



18 July 2023

Economic Regulation Authority
Level 4, Albert Facey House
469 Wellington Street
Perth WA 6000

Lodged email: info@erawa.com.au

Dear ERA WA,

RE: Draft Offer Construction Guideline and Draft Trading Conduct Guideline

Shell Energy Australia Pty Ltd (Shell Energy) welcomes the opportunity to respond to the Economic Regulation Authority WA's (ERA WA's) Draft Offer Construction Guideline (the Guideline) and the Trading Conduct Guideline, both released on 23 June 2023. We understand these documents form part of the Market Power Mitigation Strategy and will provide guidance to Market Participants (MPs) for their offer construction and assessment of offers, and will provide guidance for MP's trading conduct and compliance, respectively.

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 Australia¹, Shell Energy offers integrated solutions and market-leading² 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 has recently acquired a 50% share of Kondinin Energy Pty Ltd (Kondinin) which will be our first West Australian renewables development. The centrepiece of the Kondinin project is the Kondinin Wind Farm, a wind development which would generate approximately 230MWs, across two stages, into the SWIS. Kondinin also holds approvals to develop a 80MWs solar farm and ~60MWs BESS which comprise stages three and four of the Kondinin project.

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 – Offer Construction Guideline

Shell Energy understands that feedback from this consultation will form part of the Market Power Mitigation Framework and this Guideline concerns the offer construction obligation in Clause 2.16A.1 of the draft WEM Rules³.

As outlined in our previous submission for the ERA's consultation for the first release of the Guideline (February 2023), Shell Energy is concerned that the Guideline does not offer certainty to enable MPs to recover reasonable

¹By 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 Consolidated Companion version of the WEM Rules, 29 April 2023, <https://www.wa.gov.au/system/files/2023-04/WEM%20Rules%20-%20Companion%20Version%20Prepared%20as%20at%2029%20April%202023.pdf>

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costs from the energy markets in the WEM⁴. We see areas in the Guideline where there is too much prescription and caution that a guideline document should be to provide guidance on the interpretation of legislation, therefore we encourage the ERA to consider the points we have made in our submission around being overly prescriptive.

Shell Energy representatives attended a stakeholder workshop held by the ERA on 30 June 2023 where it was outlined that the ERA intends to have final versions of the Guideline and Trading Conduct Guideline completed one month prior to the start of the new market on 1 October 2023. We appreciate that the new market start is impending however, this compressed timeframe presents a raft of challenges for MPs including updating internal systems and significant preparation to comply with the abovementioned Guidelines. This timeframe is limited and given the importance of compliance with new rules and requirements, there have been multiple concerns raised by stakeholders that do not seem to have been addressed and properly considered. These recurring concerns have been raised through multiple consultation periods, dating back to August 2022 when the draft Market Power Mitigation Strategy was released.

We appreciate the efforts that have been made throughout this process and understand that there are multiple parties involved in the preparation of these documents which can cause a disconnect between deadlines and work processes. Thank you for the opportunity to provide our feedback below.

Transition period

Shell Energy suggests MPs are provided a transition period to allow some flexibility as we transition into new market conditions on 1 October 2023. As mentioned above, given the tight timeframes for the release of the Guideline and the Trading Conduct Guideline, MPs must adjust to the new requirements, ensure continued compliance with the general trading obligations in the WEM Rules and implement new internal processes and systems. We encourage the ERA to refer to the Monitoring and Compliance Framework in the Wholesale Electricity Market Information Paper⁵ released by Energy Policy WA (EPWA) in 2020 which outlined the need for a transition period to assist MPs with adjustment to significant changes upon the commencement of the new market.

Additionally, a review of the Guideline including stakeholder consultation at each review period should be included to allow MPs to provide feedback during a significant period of change and to allow for input on cost components that we consider should be included in the Guideline as the market evolves.

Section 3 – Test of Market Power

We strongly encourage the ERA to be pragmatic with the approach to the test of market power. The ERA has outlined that a MP who raised prices for as little as one interval will be considered sufficient enough to establish that the MP has market power, regardless of whether it was profitable during that interval. We are concerned with this approach and firmly believe that isolated instances of pricing change that do not result in a material impact to market outcomes is not an efficient nor effective tool in determining market power and request the ERA reconsider this approach.

