



EnergyAustralia

LIGHT THE WAY

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Mr Warwick Anderson
General Manager – Network Pricing
Australian Energy Regulator

Lodged via email: AERPricing@aer.gov.au

Dear Warwick,

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TRANSMISSION PRICING METHODOLOGY GUIDELINES: SYSTEM STRENGTH PRICING

EnergyAustralia (EA) welcomes the opportunity to comment on the Australian Energy Regulator's (AER's) consultation paper on system strength pricing in the National Electricity Market (NEM). EA is one of Australia's largest energy companies with around 2.4 million electricity and gas accounts in NSW, Victoria, Queensland, South Australia, and the Australian Capital Territory. EA owns, contracts and operates a diversified energy generation portfolio that includes coal, gas, battery storage, demand response, solar and wind assets. Combined, these assets comprise 4,500MW of generation capacity.

EA is dedicated to building an energy system that lowers emissions and delivers secure, reliable and affordable energy to all households and businesses. This requires being a good neighbour in the communities we operate in. We, therefore, recognise the value in working with Aboriginal and Torres Strait Islander peoples as the traditional custodians of this land. We acknowledge and respect their continued connection to all aspects of Country.

EA is appreciative of the AER's efforts to investigate and implement a new transmission pricing methodology for system strength. Ensuring this is fit for purpose will be a vital enabler of a rapid and robust energy market transition in light of ongoing and significant market, technological and operational change. In this regard, we consider Long-Run Average Cost (LRAC) pricing should be favoured over a Long-Run Marginal Cost (LRMC) approach in most cases. This is because a LRAC methodology would:

- result in stabler pricing, greater investor confidence and more efficient locational investment decisions, especially in situations where System Strength Service Providers (SSSPs) investment in system strength is expected to be lumpy;
- allocate more of the risk of system strength costs to generators with fewer residual costs having to be borne by transmission customers;
- avoid the complexities and uncertainties of LRMC modelling making forecasts likely to be more accurate;

- be simpler to calculate and apply, thereby being more administratively efficient; and
- be more consistent with other current transmission pricing frameworks.

We acknowledge there may be some cases where LRMC could be applied as an exception. For example, where centrally-procured system strength costs are material when compared with total project costs. However, we consider these situations will be in the minority. In particular, given the likely attractiveness of self-supply via the use of Grid-Forming Inverters and other non-network options such as contracting with other synchronous generators. We, therefore, consider that there should be clear guide rails and limitations on when LRMC is applied, rather than SSSPs having absolute discretion to apply it to every new system strength project.

Responses to specific questions are provided below and we would welcome the opportunity to discuss this submission further with you. Should you have any questions, please contact me via [REDACTED] or on [REDACTED].

Regards,

Bradley Woods

Regulatory Affairs Lead

Question 1: Are there any implications of the TNSP and AEMO interdependencies that could affect the form of our system strength pricing methodology guidance?

The timing and framework interdependencies will add complexities to submitting and reviewing the pricing methodology proposals by November 2022. These complexities are well articulated in the consultation paper, and we consider this will favour a Long Run Average Cost (LRAC) approach. That is, in being much easier to calculate and apply compared with the time-consuming iterative process of a Long-Run Marginal Cost approach, which may not be possible to finalise in the specified timeframes.

Question 2: Do you have any feedback on these or other relevant contextual factors and their consequences for the AER's guidance development?

EA agrees with the AER's assessment of the contextual factors, and their consequences presented in the consultation paper. In particular, we support the AER's conclusions on the pricing principles that should be favoured as a result on page 21. These will be useful in managing edge cases which are bound to arise given the bespoke locational aspects to system strength provision. For example, at system strength nodes which are electrically close but are in different NEM jurisdictions. This will require careful AER attention to ensure customer and generator pricing outcomes are equitable across regions. As detailed further in the questions below, in general, we consider an LRAC pricing approach will support this outcome by best aligning with and fulfilling the proposed pricing principles.

Question 3: What materiality considerations should inform our assessment of potential pricing methodologies?

Please see the answer to Question 5 below.

Question 4: Should our guidance specify a minimum period for "long-run", and if so, is 10 years reasonable?

EA considers 10 years is an appropriate, minimum long-run period. This is consistent with other definitions such as that used in Distribution Network Service Provider's (DNSP's) Tariff Structure Statements (TSS). Such a timeframe will minimise pricing volatility and underpin investor confidence, thereby leading to more efficient investment and customer outcomes.

Question 5: What scenario(s) (either illustrated in Figure 4.1 or others), do you think should inform our guidance development? Do you have a view on or evidence of the likelihood of these scenarios?

Consistent with the Australian Energy Market Commission (AEMC), we consider Scenario 1 as the most likely outcome. That is, with significant economies of scale to central provision even if Renewable Energy Zones (REZs) have different arrangements apply. It is, therefore, unlikely that material efficiency or incentive benefits will be had from a Long Run Marginal Cost (LRMC) approach over an LRAC one.

There could be some instances where centrally-procured system strength costs are material when compared with total project costs. This might seem to argue for an LRMC approach. However, we consider these situations will be in the minority given the likely attractiveness of self-supply via the use of Grid-Forming Inverters or other non-network options such as contracting with other synchronous generators to supply system

strength. As a result, it would seem more likely that Scenario 3 will prevail when a potential Scenario 2 situation arises.

