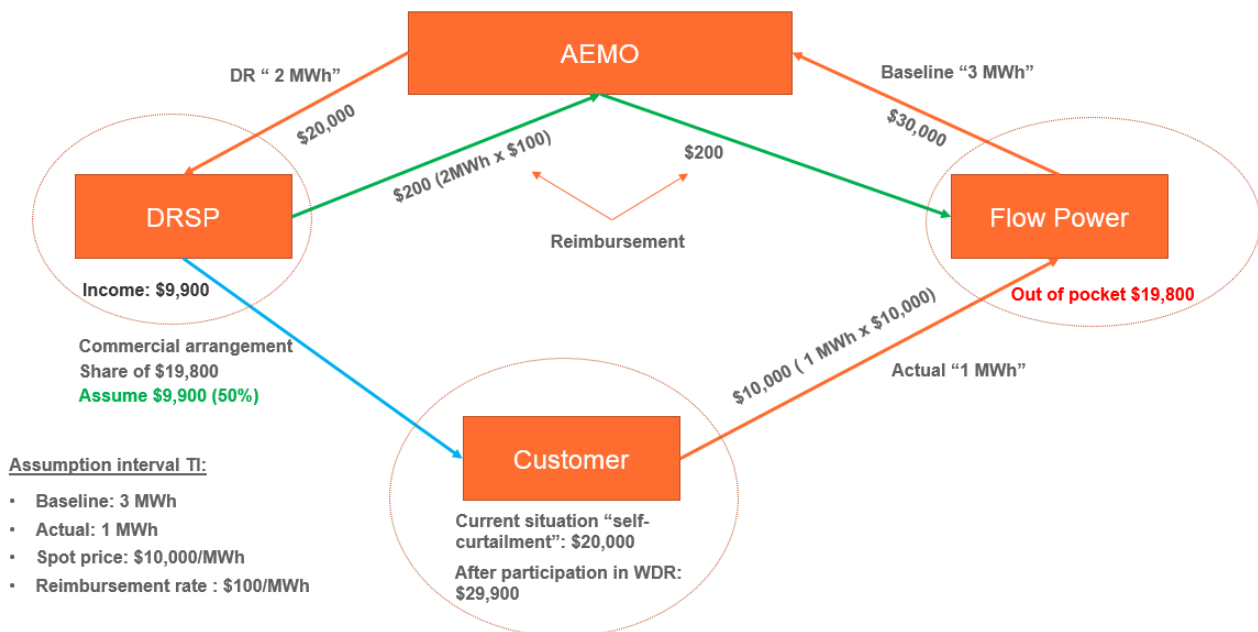
The Commission has sought to develop a settlement model which is cost-effective for consumers and market participants and would avoid imposing unmanageable or unhedgeable risks on retailers.³

The Commission has developed the settlement model around the traditional retailer 'fixed price' business model, assuming retailers hedge the entirety of their load. However, no due consideration been given to the impact the model will have on retailers such as Flow Power that provide customers spot price pass through arrangements.

By offering its customers spot price pass through arrangements, Flow Power is neither exposed to the spot price volatility or the volume risk. Consequently, Flow Power does not hedge the entirety of its load.

We strongly object to the proposed settlement model as it will impose unmanageable risks on retailers offering customers spot price pass through arrangements. Figure 1 below provides an example of the quantum of risk the proposed settlement model will impose on Flow Power.

Figure 1 – proposed settlement model example



Note, customers on spot price pass through manage their exposure to high spot price by utilising different risk management strategies, including DR through self-curtailed. The example in Figure 1 above shows that prior to the NMI being included in a WDR the self-curtailed provided the customer a saving of \$20,000. After inclusion in a WDRU, the customer achieves a double benefit, saving of \$20,000 from self-curtailed and a payment of \$9,900 from the DRSP. Consequently, Flow Power has been left \$19,800 out of pocket.

³ Draft determination, section 5.1.5, page 62

This example demonstrates that under the proposed settlement model, customers on spot price pass through will be the ones most incentivised to participate in WDR, leaving retailers with unmanageable risks.

