

Dr Kerry Schott
Chair, Energy Security Board
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Dear Dr Schott,

Re: Response to ESB COAG Paper – Two-sided Markets

Flow Power welcomes the opportunity to make a submission in response to the ESB COAG Paper – Two-sided markets (**Paper**).

Flow Power is a licenced electricity retailer that works with business customers throughout the NEM. Our model aims to give customers control over their energy costs by giving them access to spot prices or 'shape exposed' fixed contracts. We assist our customers to manage exposure and improve cost outcomes through a variety of means, including:

- + engineering services to provide demand response or load-shifting capability or onsite generation (supported by our proven systems)
- + financial hedges, such as financial hedges from markets such as ASX Energy Futures or passing through rights under long-term offtake agreements we have entered into with renewable generators

Flow Power agrees that there are benefits to be had by enabling and empowering more energy end users access to, and interaction with, the energy markets. This principle aligns with our core business model. We believe strongly in the potential for enormous efficiencies in the market to be gained by providing medium-to-large energy users with benefits for aligning their usage more naturally with the price signals in the market. As technology and education increase, these benefits will extend to small and residential energy users.

The key points we would like to make on the Paper are these:

1. The benefits of a two-sided market are described as "improved efficiency and innovation, and customer benefits including better prices and more choice". What is not considered in detail in the Paper is what alternatives are available to achieve these goals, without undertaking enormous regulatory change. We assume a detailed cost / benefit analysis on all alternatives will follow, but this has not yet been made clear. We suggest that this analysis covers the following:

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- a. Flow Power believes that if a larger proportion of consumers were exposed to some form of spot price variability, then this can help achieve efficiencies and cost benefits to consumers. Given the regulatory framework already exists for this to occur, we suggest further analysis is done by the ESB to see what successes can be achieved with alternative product take-up in the market.
 - b. We think there are changes that could be introduced to improve price signals that end users may respond to. For example, in cases when the price is likely to jump to extremely high levels on hot summer afternoons, there are significant inaccuracies between the forecast pre-dispatch and actual prices. One contributor appears to be rebidding behaviour of generators, and to the extent changes to rebidding process could improve forecasting accuracy, then this could improve demand side participation within the existing regulatory framework.
2. Network tariff charge constitutes about 50% of the total electricity bill faced by the end user. Therefore, to be effective, a two-sided market should be supported by other reforms, such as those targeting local network service providers (LNSP) to encourage them developing network tariff structures that support the wholesale market in order to encourage end users' participation. For example, spot prices in the middle of the day in regions like SA and QLD are currently lower than off-peak prices in the middle of the night. But most LNSPs still only offer peak and off-peak tariff rates. Thus, customers wishing to shift consumption to the middle of the day, which is desirable from a market perspective, will face a contradictory price signal from the LNSP.

We have provided comments in relation to the questions explored in the Paper within Appendix 1.

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

Yours sincerely



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Appendix 1

Section 3.5 Questions

Section 3.3.3 outlines the ways in which end users and traders may interact in a two-sided market, and Appendix B provides more detailed examples. Are there other types of interactions which the two-sided market design should accommodate?

The Paper makes no mention of local network service providers (LNSP) at all in the potential design of a two-sided market, albeit they are integral to the delivery of electricity between producers and consumers and they also play a role in approving access to the market.

We believe there is significant scope for market reform to include LNSPs to encourage more efficient investment and management of network assets and how customers interact with the network.

Section 4.7 Questions

- 1. What components of scheduling and dispatch should be expanded in the move to a two-sided market? That is, what processes should we expect more participation in out of MT-PASA, ST-PASA, pre-dispatch and dispatch?**

Flow Power believes there could be significant benefit to be gained from end users participating in the pre-dispatch and ST-PASA timeframes. However, our initial view is that it is unlikely that there is material value to be gained from participating in long horizon forecasts like MT-PASA – many end users are ill-equipped to provide meaningful forecasts on that timescale.

As the scope of different end users engaging in the market expands the need for more granular demand forecasts will be important, regardless of the participation model of these assets. For example, the demand forecasts should be expanded to include an estimate of price-responsive non-scheduled load, network tariff variable load or controlled loads. AEMO have much of this data through recently implemented processes like the Demand Side Participation Information Portal.

- 2. To what extent can self-submitted forecasts replace the need for centrally determined forecasts?**

Our experience suggests that sophisticated energy users have a strong grasp on how and when they use power and are well placed to self-manage forecasts of electricity consumption on a short to medium term horizon (i.e. to the ST-PASA or near MT-PASA timeframe). These users have a strong understanding of how much electricity various processes and pieces of plant consume or produce, and how production schedules impact this usage. However, this may not be the majority of end users, particularly medium and small energy users.

Traders, acting on behalf of end users, may face challenges in producing improved forecasts compared to the existing forecasts as they rely on accurate information from end users. Thus, traders are likely to either be utilising the same statistical uncertainty measures that AEMO employs, or AEMO will still need to take trader forecasts with some uncertainty as is the case currently.

