



**EnergyAustralia**

LIGHT THE WAY

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## **Review of the Wholesale Demand Response Mechanism – Confidential version**

EnergyAustralia is one of Australia's largest energy companies with around 2.4 million electricity and gas accounts across eastern Australia. We also own, operate and contract a diversified energy generation portfolio across Australia, including coal, gas, battery storage, demand response, wind and solar assets, with control of over 5,000MW of generation capacity.

We appreciate the opportunity to provide feedback on the AEMC's review of the Wholesale Demand Response Mechanism (WDRM).

EnergyAustralia recognises the valuable role of demand response in increasing the efficiency of energy delivery within the NEM and driving lower costs for all customers. We support the growth in the provision of competitive demand response products and services, and provide a number of demand response products. For our Large Customers we provide a commercial demand response product where customers are rewarded for reducing load, RERT and products offering greater spot price exposure. We observe that the market for demand response for Large customers is highly competitive. In this context, we continue to question the role of the WDRM and its effectiveness mainly due to its low uptake, which in our view cannot be resolved through further amendment.

We also have concerns about the accuracy of the mechanism's design which undermine its suitability and scalability in longer term NEM design. For these reasons, we consider the WDRM should be discontinued, but if this would involve material cost, we recommend that no further investment or change be made to it.

### **Limited effectiveness of the WDRM would support it being discontinued or no further investment**

While we acknowledge the well-intent to introduce a demand response mechanism for new participants, there is a real question over whether the WDRM is effective and whether it has delivered material benefits to customers.

The main issue is that uptake by participants of the WDRM remains low. We anticipate this will likely persist despite government support via the NSW government LTESA for firming infrastructure, any further inclusion in other schemes, or regardless of further amendment to improve it.

In its Final determination on the wholesale demand response mechanism, the AEMC noted 150 MW of capacity that results in a wholesale spot price reduction of \$4,000/MWh for at least 8 hours annually for 5 years would be required to exceed the costs of implementation. We expect this has not eventuated. While we will look to the AEMC's analysis on the WDRM's impact on spot prices, the AEMC notes DRSPs have registered a total of 74 MW of response, half the necessary capacity originally referenced to ensure that benefit outweigh the cost of the reform. We also expect that the original cost estimates were understated, further diminishing the cost to benefit ratio. The AEMC's cost estimate for retailers and DRSPs was \$10-16 million across the industry.

Confidential information has been omitted for the purposes of section 24 of the Australian Energy Market Commission Establishment Act 2004 (SA) and sections 31 and 48 of the National Electricity Law.

Limited uptake of the mechanism further means that there has been negligible impact on the broader demand response market. The WDRM was introduced in a context where there were a number of existing regulatory and commercial demand-side participation options. We consider that the WDRM has not created new value in additional demand response capability in the market, rather it has simply transferred the operation of demand response to a different participant.

The WDRM has also had negligible impact in increasing competitive pressure for demand response products on pricing and innovation terms. Since the introduction of WDRM over 3.5 years ago, only [REDACTED]

[REDACTED] This is extremely low customer uptake [REDACTED] from our Large Customer base. By contrast, there is around [REDACTED] of uptake of our commercial demand response product, which is an off-market product. This evidences a clear preference by customers to have one provider manage their overall exposure to electricity price risk - by managing both their purchase of electricity and demand response as a combined proposition.

Further, our commercial demand response product, like others in the market, also provides the flexibility for customers who seek to be rewarded for price responsive reductions in load, without the market requirements of bidding and conformance with dispatch instructions which can be inflexible. While the WDRM offers a mechanism separate to a retailer and greater market access, this might not be commercially attractive to Large Customers in practice. Given these features are intrinsic to the WDRM, we expect WDR uptake to remain very low, and that further changes to the mechanism cannot resolve these issues.

### **Inaccuracies in WDRM design further support it being discontinued or at least no further investment in it**

In addition to the above reasons around its limited effectiveness, we also consider that intrinsic inaccuracies in the design of the WDRM make it difficult to extend in mid-long term market design and limit the mechanism's scalability.

