13 April 2023

Alex Caroly
Australian Energy Market Commission
GPO Box 2603
Sydney NSW 2000

Dear Mr Caroly

RE: Review of the Interim Reliability Measure

Shell Energy Australia Pty Ltd (Shell Energy) welcomes the opportunity to respond to the Australian Energy market Commission's (AEMC) Review of the Interim Reliability Measure (IRM) draft report.

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 more than 185,000 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 disagrees with the AEMC's draft recommendation to extend the IRM to 2028. When the initial IRM was introduced in 2020, Shell Energy disputed the need for such a measure. Reliability has proven to be strong in the National Electricity Market (NEM) over its history with very few incidences of unserved energy. We recognise that risks remain as the system transitions away from fewer centralised thermal plants to a more dispersed set of variable renewable energy generators with firming capacity including, hydro, gas powered generation and battery storage. However, extending an instrument that was originally intended as an interim measure should require it to be justified though a rigorous cost-benefit analysis. We add that the Reliability Panel

[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.

has indicated that "the IRM... is significantly tighter than a level of reliability consistent with consumer willingness to pay for reliability".[3]

Extending the IRM for three more years risks increasing electricity costs at a time when many consumers, large and small, are faced with cost pressures. In its response to the introduction of the IRM and Interim Reliability Reserve, the ACCC argued that "the pursuit of marginal increases in reliability in the NEM will have negative impacts on affordability"[4] and expressed concern that the IRM and IRR "will impose additional costs on consumers, particularly small consumers".[5] Shell Energy shares these concerns and believe that at the current time, it is paramount to avoid unnecessarily adding to the electricity cost burden.

The AEMC argues that extending the IRM is unlikely to impose significant costs on consumers as although the IRM would remain the trigger for gaps under the Retailer Reliability Obligation (RRO), "T-3 reliability gap costs are limited and do not place significantly higher costs on consumers".[6] Further the AEMC suggests that although there are potentially higher costs associated with T-1 reliability gaps, the three-year notice period afforded by the T-3 trigger signals the need to comply and contract to sufficient levels to protect customers from the costs.

Shell Energy considers this underestimates the impacts of the contracting levels retailers are required to hold and the contract market dynamic given that retailers must have contracts in place more than 12 months in advance. This assessment also ignores the impact the higher reliability threshold has on costs relating to the Reliability and Emergency Reserve Trader (RERT) mechanism, where multi-year contracting at increased costs to consumers may be triggered.

Shell Energy also considers that AEMC's draft decision to extend the IRM is premature given that the Reliability Panel's rule change to increase the Market Price Cap (MPC), Cumulative Price Threshold (CPT) and Administered Price Cap (APC) is still pending and has yet to be progressed. Extending the IRM but failing to increase the reliability settings necessary to deliver that reliability outcome is a risk and could prevent investment occurring, while unnecessarily driving the need for government intervention. We note that the Reliability Panel also argue that the IRM's standard of 0.0006 per cent unserved energy "was not a level of reliability that could be implemented or reasonably achieved through the market price settings as it would require an impractically high MPC leading to systemic financial risk issues".[7]

The submission that follows outlines our concerns with extending the IRM to 2028 given the potential impact on costs to consumers at a time of already high energy prices.

Likelihood of RRO triggers under the IRM

As noted in the Draft Report, state energy ministers will soon have the power to declare a T-3 gap period themselves, as the SA Minister currently does, irrespective of AEMO's forecasts. In our view, this makes the likelihood of T-3 triggers far higher than if it was purely based on AEMO's forecasts in the Electricity Statement of Opportunities (ESOO) report. As we have seen in South Australia, the minister has issued a T-3 trigger each summer since it was granted the power to do so despite the fact the ESOO reliability assessment failed to forecast an exceedance of the IRM. We consider it highly probable that other states will follow suit.

Since a T-3 instrument is a prerequisite for a T-1 instrument, the more T-3 gap periods which are declared, the higher the chance that a T-1 gap period will eventually be declared. Yet, the purpose of the T-3 trigger is to demonstrate that capacity is needed in the market based on the ESOO reliability assessment. If there is a

[3] Reliability Panel, Review of the form of the Reliability Standard and APC, 30 March 2023, p 8.
[4] ACCC, Submission to ESB Consultation on the draft interim reliability reserve rules, p1.
[5] ACCC, op cit. p2.
[6] AEMC, Review of the IRM – Draft Report, 9 March 2023, p 7.
[7] Reliability Panel, Review of the form of the Reliability Standard and APC, 30 March 2023, p 8.

misalignment between the ESOO forecast reliability, what AEMO and Governments think reliability should be and financial markets' expectations of reliability (and therefore prices) the investment that Governments and AEMO believe is necessary, may not occur. Investment will only be delivered off the back of expected returns, supported by market settings and actual evidence of the need for new capacity.

