12 December 2024

Australian Energy Market Commission
Level 15, 60 Castlereagh Street
Sydney NSW 2000

Submitted: via online portal

RE: ERR0097– The pricing review: Electricity pricing for a consumer-driven future

About Shell Energy and Powershop in Australia

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 one of the largest electricity providers 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 service. Our generation assets include 662 megawatts of gas-fired peaking power stations in Western Australia and Queensland, to provide back-up for rising levels of renewable energy, 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.

General Comments

Powershop welcomes the opportunity to inform the Australian Energy Market Commission's (AEMC) consultation - The Pricing Review: Electricity pricing for a consumer-driven future ('The pricing review').

A key and enduring strength of the Australian energy system is its ability to harness competitive markets through sophisticated governance arrangements that "promote efficient investment in, efficient operation and use of, electricity services for the long-term interest of consumers of electricity."[3] As the sector navigates the complexities of the energy transition, it is an appropriate for the AEMC to take stock of its processes, methodologies and rules against its stated aims.

Powershop supports an outcome that ensures regulations are sufficiently flexible to cater for a wide range of possible solutions that are continually tested and (in some cases) implemented at scale in the market.

Outcomes that Powershop supports include:

- The continued development of an enabling framework that supports efficient pricing and competition to develop a variety of products and services fit for the market.

[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.

[3] National energy objectives

- Flexibility to support innovation and enable the market to experiment and deliver the best outcomes for all consumers.
- A simplified network tariff regulatory framework that:
    - provides simple and actionable tariffs for consumers;
    - enables retailers to align tariffs to the underlying network tariff to ensure they can adequately and fairly recoup costs; and,
    - harmonises competing regulatory requirements.

Powershop cautions the AEMC against prescribing a regulatory framework for hypothetical market conditions that may never eventuate. A challenging aspect of this review is future-proofing regulations so they continue to support a liberalised competitive market. We believe that this is particularly important in this period of significant change and volatility. As such, We are encouraged that the AEMC has committed to undertaking the Review in an open, collaborative, and transparent manner and we welcome the opportunity to work with the AEMC during this process.

Further comments around the Review are provided in the submission that follows.

If you would like to discuss any part of this submission, please contact Carmel Forbes at Carmel.Forbes@shellenergy.com.au

Yours sincerely

Libby Hawker

General Manager – Regulatory Affairs and Compliance

Proposed Review Approach

In an evolving market it is critical to maintain and enhance existing flexibility, allowing the retailers to innovate and find cost-effective pathways to optimal outcomes, while ensuring vulnerable consumers are not left behind. Balancing the interests of all market participants, is crucial for a regulatory system that serves as a protective guardrail against failures, rather than a prescriptive approach that is rigid and risks baking in inefficient pathways going forward. Powershop supports the continued development of an enabling framework that supports efficient pricing and creation of a variety of products and services fit for the times they are created in.

Powershop supports the AEMC taking a long-term focus to regulatory framework design which in turn encourages innovation to support the diverse needs of consumers.

However, we have some concerns around the proposed approach to the Review. The AEMC notes that '*by considering the broad range of potential future products, services, and pricing structures that consumers may want, we can identify the right regulatory frameworks to enable these future offerings*'. [4]

Determining the future consumer experience, and then solving for the market and regulatory arrangements that can deliver it, is a backwards approach to regulatory design. There is an inherent risk in assuming/defining certain future dynamics and offerings, that if wrong, will be detrimental to all consumers. Previous efforts to design and predict the future of the energy market have forecast outcomes that have not eventuated, for example, the Parer Review, which assumed consumers play no larger role in the supply chain than simply consuming energy. We have since experienced rapid technological developments that have driven significant changes in consumer behaviour, leading to the installation of 22.58GW of capacity across over 3.7 million Australian residences.[5] Further, the AEMC is undertaking the Review prior to the resolution of the post-2030 wholesale market design. It is not possible yet to predict what the impacts of any wholesale market changes will be on the retail market. Locking in prescriptive regulatory frameworks around what products, services and pricing consumers may want post-2035, before this work is complete, is a huge gamble.

Powershop recognises that it is an ongoing challenge to shape market design so that incentives efficiently allocate costs and risks, though consumers shouldn't be beholden to what the market looks like today. We agree with the AEMC that benefits should be more evenly distributed, and downsides minimised where possible. Balancing a flexible regulatory framework with the protection of vulnerable consumers is crucial for the energy industry's future. While removing barriers to innovation is essential, it is equally important to build on existing market design principles and consumer protections.

It would be more valuable for the AEMC to adopt an outcomes-based approach and not pick winners.

