

DEMAND RESPONSE MECHANISM AND ANCILLARY SERVICE UNBUNDLING RULE 2016 CONSULTATION: AEMO SUBMISSION

10 December 2015

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Dear Mr Pierce

Submission on the AEMC's consultation paper - Demand Response Mechanism and Ancillary Services Unbundling Rule 2016

Please find attached our submission regarding the AEMC's consultation on Demand Response Mechanism (DRM) and Ancillary Services Unbundling (ASU) Rule 2016.

We would be pleased to provide further assistance to the AEMC regarding the development of DRM and ASU. If you would like to discuss or have any questions regarding this submission, please do not hesitate to contact myself or Violette Mouchaileh, Group Manager Market Enhancement, on (03) 9609 8551.

Yours sincerely



Peter Geers
Executive General Manager, Markets

cc:

Attachments: Demand Response Mechanism and Ancillary Services Unbundling Rule 2016
Consultation: AEMO submission



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1. INTRODUCTION

AEMO welcomes the opportunity to provide a submission on the AEMC's consultation paper on the Demand Response Mechanism (DRM) and Ancillary Services Unbundling (ASU) Rule 2016.

AEMO understands that the AEMC is seeking further information from interested parties in order to consider the potential to facilitate DRM and ASU in the National Electricity Market (NEM).

In this submission, AEMO seeks to clarify the framework which guided our original design of the DRM and ASU that has formed the basis for the rule change proposal before the AEMC. The submission also responds to some of the questions raised in the AEMC's consultation paper.

Framework Guiding AEMO's Detailed Design of DRM and ASU

In January 2013, AEMO was tasked by the COAG Energy Council (the then Standing Council on Energy and Resources) to develop a rule change proposal for implementing DRM and ASU in accordance with the terms of reference and draft specifications determined in the AEMC's Power of Choice (PoC) final report. In undertaking this task, AEMO developed a detailed market design to inform the development of rule, procedure and system changes.

The PoC review objective was to support market conditions that facilitate efficient demand side participation (DSP). AEMO's DRM and ASU detailed market design was developed based on the DSP solution outlined in the AEMC's Final Report - Draft Specifications¹ document published on 30 November 2012. The draft specifications outlined in some detail the design framework of the DRM and ASU, which included the development of a baseline consumption methodology and establishment of new category of market participant for the provision of non-energy services.

As per the terms of reference, AEMO established a stakeholder advisory working group to work through implementation issues. The framework was developed over 10 months in collaboration with industry through the DRM and ASU working group. AEMO recognises the significant resource commitment by industry in assisting AEMO develop the DRM and ASU proposal.

During the detailed market design and rule change development process, AEMO recognised that there were market developments that occurred since the completion of the PoC review in November 2012, including falling demand and oversupply of generation in the market. Given the narrow scope of the terms of reference and accompanying draft specification there was difficulty in dealing with the changing circumstances and market conditions. In that instance, AEMO considered it appropriate to refer the detailed market design and rule change proposal to the COAG Energy Council in December 2013 for further policy guidance.

AEMO recognises that since the development of the detailed market design and rule change proposal in 2013 additional issues have been considered, including issues raised in a consultant report commissioned by the AEMC and changes incorporated by COAG Energy Council.

¹ The AEMC's Power of choice – giving consumer options in the way they use electricity. Final Report p115-120,144. Final Report - Draft Specifications, p38-54 <http://www.aemc.gov.au/Markets-Reviews-Advice/Power-of-Choice-Stage-3-DSP-Review>

2. AEMC'S ASSESSMENT FRAMEWORK

Consultation Paper: Question 1 Assessment Framework

1. Would the proposed framework allow the Commission to appropriately assess whether the rule change request can meet the rule making test?

AEMO considers that the original objectives of the DRM and ASU framework provided to AEMO by the AEMC in the Terms of Reference and Draft Specification do not align with the assessment framework outlined in the AEMC's initial consultation document.

While AEMO recognises that assessment frameworks can change for a number of reasons, including changing environment, it should be noted that the DRM and ASU detailed market design and rule change was designed by AEMO in the context of a different assessment framework.

The original AEMC assessment outlined a number of ways that the DRM was to meet the National Electricity Objective, including:

"Firstly, it enhances consumption participation in the wholesale market and allows consumers to see the value of changing their consumption in line with market signals, such as the spot price. In turn, efficient consumption in the market will result in lowered generation and network costs, as well as increased competition in the energy market that will benefit all consumers."²

AEMO considers that the DRM detailed market design does provide large customers with more competitive options to reduce energy costs. Through participation in the settlement process customers can respond to high spot price events in the wholesale market, which could result in lower generation and network costs which would benefit all customers. It was established early in the advisory stakeholder working group process that DRM would be self-scheduled and that it would not have any material impact on real-time operations.

The focus has now moved towards improvements to the market price signal, for example one assessment criteria outlined in the AEMC's initial consultation document is:

"Incorporating demand side information: whether the rule change would allow new demand side information to be efficiently incorporated into the spot price".