Investors will not build new generation solely because of a T-3 trigger, they will need to have greater confidence that the prices they can receive in the energy market are sufficient over the long term to make a profit. As such simply declaring T-3 triggers will not drive efficient investment. This is particularly the case given the low level of unserved energy (USE) allowed under the IRM, just 0.0006 per cent of total annual demand. Market expectations of prices and reliability are what will drive investors to build new capacity.

Consequently, extending the IRM will not necessarily drive investment in new capacity. It is more likely to lead to further T-1 instruments which will increases retailers' contracting levels and impose higher costs on consumers.

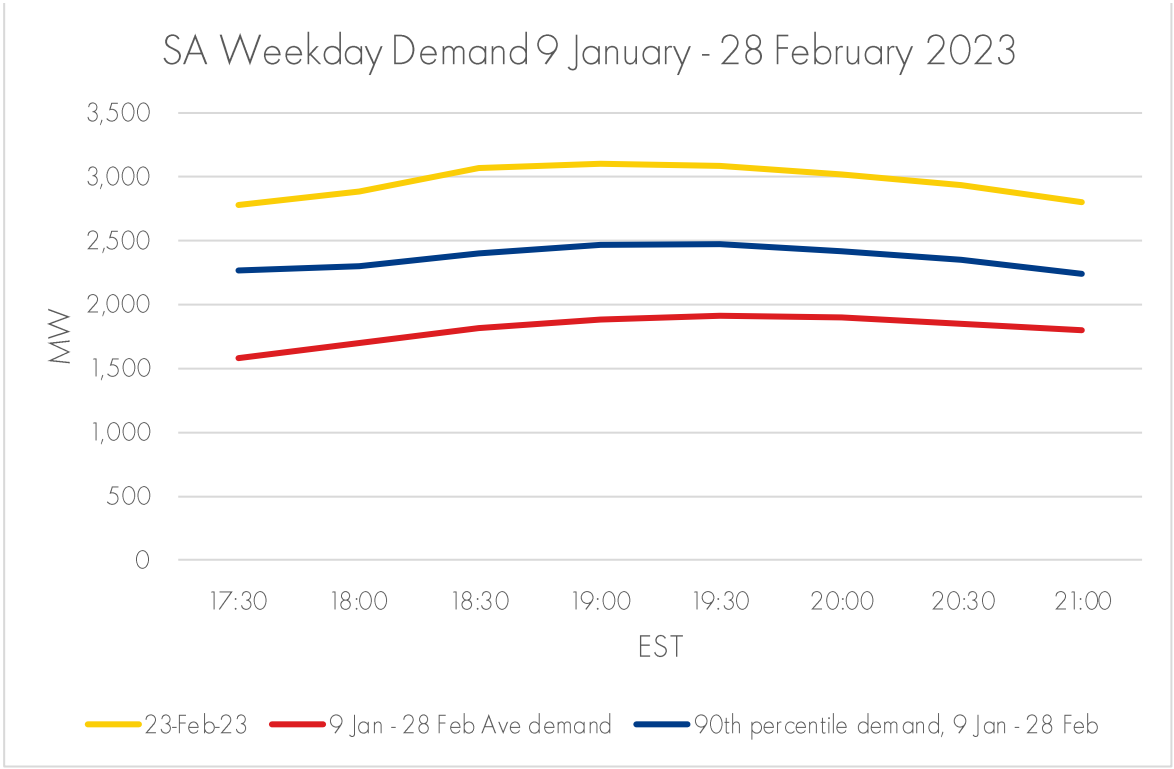
RRO costs

As noted above, the T-1 reliability instrument in South Australia is a direct result of the IRM being used as the trigger. Without the IRM being in place, no reliability gap period would have been declared. Extending the IRM until 2028 runs the risk of this occurring again and imposing additional costs on energy consumers. A T-1 instrument imposes real costs on energy consumers as retailers are required to hedge more than a year in advance for their estimated share of total demand based on 50POE maximum demand. Shell Energy observed changes in the contracts market in South Australia around the contract position day for the Q1 2024 gap period in South Australia. As background, only contracts acquired before the contract position day can be used for compliance with the RRO.

[REDACTED]

In addition, by comparing the average demand during the high demand periods in the January-February 2023 period in South Australia, we can observe the extra volume of contracts required compared to the average demand. Once this is multiplied by the costs we have observed, it is clear that the extra costs imposed are significant.

