Shell ENERGY

27 October 2021

Baharak Sahebekhtiari
Department of Planning, Industry and Environment
GPO Box 39
Sydney NSW 2001

Lodged via email: Electricity.Roadmap@dpie.nsw.gov.au

Dear Ms Sahebekhtiari

RE: Regulations for Part 6 of the Electricity Infrastructure Investment Act 2020

Shell Energy Australia Pty Ltd (Shell Energy) welcomes the opportunity to respond to the New South Wales (NSW) Government's policy paper (the Paper) on regulations to support Part 6 of the *Electricity Infrastructure Investment Act 2020* (the EII Act), which deals with the Electricity Infrastructure Investment Safeguard (the Infrastructure Safeguard).

About Shell Energy in Australia

Shell Energy is Australia's largest dedicated supplier of business electricity. We deliver business energy solutions and innovation across a portfolio of electricity, gas, environmental products and energy productivity for commercial and industrial customers. The second largest electricity provider to commercial and industrial businesses in Australia[1], we offer integrated solutions and market-leading[2] customer satisfaction, built on industry expertise and personalised relationships. We also operate 662 megawatts of gas-fired peaking power stations in Western Australia and Queensland, supporting the transition to renewables, and are currently developing the 120 megawatt Gangarri solar energy development in Queensland. Shell Energy Australia Pty Ltd and its subsidiaries trade as Shell Energy.

www.shellenergy.com.au

Overview

Shell Energy commends the NSW Government for its ongoing engagement on the Electricity Infrastructure Roadmap (the Roadmap), including the regulations subordinate to the EII Act. We consider that this consultative approach will result in better design choices, and ultimately better outcomes for NSW electricity consumers.

As an overarching comment, we observe that the concepts and questions in the Paper are relatively high-level. This is distinct from the August paper on Long-Term Energy Service Agreement (LTESA) design, which offered tangible design options for stakeholders to critique[3]. While we appreciate the opportunity to be part of early-stage consultation on the Part 6 regulations, it is difficult to provide detailed feedback without first seeing draft regulations. This is particularly challenging because Part 6 regulations will interrelate with regulations for other parts of the EII Act.

[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 2011-2020.

[3] DPIE, *Long–Term Energy Service Agreement Design*, August 2021. Accessed from: https://www.energy.nsw.gov.au/sites/default/files/2021-08/long-term-energy-services-agreement-design-consultation-paper-210316.pdf

Shell ENERGY

Therefore, consistent with our feedback to the 'tranche two' consultation, we recommend circulating a complete set of draft regulations for public comment after the tranche three consultation process concludes. This will enable stakeholders to holistically gauge the impact of the regulations. The approach we suggest is consistent with what the Department of Planning, Industry and Environment (DPIE) has previously indicated[4]. We emphasise it here because it appears not to have been mentioned in the tranche three material released so far. Notwithstanding, we offer the following feedback.

On infrastructure planning, we suggest:

- additional consultation requirements for the Infrastructure Investment Objectives (IIO) Report
- additional guidance to reduce the risk of long-duration storage LTESA tenders failing to benefit from material cost reductions prior to 2030
- the IIO Report modelling carefully assesses the assumed coal closure dates used in AEMO's Integrated System Plan (ISP).

On LTESAs and Renewable Energy Zone (REZ) access rights:

- we outline how demand response can play a valuable role in meeting reliability targets, and recommend further consultation on the detailed design of firming LTESAs
- we suggest the regulations should explicitly link the process to allocate LTESAs with the process to acquire REZ access rights.

On governance and controls for the Infrastructure Safeguard:

- we support actions to improve the transparency and accountability of AEMO as the Consumer Trustee, particularly given the risk of actual or perceived conflicts of interests due to AEMO's other responsibilities
- we note that the actions of the Scheme Financial Vehicle (SFV) will likely have a material impact on financial markets; so controls are required to mitigate the risk of unintended consequences (e.g. impacts to market liquidity, excess market power).

The remainder of this submission provides more detail in response to selected questions from Paper.