First, the mechanism relies on a counterfactual baseline which will always be subject to error. This baseline is used in market settlement to determine what the FRMP (retailer) pays AEMO, in a context where all other settled energy volumes are determined on metered load (with exceptions where the meter cannot be read). The retailer has no ability to manage the risks around this baseline error given the baseline is set by AEMO. Therefore the party (retailer) most impacted by the baseline error and best placed to manage it (being the party with the greatest understanding of the customer's shape and load), has no control over it. The fact that more individual baselines have been introduced since the introduction of the WDRM strongly suggests there are the complexities and inaccuracies around determining baselines, with more baselines being made to better reflect participating customers.

Second, we also observe accuracy issues with the wholesale demand response reimbursement rate (WDRRR). While the concept behind the WDRRR is to make the Retailer "whole" on their hedging cost for the gap between the baseline (what the retailer is charged by AEMO) and what the retailer can charge the customer (actual metered usage), it will also likely be inaccurate in virtually all scenarios given retailers' approach to price risk and hedging are extremely diverse and different. It would also be a perverse outcome if there was material uptake of WDRM, and Retailers began to hedge in line with the WDRRR methodology, removing competitive differentiation.

Third, the exemption of the WDRM from regulation FCAS recovery is also another feature which is questionable in the longer term as it undermines the efficiency of the market. It places DSRPs on a different level to other types of load meaning that DRSPs will contribute to the need for FCAS but will be exempt from its cost recovery. This raises questions regarding sufficient incentives on DRSPs to minimise adverse impacts on the system and undermines a level-playing field between participants.

Fourth, the design of the WDRM might also result in distortionary customer behaviour with flow on impacts to retailers. A retailer may hedge load on the basis of a certain shape, but if that shape changes because the customer is incentivised to shift load to peak times, it could mean retailers are further negatively impacted. The AEMC notes a similar distortionary issue for small customers at page 27 of its Consultation Paper, but we consider this issue could equally apply for Large customers.

For example, take a "campaign" customer with an intermittent load that is unresponsive to price movements. A retailer might buy a swap for a certain MW load to match the MWh volume. The retailer will therefore be long supply (when the load is offline) and short supply (when the load is operating) for that customer, but this will happen both at times when the price is low and high, therefore balancing the times it will be able to sell excess electricity when the price is high, with times when it will need to buy electricity when the price is high. As the customer's consumption is not price responsive, the retailer's approach balances out. However, if a customer were to shift its usage to times of high pricing to increase the potential for benefits under the WDRM, the retailer's approach would now expose it to being short at times when prices are high more often. This would be a perverse outcome as the mechanism is now rewarding the customer for "reducing" its load at peak times, when ordinarily the customer's load was more evenly spread across low and high pricing times.

The four issues above might be acceptable in a short term mechanism with extremely limited scale, but are difficult to support as an enduring mechanism in longer term market design.

We agree with the AEMC's view that other two-sided mechanisms, in particular IPRR, will enable price responsive demand to participate in the market. Flexible large loads were a primary use case for IPRR in the AEMC's final decision, more so than residential VPPs. IPRR will allow flexible large loads to participate in central dispatch and buy at the spot price. IPRR is a better long term demand-side alternative for flexible load, to enable greater and more direct participation in the market, without introducing inaccuracies that result in market inefficiency.

In view of the limited effectiveness of the WDRM and various accuracy issues, our first preference would be for the WDRM to be discontinued. However, we also note that this would involve some costs for AEMO, WDRPs, and Retailers (to deactivate the billing arrangements for the WDRM). If these costs are material, then we would support retaining the WDRM but leaving it unchanged with no further investment into it.

### **Multiple connection points and small customers**

For completeness, and if the WDRM is continued, we do not support the extension to multiple connection points on the basis that further investment by AEMO and industry into an ineffective mechanism is not warranted. We also have concerns that load shifting between multiple connection points to "game" the mechanism might be an issue. i.e. where load is reduced and counted towards the WDRM on one connection point, only to be shifted to another. Further, multiple connection points could raise complexities for the baseline, leading to a further expansion of different baselines (i.e. different baselines for a battery connection versus load). Lastly, we are unsure how multiple connection points will create additional value for the customer.

We do not support the extension of the WDRM to small customers, for analogous reasons regarding Large Customers above, which will only be further compounded with major complexity and accuracy issues regarding baselining small customers which have an extremely diverse load profile.

If you would like to discuss this submission, please contact me on 03 9060 0761 or [Selena.liu@energyaustralia.com.au](mailto:Selena.liu@energyaustralia.com.au).

Regards

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**Regulatory Affairs Lead**