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Australian Energy Market Commission
GPO Box 2603
Sydney NSW 2000

RE: EPR0095 – Draft Report: Review into Electricity Compensation Frameworks

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 also operates the 60MW Riverina Storage System 1 in NSW. 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.

Key Points

Shell Energy:

- Strongly supports extension of opportunity cost compensation to the directions and market suspension frameworks. We note careful consideration will be needed when calculating opportunity cost for batteries directed to a state of charge level as there are discharge costs, charge costs and state of charge boundary conditions to consider;
- Supports the use of VWAP calculation by technology type for upfront payments under directions framework, as well as capping the VWAP at the administered price cap noting that the cap should be applied following the VWAP calculation rather than on a trading interval basis;
- Urges the Commission to reexamine the issue of constrained on generation to eliminate an uncontrollable risk for participants. Due to increasing battery deployment levels, we note that the elimination of this uncontrollable risk would require compensation to be accessible when non-network constraints impact active energy output and consumption and should apply to both energy and FCAS markets.

[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.

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General Comments

Shell Energy welcomes the recommendations of the Commission in the draft report on the Review into Electricity Compensation Frameworks. The proposals generally lead to greater harmonisation between the compensation arrangements for Directions, Administered Pricing, and Market Suspension which will lead to greater clarity for participants and more efficient market outcomes. Our comments relating to specific recommendations are included below.

Compensation for Non-Network Constraints

Shell Energy urges the commission to reconsider its position on compensation when generic (non-network) constraints[3] are applied in dispatch to generators, scheduled loads, and bi-directional units (BDUs). We consider that the Commission's conclusion to not expand the frameworks to include compensation in this area is too focused on constrained-on generation and particularly generation that has been historically constrained on for provision of essential system services purposes.

Shell Energy's view is that generic constraints applied in dispatch for any reason create an uncontrollable risk for market participants. This risk unnecessarily impacts the investment environment created by the NEM in the absence of a compensation mechanism. To minimise this risk and its impact on NEM participants, we remain convinced that compensation is appropriate in some circumstances where a generator or BDU is constrained on or off. A workable alternative to the current Rules would see generic (non-network) constraints applied in dispatch automatically classified as a clause 4.8.9 Direction.

We agree that the Improving Security Frameworks (ISF) determination introduces a mechanism that should reduce the instances of generic constraint application for management of system security issues. However, there is insufficient experience with the framework to consider that it has completely erased the risk to participants. Further, if the ISF operates as an efficient incentive mechanism for the management of system security, as the Commission expects it will, then the risk of AEMO using constraints and compensation as an alternative to the ISF should be very small to negligible.

Shell Energy considers that the Commission's reasoning regarding compensation for constraints applied in dispatch does not sufficiently consider potential future market dynamics and has not taken into account constraints applied for reasons other than power system security. The market has observed generic dispatch constraints applied for reasons other than system security in limited circumstances. For example, AEMO has applied constraints to generators to limit their active energy output or non-scheduled and scheduled load consumption to manage FCAS procurement levels. As this was not undertaken by use of a Direction, compensation was not paid to the affected participant(s). The transition to a more complex mix of technologies and a more dynamic grid is likely to lead to more instances where generic constraints are applied to resolve real-time issues.

An example of this type of potential future use of generic constraints is the recent proposal from AEMO to use constraints to manage battery discharging and charging in the Victorian and South Australia regions following the initial use of generic constraints, then directions, if required, to a low state of charge to manage minimum system load events. It was clear that compensation frameworks would not have applied if this approach was taken. Our discussions with AEMO on this issue highlighted some confusion over the Rules related to the application of generic constraints in dispatch. As a result, we think that the Rules need amended provisions in clause 3.9.7 regarding the need for compensation should generic (non-network) constraints be applied which impact active energy output and/or consumption.