Infrastructure planning

Q1: What requirements for stakeholder consultation on the IIO Report should be implemented to ensure the Consumer Trustee's report is informed by the best available information?

Shell Energy agrees that the regulations should specify a minimum level of stakeholder consultation the Consumer Trustee must undertake in relation to its IIO Report. Broadly speaking, we agree that the minimum consultation should aim to ensure:[5]

- "additional inputs and assumptions not directly sourced from the Integrated System Plan have been tested with stakeholders to ensure they are credible"
- "the risks taken by the Consumer Trustee on behalf of NSW consumers are informed by stakeholder views".

[4] DPIE, *Tranche two regulations to support the Electricity Infrastructure Roadmap: Issues Paper*, April 2021, Figure 3, pp 6, Accessed from: www.energy.nsw.gov.au/sites/default/files/2021-04/tranche-two-regulations-electricity-roadmap-issues-paper-210163.pdf

[5] DPIE, Infrastructure Safeguard Policy Paper (Part 6 of the Electricity Infrastructure Investment Act), September 2021, pp 7. Accessed from: https://www.energy.nsw.gov.au/sites/default/files/2021-09/electricity-infrastructure-fund-policy-paper-part-7-eii-act-210458_0.pdf

In addition to these broad principles, we believe DPIE should consider the following issues when drafting the Part 6 regulations.

- Identifying the "new generation, long duration storage resources and firming infrastructure required to meet the explicit roadmap objectives at the lowest cost to NSW consumers"[6] is a complex modelling exercise. Key inputs include the assumed network topology and cost of augmentation options. There is a risk of an unintentional feedback loop between the IIO Report (which informs the development of REZs) and the assumed REZ network topology (which will likely depend on the required resources identified in the IIO Report). The Consumer Trustee should be required to consult on this issue for each IIO Report.
- The regulations should stipulate an appropriate minimum time the Consumer Trustee must give stakeholders to respond to consultation. This should have regard to other related processes (e.g. the Electricity Statement of Opportunities or the ISP) the IIO Report will impact, and be aligned to industry best practice.
- To ensure "the risks taken by the Consumer Trustee on behalf of NSW consumers are informed by stakeholder views", the Consumer Trustee should be required to maintain a risk register that details each risk, the rationale for taking it, mitigation strategies and consumer views (with reference to the consultation undertaken). We believe this would increase transparency and accountability.
- Any ex-ante and ex-poste controls for the IIO Report (e.g. the '20-Year Development Pathway selection' row in the Paper's Table 1) should include stakeholder consultation where appropriate.

Q2: How should changes in technology, consumer behaviours, customer investment in generation (e.g. distributed energy resources) and demand uncertainty be treated to determine the requirements for large-scale infrastructure investment?

Section 45 of the EII Act requires the IIO Report to include:

- a 20-year development pathway for generation, storage and firming infrastructure
- a 10-year plan for competitive tenders "to give effect to the development pathway, including when tenders will be conducted and the classes of LTES agreements for which a tender will be conducted".

We welcome the Paper's emphasis that the Consumer Trustee must assess "the impacts of cost reductions, new technologies and commercial models (e.g. distributed generation, household batteries and new deep storage technologies) and [determine] how this impacts the need for new generation and long duration storage"[7]. However, without more explicit guidance in the regulations, there is a risk that the 10-year plan effectively 'locks in' an inefficient outcome for consumers if LTESA tenders are run too soon. Our rationale is that earlier tender processes would give less time for developing technologies and commercial models to come down in cost, which would result in higher tender bid prices.