The chart below looks at demand in South Australia during the equivalent gap period transposed to 2023 – in this case, from 5-9pm EST on working weekdays, 9 January – 28 February. The current T-1 gap period for SA is set as 5-9pm working weekdays, 8 January – 29 February 2024. It compares average demand with 90th percentile demand and demand on 23 February 2023, which exceeded AEMO's P50 maximum demand forecast for 2023. A day of equivalent demand in 2024 would lead to compliance being assessed.



Source: Shell Energy analysis of AEMO public data

As the data show, retailers and large energy users would collectively have to contract for 1000-1200MW of demand (around 55-75 per cent) more than average conditions in SA to meet the RRO's requirements for contracting. Even if every liable entity normally contracted to the 90th percentile of demand, around 500-660MW (around 35 per cent) of contracts above the 90th percentile of demand would be required to meet the level of contracting required under the RRO. This must be done more than 12 months in advance.

As noted in the Australian Energy Regulator's 2023-24 Default Market Offer draft determination, there are higher hedging costs associated with securing additional contracts to meet higher forecast demand levels. The AER adds "if the higher demand does not eventuate the retailer would have over contracted and incurred additional costs that were not necessary".[8]

Consequently, the combination of contracting at levels far higher than average demand (or even 90th percentile demand) at prices far higher than usual, and earlier than usual, means that the overall extra cost of a T-1 reliability instrument declaration adds significant costs to consumers. Extending the IRM would increase the risks of these costs being imposed on energy users.

In addition, AEMO Services are currently tendering for additional reserve capacity in NSW covering the period from December 2025 onwards for 380 MW. This is based on achieving reserve capacity of 1,400 MW equal to the capacity of the two largest units in NSW. AEMO Services have advised that should the IRM be extended, this additional reserve capacity will increased to around 530 MW.[9] The costs of this tender are recovered from NSW consumers via increased distribution network charges, as such extending the IRM will

[8] AER, Default market offer prices 2023-24 – Draft Determination, March 2023, p 16.
[9] AEMO Services, 2022 Infrastructure Investment Objectives Report, December 2022, p 43.

have a direct and immediate impact on NSW electricity consumers by bringing forward the costs of additional capacity.

Impact on retail markets

The fact that retailers must have contracts in place 12 months in advance, but customers can contract as they please, places retailers in a difficult situation. Retailers must estimate and contract for their demand a year in advance. If their demand estimates are too high, they will have to wear these extra costs, or may be able to bring on new customers up to their estimated RRO liability. If their demand estimates are too low, they may be unable to bring on new customers. While the National Electricity Rules (NER) do contain provisions that allow retailers to apply to the AER to adjust their net contract position due to bringing on new customers under some defined circumstances, there is a catch-22: retailers won't want to sign up new customers unless they can be assured the AER will allow them to adjust their net contract position, but retailers cannot be assured the AER will permit them to adjust their NCP unless they have already signed up the new customer.

With the higher likelihood of T-1 triggers under the IRM, there is a risk that it could disrupt retail market dynamics with retail customers unable to secure retail contracts. While South Australia is a test case for this, being the first T-1 trigger event, similar issues could spill over to other states if other T-1 instruments are granted, particularly where a T-3 trigger event was not determined in the ESOO reliability assessment.

Shell Energy does not believe that the IRM and the potential for increased costs represents the value of reliability that customers indicate they want.

Conclusion

Shell Energy does not support the extension of the IRM to 2028 on the grounds that it risks increasing costs to consumers at a time of already high energy prices without delivering meaningful improvements to reliability. We do not consider that the AEMC's draft recommendations reflect consumers' views on the value of reliability and instead focusses more on the political value of reliability. Consumer submissions to the original consultation on the IRM strongly opposed its implementation.[10] Wholesale market reliability historically represents less than 1 per cent of loss of supply experienced by consumers. A higher reliability standard invoked by extending the IRM involves higher cost resources being required to meet the additional level of reliability sought. If this is procured via multi-year or medium-notice RERT contracts, then consumers will face these extra costs for what amounts to a very marginal improvement in reliability.

Without the IRM, there would still be avenues for governments to pursue stronger reliability targets without imposing the same level of costs on consumers.

The Capacity Investment Scheme can be used to bring new supply online. While we have little detail on this policy as yet, governments may be able to ensure that sufficient capacity is available beyond that required by the reliability standard.

Alternatively, as the ESB previously recommended, jurisdictional strategic reserves could allow for jurisdictions "to procure any required reserves beyond the national market reliability standard if they consider this necessary."[11] This would enhance reliability and should ensure transparent costs that can be traced back the specific decision to pursue a stronger reliability target.

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[10] E.g. submissions from Energy Users Association of Australia, Major Energy Users and Queensland Electricity Users Network

[11] Energy Security Board, Post-2025 Market Design Final advice to Energy Ministers – Part A, 27 July 2021, p 8.

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]

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