Mr John Pierce
Chairman
Australian Energy Market Commission
Level 6, 201 Elizabeth Street
Sydney NSW

21 April 2020

Dear Mr Pierce,

Wholesale demand response mechanism

ENGIE Australia & New Zealand (ENGIE) appreciates the opportunity to provide feedback on the second draft determination for wholesale demand response in the National Energy Market (NEM).

ENGIE is a global energy operator in the businesses of electricity, natural gas and energy services. In Australia, ENGIE has interests in generation, renewable energy development, and energy services. ENGIE also owns Simply Energy which provides electricity and gas to more than 720,000 retail customer accounts across Victoria, South Australia, New South Wales, Queensland, and Western Australia.

Summary of ENGIE's position on the first draft determination

Given that the second draft determination is an amended version of the initial draft determination, to which ENGIE made a substantial submission, the focus of this submission is on the changes between the two draft determinations. Accordingly, rather than reiterate in detail our perspective on the wholesale demand response mechanism, below is a summary of our perspective.

- ENGIE supports the use of cost-effective demand response in the NEM and believes that the market is already delivering such through bilateral arrangements between retailers and their customers, albeit with limited visibility to other parties.

- Demand response is not the same as a demand response mechanism (DRM).

- The introduction of a DRM represents an increase in complexity and risk, much of which will be borne by retailers.

- The model proposed in the first draft determination was very complex and characterised by high transaction costs, barriers to entry and material systems changes and other implementation costs necessitating a lengthy implementation timetable.

The changes in the second draft determination

Notwithstanding ENGIE's legitimate concerns regarding the introduction of a wholesale DRM, the changes between the first and second draft determination are broadly positive.

In this respect, ENGIE thanks the Commission and staff for taking into account the feedback from stakeholders, including ENGIE, to the first draft determination and presenting a revised proposal for stakeholder consideration before making the final rule.

Settlement

The changes to the settlement framework are a modest improvement although a good deal of complexity still remains which may limit uptake of the scheme. It also continues to represent a risk for retailers who have customers who have signed up for the DRM with a third-party demand response service provider (DRSP) -hereafter "DRM customers". The reimbursement level is unlikely to cover their incremental costs of hedging for a DRM customer. While retailers are never going to be made whole, a reimbursement calculation based on some reasonable averaging of forward contract prices is more appropriate than the proposal to use average spot prices.

This risk is compounded by the Commission's proposal that retailers' RRO obligation be based on their DRM customers' baselines rather than their actual demand. For non-DRM customers, retailers have to hedge up to those customers expected maximum demand, but they can also seek to influence that maximum demand through DR arrangements with their customers. In the case of a DRM customer, the determination of a baseline is completely outside the retailer's control or influence.

ENGIE welcomes the Commission clarifying that customers' actual demand will be the basis of allocation of unaccounted-for energy and Reliability and Emergency Reserve Trader (RERT) costs.

While the use of baselines remains fundamentally problematic for the reasons outlined in ENGIE's previous submission, given they are an integral part of the scheme, it is appropriate to give AEMO more control over what is an acceptable methodology.

Participant requirements

As a general rule, it is preferable to harmonise the requirements on different types of market participants. Accordingly, there should be a high bar for any relaxation of these requirements for specific participant types. It is not clear that the reasons put forward for not requiring DRSPs to contribute to MT PASA are sufficiently compelling. At the very least, AEMO should include its own expectations of how much demand response will be available via the DRM based on its knowledge of the market, so that all market participants can factor that into their own plans and forecasts.

Similarly, it is not obvious why DRSPs should be exempted from contributing their share of FCAS costs. It is inconsistent to exempt them on the basis that it is difficult to calculate a precisely cost-reflective share of such costs when the Commission is so relaxed about the methodology for calculating the retailer reimbursement rate.

Finally, ENGIE supports the Commission's proposal that AEMO be empowered to put a limit on the quantum of non-SCADA DRM in each region. The first-come first-served approach does create a limited risk of a "gold-rush" scenario as DRSPs rush to register customers before the limit is reached.