Section 4.3 – Fuel Costs

Shell Energy appreciates the ERA's clarity in the cost recovery treatment of Long Term Take Or Pay (LTTOP) gas contracts as described in Example 4 and 5 of the Guideline. However, the Guideline does not mention any treatment of Short-Term Take Or Pay (STTOP) gas contracts. Shell Energy encourages the ERA to consider that the Guideline, Trading Conduct Guideline and examples provided, should be explicit in being applicable to Take Or Pay gas contracts of all timeframes. The gas market has seen producers experience more unplanned outages in recent history as the current gas producing fleet continues to age. During these unplanned events, gas generators enter into the market to source STTOP gas contracts but are met with increased prices due to tightness in gas market balance. A situation in which generators are at risk of being unable to efficiently recover their cost if the contracts become out of the money, relative to electricity prices, may result in unintended consequences such as forcing these generators to not enter into these gas contracts and declare Forced Outages, leading to reduced energy system security and reliability.

⁴ <https://www.erawa.com.au/cproot/23129/2/MPM---Pub-Sub---Shell.pdf>

⁵ <https://www.wa.gov.au/system/files/2020-05/Information%20Paper%20-%20Monitoring%20and%20Compliance%20Framework%20in%20the%20Wholesale%20Electricity%20Market.pdf> , pg 14.



Section 4.6.1 – Start-up costs

With reference to Example 9, the ERA outlines a scenario where a generator had a change in estimation of the number of starts that it expects to incur over the life of the generator, and therefore amortises the expected cost accordingly over the life of the asset, which was deemed as a compliant offer. On the other hand, in Example 10, it was deemed that amortising the same cost after the rotor replacement had been done is non-compliant. In terms of efficient cost recovery, these two examples are on the extreme opposing sides of the spectrum, as one considers cost recovery at the start of generator life, and the other too late at the end of its initial expected generator life.

These examples do not provide MPs with a robust illustration of efficient cost recovery because they are challenging to relate to in practice, for the following reasons:

1. It is not reasonable to expect a generator, especially a peaking facility, to be able to have any changes in expectation on the number of starts it will incur at the start of its lifecycle without any prior operating experience, especially as market conditions are expected to become more volatile as the SWIS continues to undergo an energy transition and have a more intermittent generation mix.
2. If a generator cannot be reasonably expected to forecast with accuracy on the number of starts that it will incur at the start of its life; and if it is only compliant to amortise the cost over the entire life of the generator, then it is unclear whether a generator can efficiently recover its cost at all. Consider:
 - a. Following the assumptions used in Example 9, what if the generator experienced an increased change in start expectations during start #2,001? Does it, a) amortise incremental rotor replacement cost over the remaining extended generator life or b), amortise over all the starts it ever had, even the ones which it had spent plus its remaining extended generator life?
 - b. If (b) was chosen in the above as per Example 9, it would mean that the generator would never be able to efficiently recover its cost as 2,000 starts had already been spent which did not reflect this cost increase.
 - c. If (a) was chosen, it also does not allow for efficient cost recovery because, in terms of cash flow management, the rotor replacement work would have had to have been paid for at the time the work is completed to the service contractor. To only allow for the recovery of cost to be amortised over all remaining extended life would mean a significant portion of this cost would be recovered after payment obligations have been met, and this could lead to increased borrowing costs as the generator is forced to cover this cash outflow upfront. This increase in interest payment will ultimately be passed down to the market to wear unnecessarily.

Given the unclarity, Shell Energy strongly encourages the ERA to consider the proposal that any incremental costs that arise during generator life, and specifically for the above examples, costs associated with the replacement of equipment required to extend useful generator life, are able to be recovered:

1. From the time when the generator has sufficient evidence to form a reasonable expectation that its number of starts to be incurred will increase, and how much incrementally it will cost to facilitate such an increase in starts.
2. Over the remaining period between when such realisation is made and up to the moment of having to pay the service contractor such that any cash flow problems may be avoided.

Section 4.6.3 – Avoided start-up and shut-down costs

Shell Energy remain concerned with the approach taken to avoided start-up costs where the ERA are determining there be a minimum price offer restriction inserted into the calculation of avoided start-up costs. Example 11 appears to limit the minimum price offer which is the same approach described in the first release of the Draft Offer Construction Guideline, despite majority of stakeholder submissions being unsupportive of this proposal. It remains unclear if MPs are able to bid at the floor price to ensure generators are dispatched to ramp up for future higher-priced intervals. Placing a cap on the minimum price offer for avoided start-up costs may have a significant impact to generators along with causing a reduction in availability and reliability.

Shell Energy do not support capping a minimum price offer and suggest the ERA reconsider this approach, given the risk in using avoided start-up costs to determine optimal offer strategies, such as an offer price based on avoided start-up costs may not be low enough to ensure a generator is dispatched to ramp up or ride through, especially in a generation mix that is increasingly intermittent.



Section 5.1 – Forecasting and uncertainty

In the first release of the Guideline, the ERA proposed to include a risk margin described as follows⁶:

“Given that there is uncertainty involved in forecasting future run times and production, a risk margin could be justified. Including a risk margin as an additional cost may be acceptable in some circumstances to cover extended runs of losses, but not to guarantee profits in the real-time market or STEM. To include a risk as a margin, a market participant would need to demonstrate why such a loss cannot be rectified by improving its forecasting methods.”

