22 June 2023

Graham Mills
Australian Energy Market Commission
GPO Box 2603
Sydney NSW 2000

Dear Mr Mills

RE: Amendment of the Market Price Cap, Cumulative Price Threshold and Administered Price Cap

Shell Energy Australia Pty Ltd (Shell Energy) welcomes the opportunity to respond to the Australian Energy Market Commission's (AEMC) consultation paper on the amendment of the Market Price Cap (MPC), Cumulative Price Threshold (CPT) and Administered Price Cap (APC).

About Shell Energy in Australia

Shell Energy is Shell's renewables and energy solutions business in Australia, helping its customers to decarbonise and reduce their environmental footprint.

Shell Energy delivers business energy solutions and innovation across a portfolio of electricity, gas, environmental products and energy productivity for commercial and industrial customers, while our residential energy retailing business Powershop, acquired in 2022, serves households and small business customers in Australia.

As the second largest electricity provider to commercial and industrial businesses in Australia[1], Shell Energy offers integrated solutions and market-leading[2] customer satisfaction, built on industry expertise and personalised relationships. The company's generation assets include 662 megawatts of gas-fired peaking power stations in Western Australia and Queensland, supporting the transition to renewables, and the 120 megawatt Gangarri solar energy development in Queensland.

Shell Energy Australia Pty Ltd and its subsidiaries trade as Shell Energy, while Powershop Australia Pty Ltd trades as Powershop. Further information about Shell Energy and our operations can be found on our website here.

General comments

Shell Energy supports the Reliability Panel's ("the Panel") detailed analysis and the subsequent rule change request to amend the MPC, CPT and APC. We also support the Panel's view that increases to the CPT and MPC are needed to incentivise investment in new, fit for purpose firming capacity in the NEM. In our view, new firming capacity would help support reliability and security in the market over the coming years as several large

[1] By load, based on Shell Energy analysis of publicly available data.

[2] Utility Market Intelligence (UMI) survey of large commercial and industrial electricity customers of major electricity retailers, including ERM Power (now known as Shell Energy) by independent research company NTF Group in 2011-2021.

thermal power plants are expected to retire. Additional firming capacity would also help support liquidity in contract markets, which is crucial to underpinning efficient retail pricing.

We recognise the concerns that increases to the MPC and CPT could lead to increases in consumer costs. The AEMC's consultation paper based on the Panel's final report,[3] indicates that modelling suggests increases of 3 per cent in real terms are possible as a result of the higher MPC and CPT. The Reliability Panel indicated that this would be a total over the course of the three-year period where the MPC and CPT increase in real terms. We add that to the extent that the increased market settings do encourage new investment, the increased levels of supply may help mitigate any potential additional price increases.

The AEMC also states that it intends to "consider the role of jurisdictional scheme revenue support in assessing whether the additional consumer costs are justified". Shell Energy agrees there is a case to examine the role of jurisdictional investment schemes as part of the interaction with the reliability settings. However, it is essential that the costs of both schemes be considered. If an increased MPC and CPT does indeed increase energy costs in real terms, this must be compared against the increase in costs that consumers may bear from government schemes directing investment. We note the Reliability Panel did consider the impact of government programs to drive investment in capacity and argued:

> *"complementary mechanisms should be efficiently coordinated with market operation and price signals. The presence of such mechanisms should and ideally would enhance the scope and performance of a market rather than replace it and promote the long term interests of consumers."*[4]

In Shell Energy's view, this clearly indicates that government schemes such as the mooted Capacity Investment Scheme are not replacements for economically efficient market settings. Rather, economically efficient price caps and thresholds can work alongside complementary schemes to deliver the desired outcomes.

Shell Energy considers that this rule change should be made and will meet the NEO through enhancing reliability and security of the National Electricity Market (NEM). A decision not to make this rule change may threaten reliability and security of the NEM by failing to incentivise generation and demand side resources to enter the market. This threat to new investment is also likely to have ramifications for electricity prices over the long term.

Amendment of the MPC and CPT

The reliability standard and settings are important signals to indicate to investors when and where capacity is needed. Unfortunately, the scale of intervention over the past several years has blunted and skewed these incentives to promote efficient investment to the market. The introduction and now extension of the Interim Reliability Measure (IRM) in effect tightened the wholesale market reliability standard to 0.0006 per cent unserved energy (USE) without providing a corresponding increase to the market settings to encourage new investment. This has resulted in unnecessary intervention in the form of activation of Retailer Reliability Obligation (RRO) reliability instruments leading to increased costs for consumers. The MPC and CPT have remained unchanged in real terms over this period despite increases in costs for new firming resources weakening the investment signal. The AEMC has recommended the IRM remain in effect until 30 June 2028 covering the period over which these revised reliability settings would also apply.

The IRM will be the trigger threshold for a reliability gap under the Retailer Reliability Obligation (RRO) meaning that if USE is forecast to exceed 0.0006 per cent in a region based on AEMO's Electricity Statement of

[3] Reliability Panel, 2022 Reliability Standards and Settings Review – Final Report

[4] Reliability Panel, 2022 Reliability Standards and Settings Review – Final Report, p 84.

Opportunities report, retailers will need to hedge to their share of one-in-two-year peak demand. Conversely the ability to source contract cover is reducing as schedulable generation retires from the market. AEMO is also able to use forecast breaches of the IRM to enter into multi-year contracts for out-of-market reserves to maintain reliability, known as the Interim Reliability Reserve (IRR), the costs of which are ultimately borne by consumers.