As outlined in our tranche two submission, we believe this risk is primarily relevant to long-duration storage LTESAs[8]. Our rationale is as follows:

- Section 44(3)(b) of the EII Act legislates a minimum objective for 2GW of ≥8-hour storage before 1 January 2030. If an 8-hour storage project needed to be built today, a pumped hydroelectric energy storage (PHES) asset may be the cheapest option. However, battery energy storage system (BESS)

[6] Ibid, pp 5

[7] Ibid, pp 7

[8] Shell Energy, *RE: Tranche two regulations to support the Electricity Infrastructure Roadmap issues paper*, 21 May 2021, pp 6. Accessed from: https://nsw.us7.list-manage.com/track/click?u=838ac6dd4f9bd063762820658&id=da7652d168&e=901124014f

costs are improving such that they are likely to compete in the ~8-hour range by ~2030[9]. Further, the major civil works required to develop PHES come with substantial risks and challenges (e.g. locational restrictions, environmental impacts, water allocations, social licence, long lead time, cost and time overruns, financing challenges).

- Given these issues, the best strategy to minimise the cost to consumers of achieving 2 GW of 8-hour storage before 1 January 2030 may be to facilitate the installation of 8-hour BESS (or increase the storage duration of already-installed BESS) relatively close to the 2030 deadline. This gives substantially more flexibility and scope for cost reductions than contracting with a PHES proponent with sufficient time for their project to be developed and commissioned prior to 2030. The ability to strategically locate BESS in key parts of the network from a power system services perspective may also deliver greater transmission benefits than PHES (which is unlikely to be optimally located in the network).

To address the risk of inefficient outcomes due to early tender processes, we recommend additional guidance for the Consumer Trustee when it comes to scheduling LTESA tenders and/or assessing bids based on expected cost reductions.

Q3: What assumptions, scenarios or approaches could be prescribed by regulation to encourage an independent Consumer Trustee to make appropriate decisions regarding the treatment of future risks and uncertainties in planning for infrastructure investment?

The NSW Minister for Energy and Environment has indicated that the intent of the Roadmap is to ensure sufficient infrastructure is built to replace aging coal generators "before they close"[10].

To achieve this outcome, the Consumer Trustee will need to carefully consider coal closure dates. When conducting modelling, we recommend that the Consumer Trustee initially uses the hardcoded coal closure dates from the ISP modelling process. If the Consumer Trustee has valid reasons (in the form of supporting data and/or analysis) to depart from the closure dates used in the ISP, then the Consumer Trustee should perform sensitivity analysis based on the alternative closure dates. Stakeholder consultation should be required throughout this process.

We recommend that the regulations capture this intent, without being excessively prescriptive with respect to the Consumer Trustee's modelling process.

LTESAs and REZ access rights

Q4: What role could demand response play as 'firming infrastructure' under the EII Act and are any special considerations required in LTES Agreement design?

The role of demand response

As the energy transition progresses, Shell Energy expects there to be material growth in flexible load able to provide demand response. Under the Roadmap, we believe the lowest-cost mix of assets "to meet the energy security target and the reliability standard"[11] will likely include a material volume of demand response.

[9] AEMO, *2021 Inputs and assumptions workbook*, 30 July 2021. Accessed from: https://aemo.com.au/energy-systems/major-publications/integrated-system-plan-isp/2022-integrated-system-plan-isp/current-inputs-assumptions-and-scenarios

[10] The Hon Matt Kean MP, *Record Renewables Funding for Roadmap Rollout*, n.d. Accessed from: https://mattkean.com.au/news/media-release/record-renewables-funding-roadmap-rollout