We believe energy-focussed businesses, such LNSPs or AEMO, are still best placed to manage these forecasts as they have access to large amounts of data from a connection point level to individual NMIs and have the resources and teams to dedicate to efficient forecasting.

3. What is an appropriate mechanism for encouraging dispatch targets to be followed and complied with?

While Flow Power strongly believes in the ability for end users to more fully engage with the market, the existing scheduling and dispatch rules are largely untenable for the majority of end users. Such onerous conditions would limit direct participation or participating through a trader.

Thus, any carrot and stick approach to encouraging dispatch targets compliance must be balanced to achieve the desired objective. This is why we encourage further cost / benefit analysis is completed to see what efficiencies and consumer cost savings can be achieved from smaller changes to the current market framework; for example, via encouraging greater consumers to gain greater spot price exposure.

4. What transitional approach should be taken with moving to a two-sided market? How can we increase the level of participation in bidding and dispatch?

Firstly, the key challenge is that most energy users are not focussed on the energy market, because electricity for them is simply a means to end. Energy market rules are complex, large in number, regularly amended, arcane in some places and typically requires dedicated and educated personnel to fully understand the obligations.

Secondly, we think current inaccuracies in price forecasts could diminish participation.

In many cases, particularly when the price is likely to jump to extremely high levels on hot summer afternoons, there are significant inaccuracies between the forecast pre-dispatch and actual prices. This is often down to the rebidding behaviour of generators. The challenge is further exacerbated by the existence of the *knee point* in the generator bids.

For example, on the day prior when day ahead bids are first submitted at 12:30pm a price spike equal to the Market Price Cap for several hours may be forecast. Spot exposed energy users will see this forecast price signal and re-arrange operations to avoid using energy during this period. However, as the affected time draws nearer, generators will often sharpen their bids by rebidding – in the worst cases generators don't actually signal their intentions until very late in the piece.

The consequences of a significantly different pricing outcome than forecast are very different on either side of the energy equation – generators might be looking at a lost revenue opportunity, but customers could be looking at very high operating costs or lost production due to rescheduling in response to high predicted prices that never eventuated.

If traditionally non-scheduled participants are expected to tighten up forecasting and bidding/dispatch processes as part of the two-sided market, there should be some form of tightening and improved bidding behaviour placed on generators. The practice of leaving yesterday's bids in place until late in the afternoon and rebidding just prior to a forecast price spike is one of the worst examples of the current imbalance in the market between generators and consumers and is a poor signal to the market of actual intentions.

Section 5.6 Questions

- 1. Approaches are presented for selective participation under a two-sided market-differentiating on size customer or size of retailer. What are the relative benefits or costs of each approach? Are there any other approaches to selective participation that should be considered?**

As the Paper identified, large industrial users are the lion's share of demand in the system - according to the Paper two thirds of demand comes from less than 1% of connection points. An approach that centres on customer size seems appropriate to achieve economically efficient outcomes. However, it would be logical to standardise the definitions of what a large customer is – as noted in the Paper, the definition of a large customer currently varies by region.

We think there are range of challenges with the retailer-based approach. For example, how is a 'large retailer' defined? Is it the number of customers, size of revenue or size of the organisation? For example, a small retailer focussed on large industrial loads with no residential exposure may have a significant customer base in TWh terms but employ a small operational team. Small retailers are unlikely to have the same level of sophistication and automation in their systems compared to large retailers, who require these systems by necessity to handle millions of customers. On the flipside small retailers may be more operationally agile, and thus able to adjust to market changes more rapidly than the retail arms of gentailers.

Given all these variations, we think a uniform 'large' or 'small' retailer-based approach is likely to be unhelpful.

- 2. The paper suggests that the all three options could be adopted as a transitional pathway. What are the relative benefits or trade-offs of a longer transition? Are there other options that should be considered in the transition? Are there any parties that should be priorities to transition first?**

As discussed above – we believe the selective participation model makes the most sense, with the ability to start with large customers and scale smaller over time and as technology improves. This is likely to be the most efficient approach to achieving significant market reform for lowest cost. The framework could be put in place and the thresholds of what constitutes a large user could be varied over time.

- 3. Are there any other additional elements to participation that should be explored in the next phase of work?**

Network charges constitute about 50% of end user's total energy cost. One of the challenges in a two-sided market that does not recognise LNSPs' role in supporting the wholesale market is that full value is not realised – for example energy costs in the middle of the day in regions like SA and QLD are currently lower than off-peak prices in the middle of the night. But most LNSPs still only offer peak and off-peak tariff rates. Thus, customers wishing to shift consumption to the middle of the day, which is desirable from a market perspective, will face a contradictory price signal from the LNSP. There currently appears to be no incentive for LNSPs to change tariff structures or innovate.