14 December 2023

Essential Services Commission
Level 8, 570 Burke Street
Melbourne VIC

Sent via email to VDO@esc.vic.gov.au

RE: Victorian Default Offer review 2024-25

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 thanks the Essential Services Commission ('**ESC**') for the opportunity to provide feedback for the Victorian Default Offer review 2024-25 ('**VDO**').

We have considered the two core components which the ESC is consulting on for this stage of the VDO, being the wholesale methodology and the retail operating margin. Our submission highlights these as follows.

Wholesale Methodology

Shell Energy supports the ESC consulting on the wholesale methodology component of the VDO. We consider that there are several factors which the ESC must take into consideration before it makes its final determination. These factors are detailed below, though in short, we consider that information surrounding over the counter (OTC) prices, reference to future load shapes, and the evolution of consumer load and profiles will be fundamental in ensuring this section is well thought out.

[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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Firstly, Shell Energy understands that the ESC's final decision for the 2023-24 VDO did not include peak swap contracts in the estimation of the wholesale electricity cost benchmark. While we agree that peak contracts do not trade as much as other common contracts, Shell Energy considers that there are other considerations that the ESC must take into account for the wholesale methodology to form a more reliable view of wholesale costs.

Shell Energy considers that OTC prices should be used to inform wholesale prices. We do not necessarily consider the inclusion of OTC volume market as the way forward, but rather an OTC price curve market could be utilised to take the ratio to the base to inform a broader view on wholesale prices. In practical terms, the ESC could inquire with Brokers to receive OTC data to validate the information received from retailers.

Secondly, we also consider the need to develop a methodology for different consumer load shapes, as well as greater transparency on the existing load shapes which the ESC uses to calculate costs for small retailers. For instance, the methodology as consulted, does not appear to take solar shape into consideration, nor does it account for the impact this shape would have on the wholesale cost component. We note that this was discussed in the Frontier Economics Wholesale Electricity Report, particularly that "the increasing adoption of rooftop solar PV is likely to materially affect load factors and prices over time".[3] Broadly, Shell Energy would like to understand how changes to future load shapes are considered within the VDO, particularly given the continued and acceleration of growth of rooftop solar.

Further to the load shapes for solar, and the VDO more broadly, the ESC must also consider the dynamic change in shape which the expanded Capacity Investment Scheme will introduce. This issue will become more prominent over the next few years as states and territories are expected to assist the Commonwealth in reaching the target of 82% renewables and an additional 32GW of variable and dispatchable electricity by 2030.

Finally, in comparison to the years since 2019 with the impacts of Covid-19 or extreme demand and supply events impacting the market, 2023 has been a relatively normal year. There have been significant changes across the energy sector from wholesale costs to consumer behaviour. The load shapes and consumer profiles have changed where consumers are now working from home more, are starting to invested more in electrical appliances and vehicles but are also seeking to offset their consumption through investment in rooftop solar as well as batteries. As stated in AEMO's Integrated System Plan 2022, it is expected that by 2032, over half of the homes within the NEM are likely to have rooftop PV, with most systems complemented by battery storage.[4] Therefore, while the shapes and profiles have been in a state of transition across the energy system, historic data may no longer be the most accurate method of determining the short-term future costs of providing offers.

We are also interested to see how the ESC will consider the Gas Substitution Roadmap and Victorian Energy Upgrades program, and how these proposals will impact consumers, their behaviours and how the VDO will adapt to these.

Shell Energy welcomes the opportunity to further discuss these aspects of the wholesale methodology with the ESC within a confidential forum.

Retail Operating Margin

Shell Energy is concerned that the resilience of the B2C market does not appear to be recognised within the retail operating margin. We consider that not all retailers may have the resources to wear the costs required to remain

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[3] Frontier Economics, *Wholesale Electricity Coasts for 2023/24 – A final report for the Essential Services Commission*, (May 2023), pg.13

[4] Australian Electricity Market Operator, *Integrated System Plan*, (June 2022), pg. 10

active in the market in the long term. This is more relevant to smaller retailers who fall under Tier 2 and Tier 3 and have driven many innovations in the B2C market in Victoria. As noted in the ESC's previous VDO decision:[5]

> "*Setting a price below efficient costs may mean, in the longer term, less retail competition and less investment in the industry. The result of this would likely be less innovation in providing long term cost reductions and less reliable electricity service. This would not be in long term interests of Victorian consumers*".

Also, as stated within the VDO philosophy, there is no allowed headroom for innovation or investment in improving customer experience or products through digitalising services, improving contact resolution, or developing new products or services. Inherently, any investment in these areas will be funded out of the risk adjusted long term returns.

With the ESC and other energy regulators continuing to refer to each other's regulatory decisions on appropriate margin, there is a risk that the margins set become self-perpetuating and not reflective of the underlying risks that retailers undertake in providing services to Victorians. Additional benchmarks against returns provide for distribution and network companies and very low-risk regulatory industries are useful indicators for the lowest range of appropriate margins.

We understand that the previous VDO decision sought to build a risk premium into the margin, however we consider that while the risk-free interest rate is now 4.35%, there is only a 5% margin for a high-risk business such as power retailing is applied. We are concerned with the lack of transparency around the final decision of the last VDO where a subjective 5.3% retail margin was applied, down from the draft decision percentage of 5.7%. We agree with the previous draft decision and therefore seek that the retail operating margin be set at 5.7% for VDO 2024-25.

Shell Energy is interested in further discussing the retail margin with the ESC within a confidential forum.

Conclusions

Powershop thanks the ESC for the opportunity to provide comment and we would welcome further engagement on the points highlighted through this submission. If you would like to discuss, please contact Alan Love at alan.love@powershop.com.au.

Yours sincerely

Libby Hawker
General Manager – Regulatory Affairs and Compliance

[5] Essential Services Commission, *Victorian Default Offer 2023-24 – Final Decision Paper*, (May 2023), *pg.* 6.