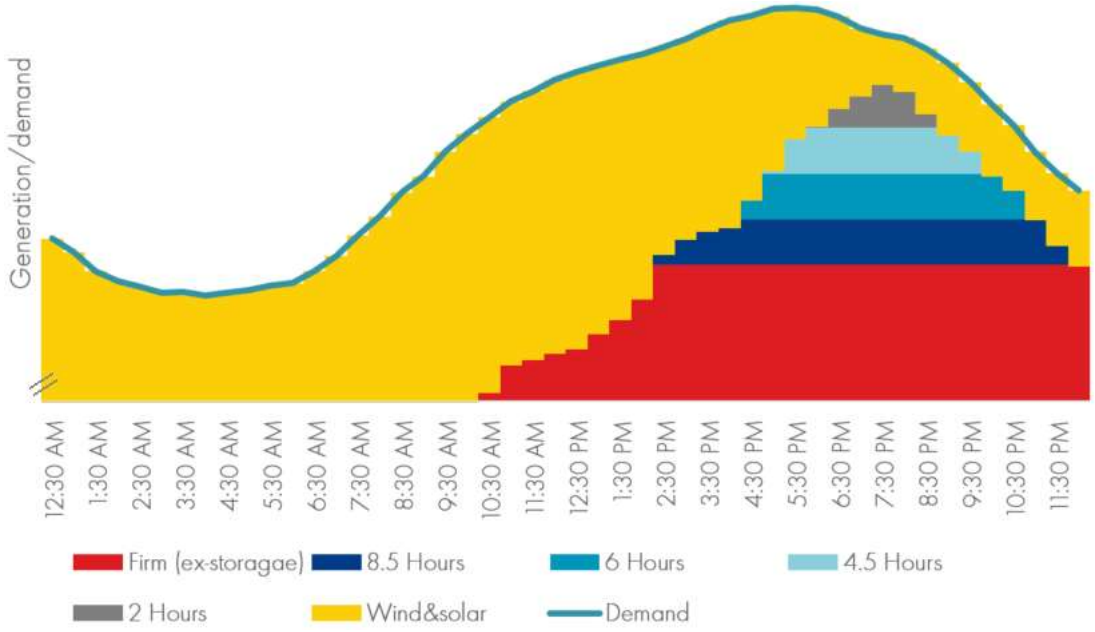
[11] NSW Government, *Electricity Infrastructure Investment Act 2020 No 44*, Section 44(2)(c). Accessed from: https://legislation.nsw.gov.au/view/html/inforce/current/act-2020-044

The precise role of demand response depends on the asset providing it and the specific challenges posed by a reliability event. For example, some assets may be well-placed to reduce consumption for a sustained period, whereas other assets may only be able to provide demand response for a shorter time. This is analogous to the capability of energy storage systems (ESS) with different durations. It is therefore important to consider the purpose of 'firming infrastructure' under the EII Act, which is to ensure the reliability standard and energy security target (EST) are met.

To inform whether LTESAs for firming infrastructure are required, the Energy Security Target Monitor (ESTM) assesses "whether or not the firm capacity will meet the [EST]",[12] noting that the EST is a conservative (one-in-ten year) estimate of peak demand, plus a buffer. By definition, POE10 peak demand events don't continue indefinitely – the demand peak occurs for a limited period (typically 30 to 60 minutes) before subsiding. As a result, it is not necessary for all generation/storage/demand response assets to operate indefinitely. Instead, the assets need to be able to collectively match the requirements of the demand profile in the time before, during, and after the peak demand interval. This might require some assets to only be dispatched for a short time during the peak, with other assets to dispatch for longer periods. For example, the actual peak demand interval might require 1GW of storage/demand response to be dispatched for an hour, whereas the second hour might only require 800MW, and the third hour 600MW.

Figure 1 below is a stylised example that illustrates how storage assets with different durations could all play a valuable role during a peak demand event (noting that coordinating the dispatch may be challenging). The same logic applies for demand response.

Figure 1: Stylistic example of potential storage output during a peak demand event



The design of firming LTESAs

Consistent with our submission[13] to the 'tranche two' consultation process, we recommend that DPIE outlines (and consults on) a detailed methodology for how duration-limited storage or demand response will be treated when calculating firm capacity. As an extension, we also recommend that the design and allocation of firming LTESAs

[12] Ibid, Section 13(3)(c)

[13] Shell Energy, *RE: Tranche two regulations to support the Electricity Infrastructure Roadmap issues paper*, 21 May 2021, pp 5. Accessed from: https://nsw.us7.list-manage.com/track/click?u=838ac6dd4f9bd063762820658&id=da7652d168&e=9011240l4f

encourages all assets able to meet the forecast reliability challenge. In our view, the technology able to make the most competitive LTESA bids will likely vary depending on the reliability challenge (e.g. a peak demand event c.f. a sustained period of low output from variable renewables). Therefore, it is important for the firming LTESA tender criteria to be linked to the services required from an asset, rather than the asset's technology.