We appreciate that at the public forum held on 16 Aug. 2019 in Sydney, the Commission recognised that the proposed settlement model causes problems to Flow Power and this needs to be addressed.

Possible solution

We offer the following solution, applicable to customers on spot price pass through arrangement with the retailer, for the Commission's consideration:

1. Set out an obligation on retailers to provide AEMO a list of all NMIs on spot price pass through arrangement via AEMO's Demand Side Participation Information Portal (**DSPIP**).
2. Where an NMI is listed in the DSPIP and at the same time included in a scheduled WDRU, the reimbursement rate applicable to that NMI, when dispatched, in a trading interval TI will be the spot price for that interval TI.

Potential risk from inconsistency with Retailer Reliability Obligation

In our submission to the Energy Security Board's National Electricity Rules Amendments – Retailer Reliability Obligation Draft Rules⁴, we raised our concerns of the potential risks and complexity the interaction between the RRO and WDR mechanism rule changes may cause in the event different rules are applied to the same set of customer's consumption data. We believe the Draft Determination creates this risk.

- Under the RRO, AEMO will use the RERT framework to secure emergency reserves required to address a reliability gap and the Procurer of Last Resort (PoLR) will function as a cost recovery for the RERT.⁵
- Under the RERT framework, AEMO calculates the volume of DR delivered by each provider in a given region by applying a single baseline methodology to the aggregate load of all activated NMIs associated with that provider (**Approach 1**). Note that this methodology is required to produce a 'good baseline'.
- If a retailer enters into a qualifying DR contract to manage its exposure to spot price volatility and a PoLR event occurs, AEMO will therefore apply Approach 1 to estimate the impact of the DR on the retailer's load in order to allow the Australian Energy Regulator assessing the retailer's RRO compliance against its net contract position.
- If, on the other hand, this qualifying DR contract is a scheduled WDRU, the Draft Determination requires AEMO to apply different baseline methodology (or methodologies⁶ as the case may be) to the same set of customer's consumption data and at the individual NMIs

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<http://www.coagenergycouncil.gov.au/sites/prod.energycouncil/files/publications/documents/Flow%20Power%20Response%20to%20National%20Electricity%20Rules%20Amendments%20-%20Retailer%20Reliability%20Obligation.pdf>

⁵ ESB, Retailer Reliability Obligation, Final Rules Package, 03 May 2019, Section 8.1, page 37

http://www.coagenergycouncil.gov.au/sites/prod.energycouncil/files/publications/documents/Retailer%20Reliability%20Obligation%20-%20Cover%20Paper_1.pdf

⁶ If many NMIs are involved, different methodologies will apply to different NMIs, as selected by the DRSP through the process of classification the load as WDR unit.

level (**Approach 2**) for settlement purposes with the DRSP and retailer. Note this methodology and approach is also required to produce a **'good baseline'**.

It is very likely Approach 1 and Approach 2 will produce different baselines. This inconsistency creates additional complexity and costs but more importantly it creates an avenue for disputes and challenges that may undermine both rules:

- If both baseline approaches are required to produce a 'good baseline' and are developed/approved by the same entity (AEMO), what issues are likely to arise if they produce large variations in results?
- For example, what would be the outcome if utilising Approach 1 the retailer is found non-compliant with the RRO but under Approach 2 the retailer will be compliant?
 - Would the decision be left to AEMO's discretion, noting each decision will have different impacts on liable entities and consumers⁷?
 - Will the retailer be able to challenge the decision, especially if both approaches are claimed to be produce a 'good baseline'?
 - If a challenge mounted by a retailer was to be successful, what are the likely consequences of setting such precedent?

We submit that the AEMC should undertake thorough assessment of the inter-relationship of this rule change and the RRO to ensure consistency, reduce complexity, minimise costs and avoid creating unnecessary risks to market participants.

⁷ A decision in favour of one liable entity may increase the share of PoLR costs allocated to other non-compliant liable entities or allocate additional cost to RERT's cost to be recovered from all consumers