Shell ENERGY

7 May 2024

Capacity Investment Scheme Team
Department of Climate Change, Energy, the Environment and Water
GPO Box 3090
Canberra ACT 2601

Lodged via email: CapacityInvestmentScheme@dcceew.gov.au

Dear Salim Mazouz

RE: Western Australia Design Paper – Capacity Investment Scheme

Shell Energy Australia Pty Ltd (Shell Energy) welcomes the opportunity to review and provide feedback to the Department of Climate Change, Energy, the Environment and Water (DCCEEW) on the Western Australia Design Paper for the Capacity Investment Scheme (the Design Paper).

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.

[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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General Comments

Shell Energy understands that feedback from this consultation will be used to inform the design for implementation of the CIS in the Wholesale Electricity Market (WEM) for both clean dispatchable capacity and renewable generation capacity. Shell Energy is supportive of the widescale adoption of clean technologies such as variable renewable energy (VRE) generators, battery energy storage systems (BESS) and demand response participation. We recognise that the South West Interconnected System is undergoing a major transition and whilst we have existing mechanisms in place such as the Reserve Capacity Mechanism (RCM), we welcome the Commonwealth proposal for the implementation of a national CIS, and believe this will support the mix of energy sources that will be needed in the future to ensure the secure and reliable supply of electricity. Therefore, Shell Energy is supportive of the requirement to encourage greater investment in dispatchable energy from clean energy sources.

Feedback has been provided under the subheadings below.

Section 3.2 – Ensuring the CIS complements existing WEM mechanisms

Whilst Shell Energy appreciates that DCCEEW is ensuring best efforts are made to complement the existing operation of the RCM in the WEM, there are differences between the RCM and the proposed CIS which will require careful consideration by DCCEEW, EPWA, AEMO and other stakeholders. The RCM is complex and whilst Market Participants (MPs) in the WEM may be comfortable with the process and operation of the RCM, we see that the implementation of a Commonwealth scheme presents certain challenges which will need a careful and well thought out design.

The CIS in the WEM is expected to facilitate the entry of 6.5 TWh of VRE and 1.1 GW of four-hour equivalent (4.4 GWh) dispatchable capacity over the period to 2030. This is a significant amount of new generation and given its scale and timing, integrating the CIS into the current market framework will need to be carefully managed.

Shell Energy encourages DCCEEW to consider the impact on projects that participate in the contract market. We note that the CIS may effectively discourage projects from participating in the contract market by safeguarding against the downside risk of low market returns and shoring up project financing. This scenario reduces incentives for projects to contract with retailers and eventually could lead to continued perverse market outcomes such as the reduction of incentives for projects to be active participants in secondary markets.

Section 3.4 – CIS process timing

The Design Paper outlines that the CIS tender process will be run in advance of the WEM RCM process for a specified Target Commercial Operation Date (Target COD), with the first WEM CIS tender proposed to run from approximately June 2024 to February 2025. We appreciate that the announcement by DCCEEW for Clean Dispatchable investment was 11 months earlier than the announcement for Generation investment to be included in the scheme., However, we would like clarity around why the two CISAs cannot run simultaneously, when there is a need for capacity in the market as soon as possible.

In addition, at Section 3.8.2., the Design Paper states that the CISA will commence on 1 October of the first year following the CISA award for which the project holds capacity credits. Shell Energy notes that aligning the commencement of CISA payments with the RCC could create perverse outcomes where a project may delay its commercial operation if it is unlikely to receive CIS and Capacity Credit payments for some time. We encourage DCCEEW to consider bringing CIS payments forward to allow Project Owners to receive these payments up to one year prior to the RCC, therefore meeting the CIS objective of fast-tracking new projects and bringing new investment into the market and the CISA payment still acting as an underwriting mechanism.

Section 3.5.1. Registration with AEMO, ownership and minimum size

The Design Paper outlines the requirement that the Project Proponent must be a Special Purpose Vehicle (SPV) that owns the project, including all assets and legal rights and permissions reasonably required to undertake the project. Shell Energy considers that there are several nuances which the SPV requirement creates which we have raised throughout our submissions on the CIS in the NEM.