[3] We note that network constraints are defined in clause 3.6.4 or the NER

We submit that an appropriate compensation regime should be created to ensure participant risk exposure is limited due to the use of generic (non-network) constraints in dispatch. As noted above, this could be done simply by classifying this kind of intervention as a 4.8.9 direction or mirroring the compensation framework applicable under a 4.8.9 direction in Clause 3.9.7, in specific circumstances. Given the increasing level of energy storage systems expected in the NEM, compensation under clause 3.9.7 would need to cover both constrained on and constrained off outcomes in both the energy and frequency control ancillary services (FCAS) markets. Shell Energy would welcome further discussion with Commission staff in this area.

Shell Energy does not support an outcome where efficient security-constrained dispatch outcomes can be modified by AEMO through discretionary manual or programmatic intervention without compensation to affected participants.

No Stronger Obligations During Times of Market Stress

Shell Energy supports the Commission's conclusion that no stronger obligations are necessary during times of market stress. The changes outlined in the draft report, including changes to the administered price cap and the current considerations around compensation frameworks, are sufficient to incentivise appropriate behaviours in times of market stress.

Comments On Specific Recommendations

Draft recommendation 1: Each compensation framework should have an objective, and the objective for directions compensation should be to enable generators to be compensated for the costs associated with complying with a direction. The administered pricing and market suspension frameworks will remain the same.

Shell Energy agrees with the Commission's reasoning that a separate objective is appropriate for the directions compensation framework. We suggest that the proposed wording does not sufficiently clarify the inclusion of opportunity costs proposed in Draft Recommendation 2. Therefore, a more specific goal which includes the words "all costs, including opportunity costs," would be more appropriate:

> *"To enable generators to be compensated for all costs, including opportunity costs, associated with complying with a direction."*

Draft recommendation 2: Participants should be eligible to claim opportunity costs in each of the directions, administered pricing and market suspension compensation frameworks.

Shell Energy supports Draft Recommendation 2. We agree that further work is required to reach a shared understanding on opportunity costs. We therefore welcome the proposal that the AEMC retain responsibility for providing guidance on opportunity cost calculations to the independent expert.

We note that assessing opportunity costs for directed BDUs, and other scheduled loads will become increasingly important as newer technologies are deployed. AEMO's proposed use of generic constraints and potentially directions to batteries in Victoria and South Australia for the purposes of managing minimum system load events highlights the complexity of the issue. If a battery is directed to discharge, then its opportunity cost calculation aligns closely with other generation technologies. However, if a battery, or other energy storage system, is directed to remain at a low state of charge (stored energy) for a period of time to retain storage headroom before being directed to charge again, or released for normal market operations, the assessment of opportunity cost requires closer examination. We consider that the opportunity cost is the difference in pricing between when it was directed to store energy, or released to be able to store energy, and the lowest price periods during the period when it was directed to remain at a low state of storage. We also note that the final state of energy storage used in this assessment should be the level prior to the energy storage system being

directed to generate. These are preliminary views and highlight the additional complexity that will be necessary to detail as work progresses to come to a common understanding on the approach to opportunity costs.

Draft recommendation 3: The upfront payment for directions compensation should be changed to reflect the volume-weighted average price (VWAP) received by assets of the same technology type in the same region for the previous 12 months.

Shell Energy supports this recommendation. The use of VWAP by technology will more closely approximate the appropriate level of payment to each type of generator and minimise over-payment and under payment due to the large variation in dispatch outcomes across technology types, as identified in the draft report. We note that it is appropriate that this calculation exclude any trading intervals where a generator or Bi-Directional Unit (BDU) is generating active energy output due to a Direction by AEMO. In addition, we recommend that any trading interval were a generating unit or BDU is generating active energy output in accordance with an essential system services (ESS) contract should also be excluded from the VWAP calculation. The VWAP calculation should only include trading intervals where the dispatch instruction results from a generator's or BDU's bid and not as a result of market intervention or dispatch of an ESS contract by AEMO.

Clear definitions for each technology type must be used. We note that it would be inappropriate to group batteries and hydro with long duration storage as a single technology type given their different operating modes and opportunity cost considerations.

Shell Energy also agrees that it is appropriate to cap these up-front payments at the APC level and subject large additional payments to the scrutiny of the compensation process. The methodology for doing this should be on an average basis. That is, the VWAP should be calculated for each technology and region for the preceding 12 months and only then limited to the APC. The alternative approach of limiting each trading interval in the preceding 12 months to the APC and then calculating the VWAP would unduly impact the VWAP by removing a significant portion of the pricing from the calculation. The result would be a large distortion to the up front payments that would move away from the goals of the change.