During DPIE's previous consultation on LTESAs, Shell Energy found it useful to be presented with a relatively well-defined draft generation LTESA structure. This allowed us to assess its likely impacts and provide considered feedback. We recommend that DPIE undertakes a similar process for firming LTESAs in a future consultation round, since neither the Paper nor the LTESA paper[14] provided details for the proposed design of firming LTESAs.

Notwithstanding, we recommend that DPIE considers the following issues when developing firming LTESA design options for stakeholder consideration:

- Section 43(2) of the EII Act states that Part 6 "does not apply to infrastructure that is part of a committed infrastructure project". Section 43(3) goes on to specify that a committed infrastructure project is one that was 'committed' or 'existing' on AEMO's generation information page before 14 November 2019. By this definition, we understand that Part 6 would apply to demand response projects; i.e. demand response projects would be eligible for firming LTESAs, regardless of whether the demand response is from a new-build or existing physical facility. However, it would be useful for the NSW Government to clarify whether this interpretation is correct. In particular, it would be useful if the NSW Government clarified its expectations around if/how demand response applicants for firming LTESAs would need to demonstrate 'additionality'. For example, should firming LTESAs only be available to projects not committed at the time of the LTESA tender process? In the case of demand response, we believe additionality criteria should only apply to the demand response capability, rather than the underlying load.
- One option for firming LTESAs would be an out-of-market contract similar to the Reliability and Emergency Reserve Trader. However, this would appear duplicative with the proposed 'jurisdictional strategic reserve' Energy Ministers supported as part of the Energy Security Board's Post-2025 reforms[15]. Additionally, we understand that the NSW Government's intent is for all LTESAs (including firming LTESAs) to encourage in-market participation[16]. Therefore, we consider that to be successful in a firming LTESA bid, a proponent would need to demonstrate their ability to independently respond to market signals at times firming is required. This is distinct from being able to respond to a direction given in advance (e.g. 24 hours' notice).
- When considering the standard design for firming tenders, we recommend that DPIE contacts the Australian Renewable Energy Agency (ARENA) Knowledge Sharing Team investigating demand flexibility. The ARENA team has started to develop incentive models for demand response, which may be applicable more broadly for firming LTESAs. ARENA's Option C (a grant, which could take the form of an optional annuity)[17] appears to broadly align with NSW's intent for LTESAs to act as a 'fallback' to assist meeting project hurdles. A key feature of this option is that it aims to facilitate in-market participation that is responsive to price signals.

[14] DPIE, *Long-Term Energy Service Agreement Design: Consultation paper*, August 2021, pp 25. Accessed from: https://www.energy.nsw.gov.au/sites/default/files/2021-08/long-term-energy-services-agreement-design-consultation-paper-210316.pdf

[15] The Hon Angus Taylor MP, *Media release: Energy National Cabinet Reform Committee*, 24 September 2021. Accessed from: https://www.minister.industry.gov.au/ministers/taylor/media-releases/energy-national-cabinet-reform-committee-2

[16] DPIE, *Long-Term Energy Service Agreement Design: Consultation paper*, August 2021, pp viii. Accessed from: https://www.energy.nsw.gov.au/sites/default/files/2021-08/long-term-energy-services-agreement-design-consultation-paper-210316.pdf

[17] ARENA, *Demand Flexibility Trial Design Workshop: 30 September & 6 October 2021*, pp 5. Not published at time of writing.

For the avoidance of any doubt, while we have provided high-level feedback, we strongly recommend that DPIE consults on a detailed firming LTESA design. Unless this occurs, we consider it unlikely that the firming LTESA design will be fit for purpose.

Q5: Other than those prescribed in the EII Act, are further LTES Agreement design principles required to support spot, contract and system services market operation and greater consistency across jurisdictional schemes and, more broadly, innovation over time?