Exclusions

The Commission's proposed exclusions appear appropriate. The logic of excluding customers who have elected to take up a spot price pass-through retail contract is sound. The decision (consistent with the first draft determination) to exclude small customers for the time being is also understandable. In any case, small customers with controllable devices such as batteries can still indirectly access wholesale market benefits through virtual power plant arrangements, such as ENGIE's own virtual power plant in South Australia. These arrangements have a significant advantage over the DRM in that they do not require the setting of baselines – an especially fraught process in the case of small customers who may not have a sufficiently consistent demand pattern on which to hypothecate a baseline.

Monitoring

It will be important to monitor and periodically review the effectiveness of the DRM and to check that it is not inadvertently driving perverse outcomes. One thing it would be useful to monitor is the extent to which apparent demand reductions achieved by the mechanism are actually being delivered by behind the meter generation or storage. Customers with such devices have the ability to carry out a form of "mechanism shopping", whereby they are likely to be able to participate in the DRM, the small generation aggregation framework, or the RERT (or presumably the proposed emergency reserve now under development). Understanding if there is a preference for one of these mechanisms over the other and why will be a useful input to determining the effectiveness and efficiency of each of these mechanisms.

ENGIE's assessment framework

ENGIE considers that any demand response arrangement will best meet a customer's needs when it is:

- **simple** to operate and understand;
- **flexible** so as to work under a range of market conditions;
- **transparent** to the market;
- has **low transaction costs** and **low implementation costs**;
- is **scalable** at the customers initiative;
- has a **short implementation timeframe**;

- is **compatible with existing arrangements**; and
- most importantly, can **maximise the value returned to the customer not a third party**.

ENGIE applied these criteria to the first draft determination. This evaluation is reproduced in Table 1 below with a qualitative assessment of whether the second draft determination better meets the criteria.

Table 1: Assessment criteria

Criteria	1st Draft	2nd Draft
simple to operate and understand;	✗	Marginally simpler but still fundamentally complex
flexible so as to work under a range of market conditions;	✗/✔	No material change – while the baseline determination process may appear slightly less flexible to a DRSP, it represents an appropriate safeguard.
transparent to the market;	✗/✔	May be less so due to lack of MT PASA info
has **low transaction costs** and **low implementation costs**;	✗	Lower: AEMO costs down to $13-17m from $40-$95m
is **scalable** at the customers initiative;	✔	As before
has a **short implementation timeframe**;	✗	Shorter implementation timeframe by 8 months.
is **compatible with existing arrangements**; and	✗	minor improvements, e.g. explicit ruling out of DRM for customers on spot pass through
most importantly, can **maximise the value returned to the customer not a third party.**	✗	Indicative settlement example doesn't support this. It is notable that the DRSP makes more money than the customer actually providing the demand response.

A two-sided market

ENGIE notes the Commission's evolving view on the likelihood that the NEM will transition to a two-sided market and agrees that a two-sided market is a more enduring solution. This highlights the transitional nature of the DRM which reduces the benefits the mechanism may deliver without any commensurate cost reduction. ENGIE's previous submission noted the advantages a two-sided market offered over a DRM and made some constructive suggestions for modest reforms to assist in the move toward a two-sided market as an alternative to the DRM. ENGIE considers that these recommendations remain valid.

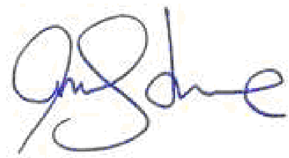
Given the Commission remains minded to go ahead with a DRM, it can send an important signal to stakeholders by reconfirming in the final determination that a genuine two-sided market is a superior approach and that in the long-run the DRM will be superseded. This will help stakeholders to understand that they should not predicate their business models or investments on this specific DRM, but rather on the ability to be able to deliver dynamic and price-responsive demand in the longer-term.

Conclusion

While ENGIE remains unconvinced that the benefits of specifically introducing a wholesale DRM will exceed the costs and risks the mechanism will incur, ENGIE appreciates the modifications made by the Commission in the second draft determination.

Should you have any queries in relation to this submission please do not hesitate to contact me on, telephone, (03) 9617 8415.

Yours sincerely,



Jamie Lowe
Head of Regulation