Summit Southern Cross Power

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Economic Regulation Authority
Level 4, Albert Facey House
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7 October 2024

Re: Draft changes to the Offer Construction Guideline

Summit Southern Cross Power (SSCP) welcomes the opportunity to provide feedback on the draft changes to the Offer Construction Guideline.

SSCP strongly opposes the proposed change to remove generators' ability to recover Contingency Reserve Raise (CRR) costs. SSCP considers that the cost of CRR is directly related with the generation of electricity. The cost contingency is inherently linked to the generation of electricity since the CRR cost goes up or down relative to production. Therefore, the cost of providing this service is a variable cost and it must continue to be considered an efficient variable cost.

The first draft Offer Construction Guideline published in 2022 did not include the ability to recover CRR costs via Short Run Marginal Cost (SRMC) pricing. During the public consultation period, Synergy corrected the oversight suggesting that ESS costs that are incurred due to facility operation should be allowed to be included in the construction of offers.

The ERA agreed with Synergy and in response commented "Runway Cost of Contingency Reserve Raise (CRR) is included in Market Participant costs in Table 1 as generators pay for the cost of procuring CRR in proportion to their energy output."[1] The ERA updated the Offer Construction Guideline accordingly.

CRR costs continue to be attributed in proportion of the energy output of a facility, relative to other facilities, and in SSCPs view there is no basis, stemming from economic principles, provided evidence or otherwise, for the ERA's reversal of its earlier position on this matter.

Additionally, SSCP provides the following comments to support of the view that CRR costs must continue to be considered an efficient variable cost:

<u>Unverified WEMDE pricing outcome:</u>

During a stakeholder meeting held by the ERA on 19 September the ERA presented their rationale behind the change removing the ability to recover CRR costs. The ERA remarked that WEMDE in its pricing calculation adds on CRR costs to market participants' bids. The ERA claimed that if market participants were to include CRR costs in their bids, it would result in CRR costs being double counted and thus, market participants being overpaid.

[1] Offer construction guideline and trading conduct guideline – Final report 2023, p.12

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SSCP disagrees with the ERA's understanding of how WEMDE is calculating prices. SSCP has not seen any evidence from market outcomes that would support ERA's claims. The SSCP trading team closely monitors pricing outcomes daily, and have not encountered the situation that ERA has presented as the basis for this change to the Offer Construction Guideline.

Additionally, the ERA has not presented any evidentiary examples of WEMDE working in the manner as described. This is an unusual action of the regulator who to date has heavily relived on evidence backed decisions.

Attached to this submission is an appendix with **<u>confidential</u>** analysis that demonstrates that WEMDE is not calculating prices as presented by the ERA. Our analysis shows that when the NewGen Power Kwinana (NPK) facility was the marginal unit, the real time energy price is equal to the bid price, and not increased as suggested by the ERA. In these intervals if the bid price did not include all efficient variable costs (including the CRR) then NPK would have been generating uneconomically.

Considering there are opposing views within the market on how fundamentally WEMDE is determining pricing outcomes suggests that there is an opportunity for the ERA to review WEMDE. Attached to this submission is an appendix with **<u>confidential</u>** analysis showcasing examples of where SSCP believes inefficient pricing outcomes have occurred. SSCP welcomes the opportunity to explain in more detail its understanding of the confidential data contained in these attachments.

Given the complexity of pricing calculations and the high ESS costs in the new market; the possibility of some underlying inefficiencies being discovered seems likely.

<u>Efficient cost recovery and inefficient pricing outcome:</u>

While SSCP disagrees with ERA's basis for the change to CRR cost recovery, even if the ERA understanding of WEMDE were to be correct, SSCP considers the blanket elimination of cost recovery as a problematic approach.

Price determination and cost recovery are entirely separate concepts. There is a natural link between the two given that one may feed into the other. But it's possible to have an inefficient pricing outcome and an efficient cost recovery. Just as it's possible to have efficient pricing outcomes and inefficient cost recovery.

SSCP is of the view that the ERA is seeking to correct an inefficient pricing outcome by eliminating the ability of market participants to efficiently recover costs. The proposed solution by the ERA does not tackle the underlying problem, and more concerning, given its uneconomic principle, is likely to have the effect of causing significant and irreversible financial damage to some generators.

<u>Inability to recover variable costs:</u>

SSCP has analysed the extent of the financial impact the proposed changed to CRR cost recovery would have, had this change been in place since 1 October 2023. This analysis demonstrates that without including ESS costs in NPK's SRMC, the facility would have only recovered 82% of ESS costs.

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Additionally, due to the lower and uneconomic SRMC, the facility would have been dispatched more often resulting in a 9% increase in ESS costs. So not only does this change prevent ESS cost recovery, it also increases the amount of unrecoverable costs.

If ESS costs are not included in the SRMC, market participants would not be able to recover costs. There is a substantial difference in SRMC prices with or without the inclusions of ESS costs due to the high cost of procuring ESS in the WEM since 1 October 2023. RTM prices would be artificially low and even non-marginal generators would be uneconomic in most intervals. This could encourage generators to minimise exposure to ESS costs either through limiting merchant supply (to avoid unrecoverable cost), increasing contracting volumes or, over the longer term, seeking behind the meter supply solutions.

Enshrining uneconomic price construction and an inability to recover variable costs into the rules is not a trivial change. The ERA should give careful regard to the broader impacts that such a proposed change might have to future generation investment decisions. As dispatchable supply becomes increasing scarce, disincentivising further dispatchable supply is counterintuitive.

Should the ERA wish to discuss any of these points further, please contact Bobby Ditric
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Yours Sincerely,

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