Consistent with our response to Q7, we recommend adding a 50(5)(e) principle(s) into the regulations to link LTESAs with the REZ access regime.

Q6: What do you think is important to include in a regulation to define 'outstanding merit'?

The definition of 'outstanding merit' is relevant only to projects located outside of a REZ seeking a generation LTESA. The Paper's starting point for considering the definition seems broadly sensible. In addition, we believe that a project showing outstanding merit would operate in a way that did not reduce the level of transmission access for existing generation/storage assets, or planned REZ projects.

We note that this issue will be explored further in the forthcoming tender design consultation paper. We will await that paper before providing more detailed feedback.

Q7: Are there further matters that should be considered when setting and using REZ access fees?

Shell Energy welcome's DPIE's expectation for "the Consumer Trustee to conduct combined tenders" for LTESAs and access rights. However, we note that the EII Act "does not require...combined tenders". [18]

In our view, the regulations should explicitly link the process to allocate LTESAs with the process to acquire REZ access rights. As outlined in our previous submissions to DPIE, the interaction between REZ access rights and LTESAs will substantially impact the value of (and bids for) each of them[19,20].

The Paper states that "a forthcoming tender design consultation paper will set out how the two products can be delivered in a single, consistent and effective process"[21]. Shell Energy welcomes this outcome, and looks forward to engaging in that round of consultation. At this stage, we observe that the link between LTESAs and REZs amplifies the importance of well-designed REZs and access schemes, which in turn depend on high-quality IIO Reports. Meaningful stakeholder consultation during each of these processes will be key.

Governance and controls for the Infrastructure Safeguard

Q8: How should stakeholders be engaged in key processes so as to ensure the ongoing success of the Infrastructure Safeguard according to the objectives of the EII Act?

It is important to acknowledge AEMO's overlapping interests as NSW's Consumer Trustee, as the market operator, as the network service provider for Victoria, and as the 'owner' of the ISP. Shell Energy considers there

[18] DPIE, *Infrastructure Safeguard Policy Paper (Part 6 of the Electricity Infrastructure Investment Act)*, September 2021, pp 15. Accessed from: https://www.energy.nsw.gov.au/sites/default/files/2021-09/electricity-infrastructure-fund-policy-paper-part-7-eii-act-210458_0.pdf
[19] Shell Energy, *RE: Central-West Orana RE Access Scheme Consultation*, 30 April 2021, pp 2, 8, 13-14, 16-17. Accessed from: https://www.energy.nsw.gov.au/media/2596
[20] Shell Energy, *RE: Long-Term Energy Service Agreement design*, 10 September 2021, pp 5. Not published at time of writing.
[21] DPIE, *Infrastructure Safeguard Policy Paper (Part 6 of the Electricity Infrastructure Investment Act)*, September 2021, pp 16. Accessed from: https://www.energy.nsw.gov.au/sites/default/files/2021-09/electricity-infrastructure-fund-policy-paper-part-7-eii-act-210458_0.pdf

is a risk of actual or perceived conflicts of interest due to these multiple roles. For example, the Paper raises the prospect of "biases in decision making (such as preferencing reliability over price outcomes...)"[22].

Shell Energy strongly agrees that "ongoing transparency and accountability in decision-making by the Consumer Trustee is critical to ensuring the Infrastructure Safeguard continues to be effective and maintains the confidence of all stakeholders". In this context, the Paper flags that "Section 67 of the EII Act provides for the Regulator to audit the performance of the Consumer Trustee".[23]

In order to maintain the confidence of stakeholders, we recommend that the regulations should:

- define a minimum period between audits of the Consumer Trustee
- mandate that stakeholders be consulted during any audit of the Consumer Trustee
- stipulate a mechanism for stakeholders to instigate an audit of the Consumer Trustee.

We believe our suggestions could be implemented in a way that keeps the Consumer Trustee accountable, without adding excessive regulatory burden.