In particular, we consider that there are other financing arrangements in which the same transparency and quarantining of transactions can be achieved other than through the use of a SPV. We consider that the objectives of the CIS and associated administration within DCCEEW itself can still be achieved and provided for with the use of an offtaker or leasing arrangement and strongly encourage DCCEEW to consider alternative approaches to be eligible for participation.

Section 3.5.3. – Expected development status of connection approvals

We refer to the Oakley Greenwood Report recently prepared for the Australian Energy Council (AEC) which identified investment bottlenecks in the WEM[3], and noted that a lack of new electricity transmission planning and investment along with a lengthy, costly and opaque grid connection process, puts WA's decarbonisation plans at risk and derails the ability for proponents to bring new renewables and dispatchable plant onto the grid. The Design Paper outlines high level eligibility criteria at Section 3.5 and in relation to connection approvals, requires the Proponent to receive a response to a connection enquiry, have entered into an access contract, or be seeking to modify an existing contract. We note that there are a number of simultaneous processes Western Power is currently running including the priority projects process[4] and the registration of interest process for the decarbonisation of energy projects[5]. Shell Energy would like more certainty around allocation of resources towards prioritising practical and actual grid connection within the fast-tracked timeframes DCCEEW intends to meet for bringing new projects online and achieving its core objectives.

Section 3.6.2. Project bid (Stage A)

Shell Energy seeks clarification around the timing and eligibility at the Project Bid stage. The Design Paper outlines that a project must be eligible to receive Capacity Credits to participate in the CIS and projects participating in the 2024 CIS tender will be merit assessed against their pathway to reaching COD no later than 1 October 2026 for facilities receiving Capacity Credits for the first time in the 2024 RCC.

We have concerns that there may be circumstances where capacity credit eligibility timing does not align with the CIS tender process and given the RCM is an iterative process, there may be a project that is still in operation by the CIS tender date yet does not hold Capacity Credits. Shell Energy queries whether DCCEEW will be working with AEMO to provide flexibility around the RCM and RCC dates, as opposed to being fixed within the Rules. This should allow Project Owners ability to meet both the CIS tender and RCC application dates and would further incentivise new projects to come forward.

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[3] https://www.energycouncil.com.au/media/vxnayul5/ogw_bottlenecks-affecting-generation-development-in-wa_final_12-feb-003.pdf

[4] https://www.wa.gov.au/government/document-collections/priority-project-determinations

[5] https://www.westernpower.com.au/resources-education/industry-resources/large-industry-customers-and-generators/industry-decarbonisation-energy-projects–roi/

Section 3.8.2. Summary of the CISA Commercial Structure

At Section 3.8.1., DCCEEW has outlined the principles of the CISA commercial structure, where this structure is intended to deliver the broader objectives of the CIS and to ensure that "there is limited to no impact on WEM and RCM functions except for performance and RCM engagement requirements." Performance requirements outlined in Table 4 of the Design Paper include requiring the Project Operator to:

- operate the project in accordance with best industry practice, including maximising availability of the Project and revenues for the Project (which includes re-applying annually for capacity certification and assignment of Capacity Credits through the RCM);
- participate in the RCM and make the Project available in line with its performance obligations under the RCM;
- respond to price signals in relevant markets; and
- comply generally with its obligations under the WEM Rules.

The Design Paper then states that if these performance requirements are not regularly met, the Commonwealth will have a termination right. Shell Energy would like to understand the rationale behind imposing performance requirements for the CIS process. The RCM is a robust mechanism which has strict performance standards and requirements that must be met in order to apply and be certified to receive capacity credits.

To address performance requirements around responding to price signals, by operating in the WEM, Market Participants must be compliant with their obligations under the Market Rules and market power obligations under the Offer Construction Guideline, administered and enforced by the ERA WA. Additionally, to address the availability performance requirements, the RCM already has mechanisms in place to enforce penalties if the facility is not made available where Capacity Credit holders must meet obligations to make their capacity available in the energy markets (STEM and RTM) and refund capacity payments if they fail to do so.