The existing MPC and CPT were based on what was previously needed to meet the 0.002 per cent USE reliability standard. The Reliability Panel's modelling shows that to achieve the 0.002 per cent USE standard an increase in the MPC and CPT is required to incentivise new fit for purpose investment. If the rule change is not made, there will be a greater mismatch between the level of reliability that governments are seeking to drive through the IRM and RRO, and the economic incentives that investors face. There is a distinct risk that if the AEMC does not make this rule change, customers will still face increased costs through the impacts of T-1 triggers under the RRO, multi-year contracts under the IRR, or an increased reliance on government-backed investments, none of which are guaranteed to deliver the efficient or fit for purpose investment outcomes. We urge the AEMC to consider these potential costs alongside the estimated three per cent increase in costs by the end of the adjustment period due to the increased MPC and CPT.

Further, with governments directing investment in new capacity through policies such as the Capacity Investment Scheme and NSW Electricity Roadmap, there is a real risk of a cycle whereby the market settings are not sufficient to incentivise private investment so governments must intervene to a larger extent to lead investment. If the market settings do not change, further intervention may then be required, through more government investment or an increased reliance on the Interim Reliability Reserve or Reliability and Emergency Reserve Trader provisions, to drive the necessary fit for purpose investment. Once the necessary changes to the reliability settings are finally made to drive private investment, a steeper increase in MPC and CPT would likely be needed to bring the settings up to the economically required levels.

Market-based investments in new capacity are also likely to have a greater ability to make contracts available in the financial contracts market compared to those supported by government-backed schemes like the Capacity Investment Scheme.[5] This is because purely market-driven investments face exposure to spot market outcomes and are therefore incentivised to both respond to spot market signals and to enter into financial contracts to manage the inherent price risks involved in the energy-only NEM. Government investment in new capacity risks reducing the need to engage in economically-efficient bidding in the spot market or making contracts available to manage the spot market price risks. Deep and liquid contracts markets are essential to underpinning efficient price discovery and retail pricing in the NEM.

Shell Energy would strongly prefer that this rule change is made in order to encourage private investment in new capacity, and in particular firming capacity. If investors make mistakes in their projects, they bear the financial risks of their actions. If governments take control, consumers bear the financial risks of any poor decisions. We would oppose any decision that presumes no change to the reliability settings is needed because governments are driving investment in new capacity.

We share the Reliability Panel's concerns that retaining the existing MPC and CPT risks not supporting the necessary investment to meet the reliability standard given the expected exit of thermal generator plant.[6]

Amendment to the APC

In our submission on the form of the standard and APC, Shell Energy argued that the APC should be tied to the MPC and expressed as a percentage of the MPC. This would avoid linking the APC to a particular marginal fuel

[5] Subject to the specific design

[6] Reliability Panel, Amendment to the CPT, MPC and APC - Rule Change Request, p7.

which may not remain the marginal fuel in the NEM over time. In practical terms, it would also lead to the APC being indexed to CPI.

We would encourage the AEMC to consider adopting this approach as part of this rule change. If such a change does not sit within the scope of the rule change, we recommend the APC remains at the 'transitional' level of $600/MWh from 1 July 2025 until 30 June 2028. In our view, this would support a stable approach to the market and may allow for new financial products to emerge over the medium-term referencing the $600/MWh level.

Retaining the $600/MWh APC is also likely to reduce the reliance on market intervention and compensation, reducing a regulatory burden on both market participants and the AEMC. The Reliability Panel has argued that a $500/MWh APC would reduce reliance on compensation to around 20 per cent of the derated thermal generation fleet, based on gas prices of $40/GJ.[7] This is a substantial volume of capacity given that when the APC was first set at $300/MWh the AEMC estimated that just four generators, with a combined capacity of less than 200 MW had a short run marginal cost greater than $300/MWh.[8] Reducing the volume of generation that may need to rely on compensation during an administered pricing period (APP) would also increase certainty to retailers and consumers as compensation costs cannot be hedged.

Conclusion

Shell Energy considers the Reliability Panel's rule change to amend the CPT and MPC should be made as per the rule change request. This recommended change is based on detailed analysis undertaken by the Panel in consultation with all stakeholders. This change would progressively increase the MPC to $21,500 in 2021 dollars by 1 July 2027. The CPT would progressively increase to the equivalent of 8.5 hours at the MPC over the same timeframe. In our view, based on the Panel's analysis, these increases are necessary to provide the appropriate signals for investment in the new firming capacity required to ensure that reliability can be maintained in the NEM over the long term and maintain an efficiently functioning contracts market which is essential to provide the lowest cost outcomes to consumers.

We also recommend that the APC be maintained at the current 'temporary' level of $600/MWh rather than reducing to $500/MW from 1 July 2025. Reducing the APC below the current $600/MWh increases the likelihood that generators will need to rely on compensation during an APP. Given that consumers and retailers are unable to hedge compensation costs, this increases the pricing risk across the market. Further, we maintain that setting the APC as a percentage of the MPC would be a preferable approach to ensure that the APC remains at a sufficient level for generators to recover operational and opportunity costs, without linking the level to a specific fuel type.

For more detail on this submission, please contact Ben Pryor, Regulatory Affairs Policy Adviser (0437 305 547 or ben.pryor@shellenergy.com.au).

Yours sincerely

[signed]

James Ell
Acting GM Regulatory Affairs and Compliance

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[7] Reliability Panel, 2022 Reliability Standards and Settings Review – Final Report, p 95.
[8] AEMC 2008, *Clarification of Schedule for the Administered Price Cap, Final Report - Clarification of Schedule for the Administered Price Cap*, 30 April 2008, p 9.