Even if not true in all cases, we highlight this would not necessarily mean an LRMC approach should be favoured in all cases. As noted in the consultation paper, LRMC is likely to be less accurate in situations where there is uncertainty about future demands and costs. This is more probable for the foreseeable future given labile technological, regulatory and political environments. Moreover, the additional administrative, modelling complexity and costs from an LRMC approach need to be factored. Given these considerations and the other LRAC advantages noted elsewhere in this submission, we consider LRAC should be the default pricing approach.

Questions 6-8: To what extent is volatility in the SSUP between 5-year periods likely to have an adverse impact on efficient generator and IBR load investment decisions? Is pricing stability desirable over successive SSUP pricing periods? Do you consider the permitted pricing methodologies will affect SSUP pricing stability?

EA considers the stability of the SSUP will be a key driver of generation investment. With little ability to respond to price signals post-connection, any uncertainty over future system strength costs will inevitably manifest in higher risk premia and the cost of capital, with a consequently higher likelihood of sub-optimal locational investment decisions. This is more likely to be seen with an LRMC approach given the significant scale economies to central procurement. That is, with lumpy investments relative to system strength demand meaning large step changes in the LRMC with each SSSP investment. Consistent with the above, we suggest an LRAC approach is used in most cases.

Questions 9-10: Should the permitted pricing method(s) place risk with the party best placed to manage it, and should any residual unmanageable risk be allocated to the party best able to absorb the risk? Do you consider that a LRAC permitted pricing methodology would support this?

EA strongly agrees with the principle of placing risks on parties best placed to bear and manage them, i.e., generation proponents rather than load customers. Doing so allows for the greatest economic efficiency. Both the AEMC and the consultation paper highlight that an LRAC approach will best achieve this for system strength procurement. This follows from the lower volatility and residual costs compared with an LRMC approach. As such, we consider an LRAC pricing approach should be favoured.

Question 11: What issues should the pricing methodology guidelines consider in relation to minimising administrative complexity and implementation costs? What data or evidence would be useful to inform the response to this question?

Per the answer to Question 5, we highlight and agree with the AER's assessment that an LRMC approach is likely to be much more administratively burdensome. In particular, given:

- the uncertainty around future political, regulatory and technological developments, and
- the likely increase in the number of system strength nodes as generation becomes more and more decentralised.

We, therefore, consider that the simpler and cheaper LRAC approach should be preferred.

Question 12: Is consistency with the pricing of other transmission services desirable?

Consistency with other transmission services pricing is desirable. Familiarity with existing processes is likely to support the most efficient administration and expeditious application of the pricing framework. As noted above and by the AER in the consultation paper, this will be best achieved with a LRAC pricing methodology.

Question 13: Could allowing different system strength pricing methodologies support innovation? Do you expect this to be material and over what timeframe might it be material?

EA considers changes in technology and regulatory incentive frameworks for SSSPs will be a greater driver of innovation in system strength provision than differing pricing methodologies.

Questions 14-15: Should the AER permit SSSPs to choose between different long-run pricing methodologies? Could differing system strength pricing methodologies between SSSPs affect competition in the wholesale market?

EA supports national consistency in pricing approaches. This will avoid further unnecessary complexity being added to evaluating generation investment in different states. More importantly, it will also reduce the potential for distorted locational incentives that are simply the result of pricing framework differences. That is, rather than fundamental economic and power system engineering drivers.

Given the advantages stated above, we consider that an LRAC approach should be favoured in most cases. However, we note there may be some cases where LRMC could be applied as an exception. For example, where centrally-procured system strength costs are material when compared with total project costs. Despite this, we consider there should be clear guide rails and limitations on when LRMC is applied, rather than SSSPs having absolute discretion to apply it to every project.

Question 16: Should the system strength unit price be indexed? If so, what method should be used for indexation?

EA supports indexation and considers current revenue determination practices would be appropriate to extend to the SSUP.

Questions 17-18: What level of detail should be contained in the forecasting principles for system strength revenue inputs? What revenue forecasting principles should be included in the pricing methodology guidelines?

We support the AER's guidance on system strength forecasting principles provided in the consultation paper.

Question 19: Are the arrangements for treatment of confidential and commercially sensitive information in the existing pricing methodology guidelines sufficient for system strength services?

EA considers the consistent application of the existing pricing methodology guidelines will be sufficient to protect confidential and commercially sensitive information.

Questions 20-22: What are the differences between AEMO as SSSP for Victoria and other SSSPs that may be relevant to our pricing methodology guideline? Are the issues discussed in sections 4 to 6 above equally applicable to AEMO as SSSP for Victoria? Are there any areas where our guideline should treat AEMO differently to other SSSPs because of any of differences between how AEMO is regulated and how other SSSPs are regulated?

To the extent possible, EA considers AEMO should be treated no differently than other SSSP for system strength. In particular, concerning transparency of the information used to inform costs and pricing forecasts. Rigorous, competitively sourced and verifiable information will underpin efficient system strength project delivery and best-case outcomes for customers and generation proponents.