We see no need for these performance requirements to be included, as there is a high threshold that exists for Project Operator to comply with RCM obligations through participation in the RCM, and the performance requirements outlined in the Design Paper become somewhat redundant by default if a Project Operator is already demonstrating the performance requirements imposed by the RCM. In addition, a key objective of the CIS is for this scheme to complement the RCM in the WEM, therefore, we see any additional performance requirements as being an unnecessary duplication to those already required within the RCM.

Section 3.8.2 – Payment mechanism for capacity component

Shell Energy understands that the proposed design of the payment mechanism for the capacity component will comprise of the floor and ceiling for the Generation CISA each having two components including:

- an energy component, bid as $/MWh of generation in the relevant support year; and
- a capacity component, bid as $/MW of Capacity Credits held by the project.

Having the capacity component bid as $/MW of Capacity Credits will mean that projects carry full exposure to any changes in the Relevant Level Method (RLM) and the Network Access Quantity (NAQ). Given that the RLM and NAQ could be amended in the future, this could have consequences such as a reduction of the amount of Capacity Credits and revenue received by projects through the CIS, therefore resulting in uncertainty around CISA payments over the life of a project and undermining the revenue underwriting objective of the CIS. Shell Energy encourages DCCEEW to amend the capacity component to reflect the nameplate capacity held by the project, so the bid is $/MW of nameplate capacity.

Section 3.8.2. – Underwriting Mechanism

Shell Energy seeks clarification on the allocation of project costs for the Generation CISA. The floor and ceiling for the Generation CISA outlined in Table 4 comprise of two components:

- an energy component, bid as $/MWh of generation in the relevant support year; and
- a capacity component, bid as $/MW of Capacity Credits held by the project in the relevant support year.

Our understanding is the interaction between the above components and the floor and ceiling will be as follows:

a) The floor and ceiling will be set for energy (energy sales + ESS) on a $/MWh basis, and for capacity (capacity credits) on a $/MW basis, and the project will calculate the respective revenues.

b) The project cost are then calculated as ESS costs, Market Participant fees, Market Suspension Compensation, and payments under Eligible Wholesale Contracts.

It is unclear how the costs in calculated in b) above are then converted into either $/MWh or $/MW and apportioned between energy ($/MWh) and capacity ($/MW)? We request that this scenario is clarified as there appears to be some inconsistency between the unit of calculation for revenue and how these costs will then be apportioned.

Confidential Information

DCCEEW have included high level bid parameters and described the differences between parameters for Clean Dispatchable and Generation CISAs. The Design Paper states that revenue earned under bilateral contracts will be included in underwriting calculations and as such, a CISA is expected to require project owners to share information about revenue earned under such contracts[6]. Shell Energy are concerned at the level of information gathering, noting that both DCCEEW and AEMO representatives will have access to highly sensitive commercial information. We understand that it is necessary to obtain certain commercial information and financial data however, we request certainty from DCCEEW and AEMO that any information provided by a Proponent and Project Owner be kept confidential and not be made available for to parties for purposes other than determining revenue for CIS purposes.

Additional Comments

Rewiring the Nation funding has been referenced however, the WA Minister for Energy and Minister Bowen have indicated that the Rewiring the Nation funding for WA is being allocated to projects located in the North West Interconnected System (NWIS) and will not be allocated towards the SWIS[7]. To help us better understand the cost allocation to the SWIS, we request clarification and a breakdown of costs.

Conclusion

We appreciate DCCEEW's consultation efforts and look forward to reviewing the CIS Tender Guidelines once released for further detail on requirements and obligations. We welcome the opportunity to discuss our submission further. Please contact Tessa Liddelow at [redacted] for any queries regarding this submission.

[6] Page 1, Design Paper.

[7] https://minister.dcceew.gov.au/bowen/transcripts/press-conference-premier-western-australia-roger-cook-and-wa-minister-mines-and-petroleum-energy-hydrogen-bill-johnston

Yours sincerely

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General Manager – Regulatory Affairs & Compliance

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