Consumer Preference Principles (CPPs)

The AEMC has developed a set of CPPs to assess if potential future regulatory frameworks meet (or do not meet) the needs of future consumers. This approach appears to give the AEMC the role of a future product designer, a potential conflict of interest with its role in the energy market. Powershop does not support how the AEMC proposes to use the CPPs and we consider that the National Electricity Objective[6] and the National Energy Retail Objective[7] provide sufficient guidance in the long-term interest

[4] AEMC, The pricing review: Electricity pricing for a consumer-driven future, Consultation paper, 07 November 2024, pg 17

[5] Australian Energy Council, Solar Report, Quarter 1 2024

[6] National Energy Objectives | AEMC

[7] AEMC, How the national energy objectives shape our decisions, August 2024

of consumers. It is then the role the market to develop and test the products and services that consumers want.

Consumer Archetypes

The differentiation of consumers into different archetypes based on their engagement with the electricity market is a valid exercise to inform the Review. However, the level of consumer inertia in the market shouldn't be trivialised. In Victoria, regulation has been used to incentivise customers to be more engaged in the market for a number of years, for example, using switching credits and best offer requirements. Despite considerable effort to activate consumers, the historical monthly annualised transfer rate highlights that at most one third of consumers are engaged enough to switch retailer (in Victoria, the state with the most churn in the NEM) and 75-85% of consumers remains disengaged across the NEM.[8] Many customers simply prefer simple and predictable pricing.

A key element missing in the proposed archetypes is an understanding of the cost to serve the different segments. It is important to understand base costs and any potential cross-subsidy required to avoid prioritising one customer segment over the other. As it stands today, the cost base of engaged and well-resourced consumers (those in the right-hand side of the consumer archetypes grouping) is very different to those on the left-hand side. When looking through the prism of pricing, these archetypes articulate the cost base differences and implications for pricing efficiently.

Future Products, Services, and Pricing Structures

The mix of products and services available to energy consumers is continuing to evolve, particularly as the upfront cost of consumer energy resources (CERs) - batteries in particular - continue to fall and other new technologies are developed.

To date, the existing regulatory principles and market forces have provided sufficient incentive to invest in and develop new products and services that meet the diverse needs and interests of consumers. At the same time, current rules (and rule change processes) have provided scope for the integration of new products in the market, such as the rollout and connection of CERs to the grid. We expect that this cycle will continue, and continual improvement in the rule change processes will set the sector up for success. As new products and services are developed, including those enabled by technology not yet available, **we encourage the AEMC to continue to build in flexibility to support innovation and enable the market to deliver the best outcomes.**

Incentives, such as subsidies for residential solar, have been very effective in driving uptake of these products. However, the reality of an evolving energy market has meant that the challenges of integrating these resources into the grid requires a step change in regulatory approach. The inherent risk of short-term incentives is that as inducements expire or settings are changed, consumers that took advantage of the incentives can be less well off as a result.

In the case of residential solar, changes that are necessary for the efficiency, reliability and security of the energy system can reduce the productivity of assets or delay payback periods, leaving consumers worse off. A competitive market supported by an adaptable regulatory environment will facilitate the most efficient means of integrating new products.

To maximise the upside and minimise the downside as well as improve our understanding of the medium- to long-term impact of CERs (and other product innovations on the horizon), the regulatory framework

[8] National Electricity Market Monthly Transfer Statistics, AEMO November 2024

should take a pragmatic and holistic outlook and support market mechanisms that promote efficient outcomes.

Network Tariff Design

As the AEMC notes, network tariffs are a key component of current electricity costs structures. According to the AER, electricity network charges made up as much as 46% of a residential customer's electricity bill in 2023, with distribution network services accounting for majority of these costs (63% to 92%).[9] As such, Powershop encourages the AEMC to examine the role of DNSPs and network tariffs in an evolving market as part of this Review.

Powershop considers that there are two important elements the AEMC should resolve in this Review which support the design of efficient tariffs that are simple, actionable, and practical to operationalise.

1. Resolve the misalignment between retail and network tariffs.

A customer's experience is not only dependent on their retailer but also their underlying distribution network. Distribution networks have a role to play in ensuring that tariffs are not overly complex and can be readily understood by customers, as retailers often pass through network tariffs. Given network tariffs typically represent the greatest component of retail tariffs, retailers will rightly attempt to structure tariffs to match the underlying network tariff, to sufficiently recoup their costs.

