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Mr John Pierce
Mr Neville Henderson
Dr Brian Spalding
Australian Energy Market Commission

Dear Commissioners

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Demand Response Mechanism and Ancillary Services Unbundling, Consultation Paper, 5 November 2015

EnergyAustralia welcomes the opportunity to respond to the Demand Response Mechanism and Ancillary Service Unbundling consultation paper. We are one of Australia's largest energy companies with over 2.5 million electricity and gas accounts in NSW, Victoria, Queensland, South Australia, and the Australian Capital Territory. We also own and operate a multi-billion dollar energy generation portfolio across Australia, including coal, gas, and wind assets with control of over 4,500MW of generation in the National Electricity Market.

The Demand Response Mechanism (DRM) is a mechanism designed to allow third party providers of Demand Response (DR) to monetise their product directly in the wholesale electricity market rather than partnering with retailers as currently. The DRM seeks to provide an additional way for consumers to access wholesale market benefits by separating services for short-term price responsiveness from all other energy services. Past value for demand response products no longer exists in an over-supplied market, and so it is difficult to see that there is any overall benefit that will flow through to customers, demand response aggregators (DRAs) or retailers from the DRM.

While we support the concept of DR and offer these products to our customers (amongst many others), we do not believe the proposed DRM is a useful, practical or viable proposition in the current market. The DRM will add unnecessary costs and complexities to all retail businesses but provide only limited value to a very small number of customers. Retailers compete on providing value through a lower energy bill for their customers. Working with customers to understand their needs and the ability to provide load-shape management, energy efficiency improvements, power-factor correction, network tariffs and connection optimisation, and accessing spot market benefits all contribute to a retailer's service offering. Strong competition in the retail market continues to ensure that retailers deliver a package that is most beneficial to the customer.

EnergyAustralia was involved in the detailed design of the DRM. During the development it became clear that the mechanism would create material complexities and costs for both retailers and DRAs in addition to any issues with delivering the actual demand response capability. Although the proposed DRM would be optional for customers and retailers, it may create confusion for customers and significant costs for AEMO if implemented.

We have previously commented on the DRM as part of the Council of Australia Governments Energy Council Cost benefit assessment of the DRM[1] and explore the issues further below.

Competition in the provision of Demand Response services

Recommendations from the Commission's Power of Choice review were made in 2012. This review identified potential opportunities in the wholesale and retail market improve competitive outcomes by increasing consumer engagement. The DRM is one of the recommendations identified to facilitate higher engagement for a consumer-led market.

The Commission correctly identified that energy and retail markets must change to stay relevant and deliver the most value to consumers. Retailers must always re-examine their strategies and core business models as a result of changing consumer preferences, market conditions and new technologies. The retail market, especially in the commercial and industrial sector, is extremely competitive. For commercial and industrial customers, value is invariably centred on obtaining energy supply at the lowest cost. Success for retailers is completely dependent on identifying and delivering cost effective solutions to their customers.

We are observing increasing segmentation and differentiation in service offerings among retailers under varying business models. Some of the perceived obstacles to demand side participation, such as the alleged preference among retailers to only offer volume-based contracts, are not genuine obstacles in practice. Retailers seek to retain customers by understanding their needs and then tailoring products to those needs. Retailers compete strongly through multiple rounds of pricing during competitive tendering processes to shave prices to the lowest possible level to attract and retain large customers. To suggest that value is collectively left on the table and viable options are left unexplored by competing retailers is ridiculous.

The market is currently delivering load-shape management and energy efficiency in a manner and volume that reflects the current state of technology, customers' business practices (including production processes), the relative importance of energy as a production input, and the risk profile of customers. Customers are becoming more informed and demanding more of retailers. Many large customers are becoming educated by competing retailers and energy brokers during the process of entering a new energy contract. Other large customers are more frequently approaching us wanting to discuss options for new and complex deal structures that suit their needs. A wide variety of different types of price structures, options, buy-back, bundling even across wholesale components are commonly negotiated and are often bespoke.

Standardisation of methodology, as in the proposed DRM, is something that can assist comparisons between product offerings but it does limit flexibility and innovation. If it is determined that standardisation of DRM offerings is necessary to increase the ability for consumers to compare offerings between retailers, it could be delivered independently of central settlement by AEMO; either by regulating a standard methodology or requiring products to have a 'comparison rate'. However, we do not believe that regulating standardisation in a changing market would deliver net benefits to customers.

Current and future value of Demand Response in the wholesale market

The value in demand response is that it can defer capital investment in infrastructure. DR is increasingly being used by networks to this effect with significant savings to the providers and consumers. Customers providing network support through DR can be offered high availability payments while being called for dispatch infrequently. This is possible due to the nature of network support demand response which provides redundancy to the network assets and not

[1] https://scer.govspace.gov.au/files/2013/03/Energy-Australia.pdf

relied upon in normal operating conditions. There are also substantial benefits that customers can access by cutting demand spikes to reduce their network costs.

Similar value is not currently available in the wholesale market where an increasing over-supply of generation capacity is forecast. Fuel costs of generation will generally be below the price point of demand response. As such, the contribution of demand response to the long-term interests of consumers comes predominately from deferred or avoided capital costs. Given the current state of the electricity market, the value may come from reducing capital spend and accelerating the exit of existing generation - but this value is not likely to be significant. The limited opportunity for DR to defer capital investment in generation capacity to deliver value is highlighted in Oakley Greenwood's cost benefit analysis.

It is not straightforward and costless for major users to simply cease or reduce energy use on a significant scale to coincide with periods of high prices and to later recommence operations without significant disruption to business and production processes.

A customer entering into a DRM arrangement will want to ensure that any investment and operational costs of responding are offset by the value they will receive. Part of this assessment is to understand the frequency of DR events (ideally per season/day of week/time of day), the timing of notification of the event, the likely load reductions they will need to make and the payment they are likely to receive by responding. In the current wholesale market, the frequency of extreme or even very high price events is much lower than it was at the time the Power of Choice recommendations were made, and often the extreme price events are short, unpredictable and occur at odd times of the day. This limits both the number of customers who can respond in a timely manner and the amount they will receive under a DRM arrangement.

Conclusion

Increasingly, retailers are differentiating themselves through service offerings outside the traditional core-business of providing energy. The identified barriers to the delivery of an efficient level of DR are without merit. Competition ensures retailers will deliver this value to consumers. As the available value and cost of technology improve, product offerings and take-up by consumers will follow.

The reason that DR products and services are not as prevalent in the market as some may assume they should be is that there is little value in wholesale demand response in an oversupplied and less volatile wholesale market. With new technologies such as batteries becoming available, we envisage that customers will soon have superior options for managing their energy needs and lowering their energy costs. Therefore, the DRM is unlikely to find a useful role in future even if past wholesale market conditions return.

These significant changes in the wholesale market and consumer-driven retail businesses mean that there is no longer a case for the DRM. Ultimately, there are far simpler ways to offer DR and increasing better alternatives to offer value to customers than to proceed with the Demand Response Mechanism.

If you any have further questions please contact me on (03) 8628 4518.

Regards

Ben Hayward

Industry Regulation Analyst