We agree with DPIE that stakeholder confidence would be strengthened if there was a 'Consumer Panel' for the Roadmap. In our view, consumer panels used as part of the ISP consultation process, network regulatory resets and large network infrastructure projects have substantial value. In addition to the role described in the Paper[24], we believe the Consumer Panel should monitor and report on the level of effective engagement and consultation by the Consumer Trustee – similar to the Consumer Panel's role for the ISP.

Similarly, we support the concept of an ex-ante and ex-post controls framework to ensure Consumer Trustee activities are subject to appropriate governance. We look forward to engaging with DPIE further on this topic once the concepts in the Paper's Table 1 are developed in more detail. At this stage, our core observation is that reviews should generally be conducted (or at least approved) by an independent body (e.g. the Regulator), not the Consumer Trustee itself.

Q9: Where could the regulations provide guidance to the Consumer Trustee in relation to the risk management framework, to increase transparency and confidence for stakeholders?

It is plausible that by 2030, the SFV will be the counterparty to LTESAs underpinning 12 GW of VRE, 2GW of ≥8-hour storage and additional firming infrastructure[25]. This may increase (either prior to or after 2030) depending on how the market evolves. Consequently, DPIE has flagged that there are a range of risks the SFV will be required to manage, including:

- reduced market liquidity if a substantial capacity of generation LTESAs are concurrently exercised, which would increase costs for retailers (including in relation to the Retailer Reliability Obligation)
- costs to consumers due to LTESA liabilities, or unnecessarily high contributions from distribution network businesses due to uncertainty of future LTESA liabilities.

To manage these risks, DPIE envisions the SFV participating in financial markets.

In Shell Energy's view, the SFV has the potential to become a major (if not the largest) participant in financial markets. Therefore, there needs to be adequate controls to ensure that the SFV is enhancing liquidity and not exercising market power. As stated elsewhere in this submission, it would be useful for DPIE to present

[22] Ibid, pp 20
[23] Ibid
[24] Ibid, pp 6
[25] Consistent with the minimum objectives in Section 44(3) of the EII Act.

stakeholders with draft controls to assess, rather than starting from a mostly 'blank slate'. Notwithstanding, we offer the following suggestions and observations, some of which also relate to questions 10, 11 and 12.

1. To mitigate the risks of excessive market power and lower liquidity, it may be appropriate to 'break up' the SFV by creating multiple (at least three) independent trading desks that are allocated the long-term positions underpinned by the SFV's portfolio of LTESAs. In this model (and using three trading desks as the example), each trading desk would be the counterparty to an equal (1/3) share of each LTESA. Each trading desk would then independently manage its risk based on the risk framework, which would be developed by the Consumer Trustee (see question 12). Having three trading desks would increase market competition compared to a situation with only one trading desk. Similarly, allocating an equal portion of each LTESA to each trading desk would ensure there was no negative impact on liquidity compared with a single trading desk scenario. This is our preferred option.

2. As an alternative to the option outlined in point 1, the SFV/Financial Trustee could conduct a tender process whereby market participants bid for the rights to manage a portion of the LTESA book. Each portion would be split in an identical fashion to what we proposed in point 1.

   This option would provide a source of income for the SFV, de-risk the management of the LTESA book, and potentially reduce SFV staffing costs/required capabilities (see question 11). To mitigate the risk of a participant gaining excessive market power, there would need to be a limit on the book percentage a participant could own. We consider that the Australian Competition and Consumer Commission would need to be consulted when setting this limit, but our preliminary position is that it should be no more than ~20% of the total LTESA book. This is a lower percentage than the independent SFV trading desks in point 1, since tender participants would likely have other holdings in NSW (hence giving them greater market power).

3. The Paper flags that, "While AEMO Services Limited will initially be exclusively focused on its obligations as the NSW Consumer Trustee, it may take on other functions over time, including those conferred under statute by other Australian states and territories"[26]. If the SFV's remit expands across regions, then the aforementioned risks relating to liquidity and market power may grow in scale. To limit these risks, we consider that it would be necessary to replicate the kind of risk-management options described in points 1 and 2.