However, regulatory changes[10] have seen increasing misalignment between retail and network tariffs which can mean retailers are unable to recover costs over an extended period of time. Retailers, who have limited influence over the structure or cost of DNSP tariff settings, cannot mitigate or hedge the largest component of the retail tariff. The impact of this misalignment can be significant, particularly for small and medium retailers, who will be impacted in their ability to remain competitive amongst larger retailers who are able to recoup their costs from a larger cohort of customers. Ultimately, this will further reduce competition in the market, which will have a negative impact on consumers.

Powershop encourages the AEMC in this review to **explore a regulatory framework that enables retailers to align their tariffs to the underlying network tariff to ensure that retailers can adequately and fairly recoup costs**. This will also assist retailers in educating consumers on electricity tariffs, particularly around pricing methodology. Anecdotally, questions about tariffs constitute a large number of consumer enquiries into our call centre.

2. Harmonise competing regulatory requirements.

The AEMC notes that a future energy system needs network tariffs designed to balance consumer protections, commercial realities, the need for innovation, and overall efficiencies. As networks get increasingly more precise and complicated to accommodate for a variety of developments, we can reasonably expect the number of tariff choices to increase. However, Powershop believes that it is unlikely that increasing complexity and diversity of choices for consumers will improve engagement given most consumers' preference for simplicity.

There is a risk that the increasing complexity of network tariffs may result in consumers not getting a clear price signal. New regulatory requirements and retail price regulation further exacerbate this risk. To achieve the objective of supporting a future energy system characterised by multi-directional flows of energy, we would encourage the AEMC to consider if the foundations are correct. Better harmonisation around tariff reform is inherently important for consumers and enables better communication so that

[9] AER, State of the energy market 2024, pg 96

[10] For example, the current rules requiring referencing pricing to the Default Market Offer may become a barrier to greater tariff design improvements. This is especially true if retail consumers are placed on a variety of tariffs at the network level, it becomes complex to provide an accurate and simple indication of a reference price.

customers can make more informed decisions on how to respond to price signals – i.e. through energy efficiency or CER uptake.

The introduction of cost-reflective pricing from 2014 required distribution businesses to '*develop network prices that are cost reflective and send efficient pricing signals to consumers.*'[11] The AEMC noted that this '*will allow consumers to make more informed decisions about their energy use as new technologies emerge and result in better outcomes for both individual consumers and the overall electricity system.*'[12] The rationale being that price signals would flow directly to consumers and ideally shifts their behaviour in such a way that justifies lower investment in the networks. The AEMC should consider if consumers have responded to these price signals and if the cost of future network augmentation was avoided/deferred.[13] There is evidence to suggest that capacity to meet peak demand is no longer a critical issue, particularly as CER uptake increases.[14] It would be beneficial for this Review to determine if current network investment incentives remain fit-for-purpose.

The recent AEMC Accelerating Smart Meter Deployment Final Decision[15] counters these 2014 reforms. The changes will limit the ability of retailers to effectively send pricing signals to consumers. The establishment of a new two-year explicit informed consent (EIC) period for retail tariff variations and a requirement for designated retailers to make flat tariffs offers available, while DNSPs will still be able to apply a new cost-reflective network tariff when the customer receives a new smart meter, will create a perverse outcome. It creates a greater disconnect between the DNSP incentives to efficiently manage the network and retailers' ability to adequately manage risk pricing profile, leaving retailers more exposed. This risk is exacerbated if the Default Market Offer doesn't account for a risk premium.

Retailers are well placed to continue to utilise their existing expertise in managing risks for customers if the regulatory settings enable this. Powershop believes there is scope to **reimagine the current arrangements so that there is a more efficient model for sharing the benefits of efficient tariffs**. This could be a simple as standardisation of network tariff structures across DNSPs. Or unbundling the network tariff from the retail tariff on a customer's bill. This provides a level of transparency and understanding of exactly how much consumers are paying for network services versus the actual energy they consume.

As we navigate this transition, the case for regulatory harmonisation and alignment to deliver better customer outcomes grows. Adopting a holistic view of all market participants and the regulatory environment influencing their relationships will be increasingly important in the emerging energy system. Powershop supports the opportunity in this Review to step off the treadmill of patch fixes and target holistic reform that considers how settings are coordinated and interact with one another.

[11] AEMC 2014, Distribution Network Pricing Arrangements, Rule Determination, 27 November 2014, pg vii

[12] Ibid, pg vii

[13] The AER's 2024 State of the Energy Market report notes that as at 30 June 2023, approximately 36% of residential consumers were served by a retailer that faces cost-reflective network tariffs. pg 83

[14] Energy Consumers Australia, 2024, 'Cost reflective network tariffs aren't cost reflective', pg 2

[15] AEMC, Accelerating Smart Meter Deployment Final Decision, 28 November 2024