Shell Energy sees little likelihood of gaming under the proposed approach given the 12 months period being considered.

Draft recommendation 4: The upfront payment for market suspension compensation should be the greater of the MSPS price and the upfront payment for directions (calculated as the VWAP).

Shell Energy supports this recommendation. We agree that it will provide greater clarity to participants regarding the different frameworks.

Draft recommendation 5: All compensation claims should be lodged with AEMO.

Shell Energy agrees that a single market body should handle all claims. A single point of contact simplifies administration and minimises the potential for confusion during a potentially stressful process.

Draft recommendation 6: AEMO, using the independent expert function, should assess claims for administered pricing in addition to the directions and market suspension compensation frameworks. All claims for opportunity costs should be assessed by the independent expert.

Shell Energy supports this recommendation and the principle underlying it which is to provide consistency across the frameworks. The use of the independent expert function is a sensible approach and ensures that appropriate expertise is applied on a consistent basis across frameworks and events. Shell Energy also

recommend that the Rules provide improved transparency in the process for the selection of parties who form the independent expert panel. Currently this is an opaque process.

Draft recommendation 7: The Commission should retain responsibility for the guidelines for assessing opportunity cost claims. These guidelines will apply across all frameworks.

As previously noted, we support the Commission retaining responsibility for the guidelines for assessing opportunity cost claims. Noting the comments in the draft report around the need for further work to reach a common understanding on opportunity costs, we suggest that the final report should detail the process for consultation on the opportunity cost guidelines. We further suggest that this work be scheduled to occur promptly following the conclusion of this review.

Draft recommendation 8: Administered pricing compensation should be assessed by trading interval within an eligibility period rather than by net revenue in an eligibility period.

Shell Energy supports this recommendation. This approach, combined with recommendation 9, improves the incentives for operating plant efficiently during an eligible period.

Draft recommendation 9: Administered pricing compensation should be assessed on an individual unit level rather than across all units that make up a claim for compensation.

See previous response.

Draft recommendation 10: There should be the same time limits on all compensation claims including claims for administered pricing compensation. The time limits should be aligned with AEMO's intervention settlement timetable, which currently sets out the timeframes for directions and market suspension compensation processes.

Shell Energy recommends erring on the side of caution and providing a longer period for compensation claims (e.g. 120 days) as in the immediate aftermath of market stress events like those experienced in June 2022, there can be multiple requests for information from other bodies such as the AER and staff are generally busy dealing with the market events themselves along with other information requests.

Draft recommendation 11: The same types of direct costs should apply to all compensation frameworks and be identified in a single list.

We consider it appropriate to create a single list of claimable direct costs within the Rules. The list should include all costs identified in the current lists at 3.14.5B and 3.15.7B and we support the recommendation to expand the list to include the following per generator or bi-directional unit:

- energy input costs incurred;
- operating and maintenance costs directly attributed to the operation of the facility to provide services;
- wear and tear directly attributed to the operation of the facility; and
- other costs incurred.

Draft recommendation 12: Cost recovery for administered pricing compensation should be determined on a trading interval basis, with costs recovered from the region where the price is set by the APC.

Shell Energy supports this approach. We agree that it will help avoid perverse incentives for generators and that consumers are the beneficiaries of such directions. We also note that it may not be appropriate to separate out "capacity directions" to storage facilities from other directions. As BDUs become more common these types of directions may be used more frequently. It would be better to harmonise the treatment of these interventions with other types to ensure that all perverse incentives are avoided and to reduce confusion for market participants.

Draft recommendation 13: Costs of capacity directions should be recovered from consumers only.

As noted above we support the harmonisation of directions across generators, BDU's scheduled loads and unscheduled loads.

Draft recommendation 14: The same standards of supporting information should be required across all compensation frameworks.

Shell Energy supports this recommendation.

To discuss this submission further, please contact Peter Wormald (peter.wormald@shellenergy.com.au).

Yours sincerely,

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