AEMO's DRM detailed market design (as per its terms of reference) was designed as response mechanism, i.e. responds to spot price rather than sets it, which may not satisfy some of the new assessment criteria.

This potentially reflects that the narrow scope of the original work plan designed around a specific solution which may no longer be fit for purpose. A more accommodating framework that avoids solution lock by allowing the flexibility to adapt as the rule change is developed could have beneficial results for the AEMC, AEMO and participants.

3. VOLUNTARY APPROACH

Consultation Paper: Question 10 Voluntary and staged approach

² AEMC Final Report - Power of Choice review – Draft Specification

1. The Council proposes a voluntary approach for retailers to enable their customers to participate in the DRM. How effective do stakeholders think this voluntary approach will be in encouraging retailers to enable their customers to opt-in into the DRM?

AEMO considers that participation in DRM would be reduced if retailers could veto all of their customers participating. Given that third parties are likely to participate as Demand Response Aggregators (DRAs), retailers may have less interest in allowing their customers to participate as it opens up their customer base to third parties. There is a risk that, due to its voluntary nature, participation in DRM may be low.

4. COST RECOVERY

The costs for development of procedures, systems and processes required to support DRM and ASU are to be borne by AEMO. The recovery of AEMO's implementation costs may need some additional clarity.

The initial consultation document outlines that operational cost recovery arrangements under DRM will require DRAs to pay a fee at a rate per MWh of demand response and retailers pay customer fees based on baseline energy.

If the costs are to be recovered on the principle of the user pays, i.e. the participating DRAs bear the cost, this in itself could act as a disincentive for participation in the DRM. Under voluntary arrangements there could be a scenario where there are no DRA participants, meaning that AEMO would not be able to recover its costs. Recovering in this way could also have the unintended consequence of discouraging participation as fees may be high if only a small number participate and the costs must be shared between them.

If cost recovery is intended to be recovered via participant fees the risk to AEMO would be mitigated and the costs would be shared across participants, even those that do not participate.

Further consideration is required with respect to the fee recovery approach.

5. OVERALL DRM DESIGN PROPOSAL

Consultation Paper: Question 3 Questions on the overall DRM design proposal

2. Would the proposed DRM generate useful demand-side information in relation to improving the management of transmission constraints through the dispatch process? How significant would this improvement be?
3. Would the proposed DRM generate useful demand-side information in relation to improving the provision or procurement of ancillary services? How significant would this improvement be?
4. Would the proposed DRM operation result in a technology neutral approach between demand response and generation resources?
6. Would the DRM result in system-wide benefits and/or costs that might impact the operation and investment in electricity transmission and distribution networks? What aspects of the design would contribute to this?
7. Would the DRM result in improved ability for AEMO to manage system security and reliability? What aspects of the design would contribute to this?

Management of Network Constraints and Ancillary Services

The AEMC's draft specification did not consider using DRM for management of transmission constraints and this would not be consistent with the reactive, price-responsive mechanism proposed in the specification. AEMO's detailed design does not use DRM information for managing transmission constraints, although the information may be useful for post event analysis.

In regards to demand side information that DRM provides, AEMO does not expect that this would help in the provision or procurement of market or non-market ancillary services, DRM related information is separate to ASU.

Technology neutral approach between demand response and generation resources

The NEM rules and processes are designed around infrastructure to supply electricity, including dispatch requirements, providing a trading framework beneficial to participants whose core business is energy production. The DRM allows businesses to participate through a third party aggregator, allowing businesses with a non-energy focus to participate in and respond to the market. This addresses some existing bias towards standing generation.

Transmission networks

Considering that the nature of DRM is voluntary and self-scheduled this information may not be useful until enough statistical data is gathered for assessment. Demand response could be incorporated into planning, has the potential to reduce the amount of future transmission infrastructure required, and could be considered as an augmentation option. In the future DRM information could potentially inform forecasting work.

System security and reliability

AEMO would not be in a position to factor expected DRM related demand responses into its operations to improve system security. Therefore it is not expected to help AEMO manage system security and reliability issues.

6. OVERALL ASU DESIGN PROPOSAL

Consultation Paper: Question 12 Questions on the overall ancillary services unbundling (ASU) proposal

1. In stakeholder's view, how would the ASU proposal impact on the cost of balancing supply and demand in the NEM?
2. Would the ASU proposal result in improved ability for AEMO to manage system security and reliability? What aspect of the rule change would contribute to this?
3. Would the ASU proposal result in reduced ability for AEMO to manage system security and reliability? What aspect of the rule change would contribute to this?

AEMO considers that the ASU proposal would not impact the cost of balancing supply and demand. Balancing supply and demand is done through the energy market while ancillary services which manage short term imbalances.

ASU may enable a broader number and new types of frequency control ancillary services (FCAS) providers into the market, potentially expanding competition. This could potentially

provide improvements in system security and reliability through increased levels of FCAS being offered into the market.