Your ref: AER213736

26 April 2022

Mr Warwick Anderson
General Manager – Network Pricing
Australian Energy Regulator
Submitted via email to: AERPricing@aer.gov.au

Dear Mr Anderson

Submission: Pricing Methodology Guidelines: System Strength Guidelines Consultation Paper

CS Energy welcomes the opportunity to provide a submission to the Australian Energy Regulator's (**AER's**) Pricing Methodology Guidelines: System Strength Pricing Consultation Paper (**Consultation Paper**).

About CS Energy

CS Energy is a Queensland energy company that generates and sells electricity in the National Electricity Market (**NEM**). CS Energy owns and operates the Kogan Creek and Callide B coal-fired power stations and has a 50% share in the Callide C station (which it also operates). CS Energy sells electricity into the NEM from these power stations, as well as electricity generated by other power stations that CS Energy holds the trading rights to.

CS Energy also operates a retail business, offering retail contracts to large commercial and industrial users in Queensland, and is part of the South-East Queensland retail market through our joint venture with Alinta Energy.

CS Energy is 100 percent owned by the Queensland government.

Key questions

CS Energy acknowledges the range of questions outlined in the Consultation Paper but believes there are a couple of fundamental questions about the methodology that should be addressed before effort is expended on detailed design questions, namely the choice between Long Run Average Cost (**LRAC**) and Long Run Marginal Cost (**LRMC**) and what constitutes "long run" in this context.

Long Run Average Cost versus Long Run Marginal Cost

CS Energy does not support the AER permitting System Strength Service Providers (**SSSPs**) to choose between different long-run pricing methodologies, as different methodologies across jurisdictions may affect locational decisions at the investment timescale and economic competitiveness at the operational timescale. Different methodologies would also introduce additional complexity when system strength issues do not align with jurisdictional borders which is anticipated to arise with the emergence of Renewable Energy Zones (**REZs**).

The guidelines should stipulate a single long-run pricing methodology for determining the system strength unit price (**SSUP**). The Consultation Paper notes the respective strengths and weaknesses of applying LRAC or LRMC in this context. Despite LRAC expected to typically be greater than LRMC, the arguments for LRAC posited in the Consultation Paper include:

- The increased likelihood that residual costs would fall to common transmission services and ultimately load customers if LRMC pricing were allowed;[1]
- Additional complexity and costs associated with estimating LRMC;[2] and
- For SSSPs to leverage economies of scale in the provision of system strength at a node, it is likely that investments would be required in large lumps relative to the expected increase in system strength demand. In this case the LRMC of system strength provision would tend to vary significantly relative to the LRAC.[3]

While CS Energy broadly agrees with this assessment, the draft determination should expand on the analysis of differences between the methodologies presented in Section 4.2.3 of the Consultation Paper to provide further information about how these methodologies would be applied by SSSPs and the differences in resulting SSUPs.[4] This will enable stakeholders to provide informed views of the materiality of this metric and the preferred methodology.

Definition of 'Long Run'

Irrespective of whether LRAC or LRMC is prescribed in the guidelines, the time period over which this pricing applies needs to be defined and consistently applied. CS Energy agrees with the statements in the Consultation Paper concerning defining long run as 10 years, consistent with other key processes (principally the Australian Energy Market Operator's (**AEMO's**) System Strength Report and the Transmission Network Service Provider's (**TNSP's**) Transmission Annual Planning Reports (**TAPR**)). The application of this definition will also need to ensure impartiality between network and non-network solutions.

Other issues

System Strength Unit Price objective

Clarification is also required about the intent of the SSUP. The Consultation Paper notes the potential impacts of volatility on the SSUP and the uptake of centrally procured system strength services; for example, "expectation of future volatility could distort upfront

[1] Australian Energy Regulator, *Pricing Methodology Guidelines: System Strength Pricing Consultation Paper*, p. 33
[2] *Ibid*, p. 25
[3] *Ibid*, p. 32
[4] *Ibid*, p. 30

connection location and investment decisions".[5] While pricing stability is desirable, the primary objective for SSUPs should be to accurately reflect the cost of providing system strength services, which may change over time.

Risk allocation

The Consultation Paper needs to further explore the potential impact of the over-procurement of system strength services on consumers to ensure this risk is minimised. Over-procurement will be driven by factors such as timing mismatches between system strength procurement and connecting parties nominating to buy system strength services, or lower-than-expected uptake of centrally-procured system strength services.[6]

The Consultation Paper notes the risk management principle that unmanageable risk should be allocated to the party best able to absorb the risk (which in this instance is consumers). CS Energy suggests there be provision for a review within a five-year regulatory period in the event of a material divergence between expected and actual uptake of system strength services to reduce the potential costs on consumers. The outcome of the review may result in changes to the forecast for the next period or pricing methodology improvements, resulting in a reduction of system strength costs allocated to consumers and minimising the volume of underutilised or stranded system strength services.

Treatment of AEMO as System Strength Service Provider for Victoria

CS Energy does not consider there is any justification for the pricing methodology guideline treating AEMO differently to other SSSPs. Given AEMO's role as both the market operator and Victoria's TNSP, ringfencing of its TNSP responsibilities should remove any consideration or requirement to have a pricing methodology guideline that differs for the other NEM SSSPs.

Conclusion

While CS Energy appreciates AER's early engagement on the development of the system strength pricing methodology guidelines, further work is required on key aspects underpinning the methodology so stakeholders can provide informed feedback. CS Energy looks forward to engaging with the AER on the draft determination.

If you would like to discuss this submission, please contact Evan Jones (Market Regulatory Manager) on [redacted] or [redacted]

Yours sincerely

[redacted]

Dr Alison Demaria
Head of Policy and Regulation (Acting)

[5] *Ibid*, p. 25
[6] *Ibid*, p. 20