The introduction of a risk margin into the Guideline has now been removed and we do not support the conclusion that a MP without market power would not include a risk margin in its price offers as an additional cost. Shell Energy considers it is unreasonable to assume MPs without market power would not have risk associated with forecasting and include this as an additional cost in some circumstances.

We request the ERA reintroduce a risk margin in the Guideline to ensure that MPs do not continually under-recover their costs.

Section 5.2 – Below-cost offers

The approach taken when considering below-cost offers outlined in both the Guideline and the Trading Conduct Guideline fail to consider operational reasons that generators may have for dispatching their facilities. There are genuine operational reasons for generators to ride through for a minimal number of negative-price intervals and remain online rather than being forced to shut down for an extended period of time. We believe this situation is reasonable in the circumstance during ramp periods where generators bid at the floor price to ensure they are ready for dispatch at higher price intervals.

The Guideline appears to put limitations on this scenario as minimum offers are capped at avoided start costs, and this may not be low enough in some cases, leading to perverse outcomes such as a reduction in reliability and availability. In addition, there is reference in the Guideline to additional guidance on compliance with Clause 2.16A of the WEM Rules⁷ being included in the Trading Conduct Guideline however, both documents do not contain detail which covers operational reasons for MPs bidding below cost. Shell Energy strongly suggests that the Guideline and the Trading Conduct Guideline be amended to provide for flexibility in the application of this clause for temporarily bidding below cost to avoid unintended outcomes as outlined above.

In addition, Shell Energy would like to seek further clarification from the ERA around whether it is reasonable for a generator to place maximum price offers for dispatch intervals in the circumstance that a generator does not believe there would be efficient cost recovery allowable if the dispatch and pre-dispatch schedule included low forecast prices.

Section 10.1 & 10.2 – Record Keeping

While Shell Energy recognise that maintaining adequate records is essential for transparency and regulatory compliance, the volume and specificity of the information requested in these clauses may hinder the efficient functioning of MPs and increase administrative burden and costs associated with maintaining records.

We request the ERA to encourage an environment where MPs feel empowered, striking a balance between regulatory oversight and practicality, whilst ensuring the framework promotes transparency and accountability.

Trading Conduct Guideline

Shell Energy are supportive of the majority of requirements in the Trading Conduct Guideline and note that we operate in alignment with the principles and conduct that the ERA has outlined. Please see our comments below.

⁶ <https://www.erawa.com.au/cproot/23066/2/Draft-offer-construction-guideline---For-Publication.pdf>, pg 17.

⁷ Clause 2.16A in the Consolidated Companion version of the WEM Rules, 29 April 2023, <https://www.wa.gov.au/system/files/2023-04/WEM%20Rules%20-%20Companion%20Version%20Prepared%20as%20at%2029%20April%202023.pdf>



Section 3.3 – Distorting or Manipulating Prices

The ERA has provided an explanation of the treatment of distortion and manipulation of prices in Example 7 on page 10 of the Trading Conduct Guideline. The example in the Trading Conduct Guideline seems to conflict with the principle of the Guideline where MP's would reasonably expect prices to be determined in a competitive market, being that each MP is seeking to optimise where and how to deploy their resources, within the constraints of the WEM Rules.

Additionally, participation in the Frequency Co-Optimised Essential System Services (FCESS) is optional (after WEM Rule 1.49.9 expires), WEM Rule 7.4.1 (b) requires a submission for accredited services however, this could be OMW up to the max enablement quantity as per WEM Rule 7.4.41. Shell Energy disagrees with the example provided and suggests the ERA revise this requirement given it is conflicting with the existing WEM Rules regarding FCESS participation and does not align with the competitive market principles of the Guideline nor do we think it is reasonable for the ERA to assert that reductions in FCESS volume can only be for physical reasons such as de-rates/outages, and not to optimise the asset. This may also result in MP's opting out of the service provision entirely, limiting supply and impacting on the cost of FCESS.

Conclusion

We appreciate the opportunity to provide feedback on the Guideline and the Trading Conduct Guideline.

We strongly encourage the ERA to consider the stakeholder feedback provided and continue to engage with MPs and we welcome the opportunity to discuss our submission further. Additionally, as requested in our submission, we would like to reiterate the importance of the ERA ensuring a transition period is introduced given the Guideline and Trading Conduct Guideline will only be finalised one month prior to the new market start.

Please contact Tessa Liddelow at tessa.liddelow@shellenergy.com.au for any queries regarding this submission.

Yours sincerely

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