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8th February 2013

Submission on the Allowable Revenue and Forecast Capital Expenditure for the Independent Market Operator and System Management (23013/14 to 2015/16).

Griffin Power welcomes the opportunity to provide comment on the Economic Regulation Authority's (ERA's) Issue Paper for the Allowable Revenue and Forecast Capital Expenditure for the Independent Market Operator and System Management (23013/14 to 2015/16).

Griffin Power is a privately owned Generator and Retailer operating in the W.A. Wholesale Electricity Market with ~453MW of certified capacity in this market.

Griffin acknowledges that both the IMO and System Management are in a period of long overdue evolution and improvement. Griffin has concerns however that the improvements are not being adequately evaluated by any independent bodies to determine the success in delivering net benefits to the market and support further claims for related costs.Likewise the improvements are not being held against any forecast cost-benefit analysis to determine their effectiveness before ploughing on with further development.

Griffin believes the performance of these entities, relative to the cost of providing their services, should be in some way benchmarked. How else is it possible to evaluate if the direction the IMO and System Management propose to proceed will result in more efficient and sustainable outcomes? How can the ERA evaluate the justification for the allowable revenue proposals without clear evidence that the net result of projects already implemented have in fact been successful?

This is surely a question which the ERA must seek to answer to determine if the allowable revenues requested by the IMO and System Management are resulting in a discernible result being "the lowest practicably sustainable cost of delivering the services…" over time. If the total increase in Market Fees by the IMO and System Management outweigh the final delivered cost of energy to the end user the ERA must seek more detailed assessments by the IMO and System Management before approving marked increases in Allowable Revenues.

Process to be Follow by the Authority

Benchmarking:

Griffin Power would like to express some concern that the ERA has stated that:

a) It "… does not intend to benchmark the costs of the IMO and System Management (SM) against the costs of providing similar services in other jurisdictions."
b) The benchmarking the Authority does intend to apply is to assess the IMO and SM's proposals against a benchmark of the two previous Review Periods (presumably *actual*) costs.

Our first concern is that the ERA cannot identify any <u>similar</u> service to benchmark in any jurisdictions. While Griffin acknowledges that the isolated nature of the SWIS and it's market may make it somewhat unusual, Griffin believes some sort of similar service provision could be identified either on whole, or as a subdivision or proportion of a larger, similar service. Griffin would like to advocate that the ERA reconsider this stance, perhaps engaging consultants in the energy field to either identify a similar service, or support a finding that none exist.

Our second concern in this area is more generic. While it may be that both the IMO and SM are in fact operating extremely efficient, sustainable operations, it is also possible that relative to similar services elsewhere, they are very inefficient. Without adequate comparison Griffin believes that benchmarking against previous Review Periods may consign both organisations going forward to efficiencies too tight to maintain, or the opposite by allowing both organisations to operate at a relatively high costly levels that are borne by the end customer with no independent measure to make an adequate assessment.

Griffin would like to advocate that the ERA reconsider their current stance, perhaps engaging consultants in the energy field to either identify a similar service for benchmarking, or support an independent finding that none exist.

Methodology:

Griffin notes that "<u>Depreciation</u>" is included in the claim for allowable revenues recoverable from market participants.

Griffin has concerns about the level of Depreciation revenue requested by the IMO, specifically the clarity of relationship between the assets being depreciated and the resultant claim for depreciation. Griffin requests that the ERA comprehensively review the IMO asset register to evaluate appropriateness of depreciable assets attributable to Market Participants for the purposes to the Allowable Revenue Proposal.

Griffin's also has concern's as to whether or not labour is being capitalised. If this is the case, is that labour cost being deducted from the claim for depreciation (since it would previously be paid for in the normal operating expenses allowable revenue items)?

<u>IMO Allowable Revenue:</u>

Griffin acknowledges the progress the IMO has made in developing the energy market in Western Australia. Griffin has noticed significant improvements in the last two years with regards service and systems and a greatly improved energy market.

Those improvements have come at a cost however Griffin believes the bulk of project development in the Electricity Market has been done. Typical rule changes aside Griffin expects the maintenance of existing systems, the development of a competitive Spinning Reserve market, and move to a closer-to-real-time market should not be as expansive, or expensive, as the MEP project which implemented a competitive Balancing and LFAS market.

Griffin supposes that a logical result from such major investment in new systems should in fact be more automation with a lower requirement for staff going forward. Griffin notes the staffing levels forecast to remain relatively stable over the Review Period. Are the market improvement projects actually resulting in a lower cost to supply energy to end users?

<u>System Management Allowable Revenue:</u>

Griffin acknowledges the considerable project work that System Management has undertaken to meet the requirements of the Market Evolution Program and the implementation of the competitive Balancing and Load Following Markets.

Griffin is concerned that the Allowable Revenue requested in 2015/16 is 42% higher than the 2013/14 period. If this is attributable to the implementation of systems and process relating to the MEP Griffin is surprised that the costs are not reducing by 2015/16 rather than increasing. Griffin notes the reduction in capital expenditure during that same period. To be efficient Griffin would anticipate that the automated systems should require less operational expense going forward, rather than more.

Griffin notes the capitalised labour line item. If this labour expense has already been paid for in previous claims for operating or project expenses Griffin believes this should not be claimable (or form part of any depreciation claim). Will the ERA verify that the claim for capitalised labour has not already been funded by participants via previous allowable revenue claims?

System Management is claiming a “Return on Capital” line item. In the current market Griffin believes it is not unreasonable for the state-owned system operator to claim a return on capital utilised to provide the service of operating the SWIS for the component of costs which are *not* already funded by Market Participant. Can the ERA verify that the “Return on Capital” line-item is only for capital costs not paid for by Market Participants?

It is unclear to Griffin what the composition of the “Tax Payable” line item is. Griffin is concerned that this item may be a recovery of tax paid on the “Return on Capital” line item.

The ERA issue paper notes that System Management are using a weighted average cost of capital of 6.66% versus the ERA’s recent decision to use 3.6% when recently assessing Western Power’s Access Arrangement for the purposes of arriving at the Maximum Reserve Capacity Price. Griffin’s concern is that clearly the ERA and Western Power are not comparing ‘apples with apples’ for the forward years 2013/14 to 2015/16.