4. The identity of the Financial Trustee (who will administer the SFV) is currently unknown because they have not yet been appointed by the Consumer Trustee. There may be additional risks specific to the Financial Trustee, which would necessitate additional controls. We make this observation with Section 61(3) of the EII Act in mind, since it dictates "the Financial Trustee is not subject to the control or direction of the Consumer Trustee or the Minister".

Q10: When should the Scheme Financial Vehicle enter hedging contracts?

In our view, for the SFV to effectively manage risks using financial markets (per point 1 in our response to question 9), it would need to be set up with a traditional trading function, and enter into hedge contracts on a rolling basis. Our rationale is as follows:

- The SFV's risk is in managing a portfolio of long-term offtake agreements that have sold short term optionality.
- One risk management option would be to employ a passive approach and just 'set and forget' the long term contracts. However, the SFV would likely achieve better financial outcomes if it had a trading

[26] DPIE, *Infrastructure Safeguard Policy Paper (Part 6 of the Electricity Infrastructure Investment Act)*, September 2021, pp 20. Accessed from: https://www.energy.nsw.gov.au/sites/default/files/2021-09/electricity-infrastructure-fund-policy-paper-part-7-eii-act-210458_0.pdf

function that assessed short term (1-4 quarters ahead) market fundamentals and optimised the long-term position as it matured.

Q11: What capabilities will the Consumer Trustee or Financial Trustee need to manage net exposures under hedging contracts and LTES Agreements?

At a minimum, the Financial Trustee would need the capability to facilitate trading, risk and settlements functions for the SFV[27].

DPIE's "preliminary position is to recommend that the risk management framework provide[s] for the Regulator to verify [appropriate systems, process and capabilities] are in place before any trading commences"[28]. We observe that, for the Regulator to make an informed assessment, the Regulator will be required to have the appropriate expertise. Given that the Regulator has not yet been appointed, it is not clear that they will necessarily have this expertise.

Q12: What parameters, principles and structures should be regulated to limit net basis risk exposures for consumers?

We consider that the Consumer Trustee should be responsible for determining its risk tolerance, in its legislated role to act in the long-term financial interests of NSW electricity customers. The risk management framework with which the SFV must comply could subsequently be developed, with volumetric and/or statistical risk metrics that reflect the overarching risk tolerance.

This is the same general process followed by any major trading entity. The main difference is likely to be the risk tolerance of the Consumer Trustee, which is inherently subjective. To help guide this tolerance, the NSW Government may wish to create bounds using the expected savings to consumers from the Roadmap. For example, a broad set of bounds would be for exposure at any point to be between 0% and 100% of the total consumer benefit expected to be delivered by the Roadmap. A more realistic set of bounds might be (say) between 0% and 15%. The NSW Government may also wish to consider whether this tolerance should be in relation to the high, low, or central expectations for consumer benefits.

As stated elsewhere in this submission, we consider it would be useful for there to be further consultation once there is a more defined proposal for the risk management framework.

Conclusion

Shell Energy thanks the NSW Government for the opportunity to provide early-stage feedback on the Part 6 regulations. This submission offers a range of suggestions relating to infrastructure planning, LTESAs and REZ access rights, and governance and controls. However, given the Paper's relatively high-level questions, we recommend a subsequent round of consultation with more detail provided by DPIE (e.g. a full set of draft regulations and firming LTESA design options).

We look forward to engaging further as the NSW Government continues its Roadmap consultation.

[27] To operate in the fashion outlined in point 1 in our response to question 9.

[28] DPIE, *Infrastructure Safeguard Policy Paper (Part 6 of the Electricity Infrastructure Investment Act)*, September 2021, pp 25. Accessed from: https://www.energy.nsw.gov.au/sites/default/files/2021-09/electricity-infrastructure-fund-policy-paper-part-7-eii-act-210458_0.pdf

If you would like to discuss this submission further, please contact Matthew Ladewig, Policy Adviser at [redacted] or on [redacted]

Yours sincerely

Libby Hawker
GM Regulatory Affairs & Compliance
03 9214 9324 – libby.hawker@shellenergy.com.au