24 December 2024

Essential Services Commission
Level 8, 570 Bourke Street
Melbourne VIC
3000

Submitted via email to: VDO@esc.vic.gov.au

RE: Victorian Default Offer 2025-26

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 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. 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, as well as the 200MW Rangebank Storage System and 370MW Koorangie Storage System both located in Victoria.

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 Feedback

Shell Energy welcomes the opportunity to provide feedback to the Essential Services Commission (ESC) consultation on the Victorian Default Offer 2025-26 (VDO).

We support the ESC largely maintaining a consistent approach for the VDO, which ultimately leads to positive outcomes for consumers where retailers are not required to alter their underlying pricing structures year on year to align with regulated pricing. This provides greater certainty for all participants within the Victorian market. While there have been slight adjustments to some components which inform the methodology, the core purpose and objectives of the VDO should continue to be upheld.

Retail operating costs

---

[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.

Shell Energy understands that in order to estimate efficient retail operating costs, the ESC uses a benchmark based on a customer-weighted average of actual retailer operating costs which applies evenly to residential and small business customers despite retailers reporting costs separately for these cohorts.

In light of the above, Shell Energy would support the ESC working with retailers to identify whether separating operating costs associated with small business and residential customers would result in a more accurate VDO price that applies to the different customer cohorts.

Retail operating margin

Shell Energy supports the current approach's principles and methodology to determine retailer margin, which represents the operating margin required to compensate investors for the capital they provide electricity retailers. However, we question if the current margin accounts for changing risk and returns for retailers and appropriate regulatory benchmarks.

In the context of a rapidly evolving and decarbonising market, retailers are expected to face greater levels of risk in supplying power to customers. Retailers are increasingly required to hedge their portfolio against variable generation resources, growing solar and other consumer energy resources (CER), and an increased reliance on electricity. State and federal government programs such as Victorian Energy Upgrades (VEU) or federal schemes that encourage greater use and efficiency of electricity, and take-up of CER also make compliance risk and costs higher. These are all factors which retailers take into consideration when determining an appropriate hedging strategy which seeks to mitigate risks arising from changing market dynamics.

Retail margins could move in line with the evolving market to ensure that retailers are able to accommodate the changes as well as shield consumers from the impact of wholesale market volatility. The current retail margin of 5.3% should be higher where retailers are expected to take on a greater level of risk in supplying consumers.

A higher retail margin would also encourage greater innovation from retailers, which would empower consumers in the long-term. Where risks are matched against a higher margin, retailers can be innovative and flexible in pricing structures and develop new products and offerings that help customers in general, but can also enable them to navigate the transition through, for example, plans specifically tailored for solar or EV customers.

Shell Energy also considers that the Independent Competition and Regulatory Commission (ICRC) benchmark, developed for the Australian Capital Territory (ACT), is not appropriate for the Victorian market. The ACT market is dominated by a single retailer and is therefore a highly regulated electricity market compared to the competitive market in Victoria and the ICRC benchmark does not correlate to the actual costs faced by retailers in Victoria. Rather, Shell Energy would support the ESC establishing margins that reflect the retail environment in Victoria that supports competition. The previous approach, which was supported by Frontier Economics and resulted in a retail operating margin of 5.7%, would be more appropriate in light of the above. This percentage is significantly more reflective of the Victorian retail market and aligns with the initial VDO approach which set a benchmark based on regulatory margins across New South Wales, Queensland, ACT, and Tasmania.[3]

Environmental costs – estimating Victorian Energy Efficiency Certificate prices

Cost estimates for the Victorian Energy Efficiency Certificate (VEEC) prices against the actual costs borne by retailers should be benchmarked by the ESC. The previous VDO underestimated these costs, and several stakeholders said the costs used were significantly below the actual cost borne by retailers to comply with the VEU.

To ensure accuracy, Shell Energy supports the ESC completing a look back once to ensure the price is cost-reflective of the 12-month trade-weighted average. Taking the difference between last year's forecast and actual costs would be a good starting point.

The VEEC component of the VDO is currently based on the forward market. Retailers enter into contracts with third parties to fulfil their VEU obligations, however, due to issues with the availability of VEECs and program

[3] See: **Victorian Default Offer to apply from 1 July 2019**. P.g. 80.

administration, contracts are either not being fulfilled by third parties or there is a delay in certificate creation once the activities have been carried out. This means that where retailers have purchased certificates in the forward market, there are situations in which the VEECs are not issued. This presents a risk in that the current methodology is not reflective of procurement costs in a tight certificate market where supply has been an issue and retailers are paying penalties.

This could be mitigated if the ESC built a risk premium into the retail operating margin. Alternatively, the approach for estimating costs could be aligned to the spot, rather than the forward market, to ensure price estimates are accurate and reflective of a retailer's actual costs.

Wholesale electricity costs – treatment of solar exports in load profile

Australia is a global leader in the uptake of rooftop solar, with at least one third of detached homes having rooftop solar installed, and AEMO projecting that this will rise to more than half of detached homes in the NEM by 2034. Victoria alone contributed to 18.3% of total new solar installations across the National Electricity Market, ranking in the top three states in Quarter 3, 2024.[4]

Shell Energy supports the ESC continuing to include solar exports in load profile estimates, as retailers do not exclude solar exports from their load profile when buying future wholesale electricity contracts. Indeed, the ESC should uphold the original terms of reference provided by the government which explicitly stated that:[5]

> *"the ESC is requested to develop a methodology for determining an efficient price for electricity and use that methodology to recommend a VDO for Victoria that will be offered unconditionally by each licensed electricity retailer to all domestic and small business customers including those domestic and small business customers who export power under feed-in-tariffs."*

Shell Energy opposed the approach the Australian Energy Regulator took for the Default Market Offer on the basis that rooftop solar has a material and direct impact on load profile estimation and forecasting, and therefore retailer hedging strategies. Solar exports are making hedging more costly and challenging, and some elements of shape risk is un-hedgable where the retailer sits with open risk exposure. Many retailers will hedge at a portfolio level, which includes solar (consumption net of exports). If solar were excluded, this would overlook higher hedging costs imposed on retailers. Further, retailers cannot be expected to provide a price to solar customers that doesn't consider the impact of their shape on hedging within the wholesale market.

Including solar within the VDO is the best way to accurately capture retailer's wholesale costs given the high levels of solar PV among residential customers.

Shell Energy welcomes further engagement on this topic. If you have any questions or would like further details relating to this submission, please contact [redacted].

Yours sincerely,

Libby Hawker
General Manager – Regulatory Affairs and Compliance

---

[4] See: **australian-energy-council-solar-report-q3-2024.pdf**, p.g. 5.

[5] Terms of Reference for the Essential Services Commission. See: **retatil-market-review-victorian-default-offer-terms-of-reference-20181221.pdf**