



29 April 2016

Mr Jeremy Threlfall
Economic Regulation Authority
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Email: records@erawa.com.au

Dear Jeremy,

**DETERMINATION OF ALLOWABLE REVENUE AND FORECAST CAPITAL EXPENDITURE FOR
IMO (WEM FUNCTIONS) AND SYSTEM MANAGEMENT, 2016/17 TO 2018/19 – ISSUES PAPER**

Alinta Energy (Alinta) appreciates the opportunity to provide a submission to the Economic Regulation Authority (the Authority) on the proposed Allowable Revenue (AR) and forecast capital expenditure for the Independent Market Operator (IMO) in relation to its WEM functions and System Management over the next three year period.

The Electricity Market Review (EMR), currently underway, will likely result in major changes in the operations of the WA's Wholesale Electricity Market (WEM). It is expected the proposed changes will result in the more efficient dispatch of generating plant to meet customer load and ancillary service requirements while ensuring the system remains safe and reliable. Improved dispatch efficiencies should translate to reduced wholesale energy costs paid by customers.

Alinta understands the program of proposed changes, including the Australian Energy Market Operator (AEMO) assuming the role of independent system operator (market operator/system manager) may result in, at least initially, an increase in market fees to be recovered from Market Participants. To some extent this is understandable as the proposed changes will transition the WEM to a near real-time, individual facility based, multi-product competitive energy/ancillary service market.

However, to ensure that any material increases in fees are adequately justified, Alinta fully supports the Authority scrutinising, including by way of comparative benchmarking, the allowable revenue and forecast capital expenditure proposals to determine that they are appropriate, and also take full account of merger efficiencies arising from System Management being consolidated into AEMO.

System Management- Proposed Allowable Revenue

Alinta notes System Management's submission states that it anticipates major structural reforms will result from the EMR "...which will drive corresponding changes to operations."¹ This raises the broader question of whether System Management/AEMO, when preparing its AR proposal, have considered differentiating proposed expenditures along the lines of what is absolutely necessary for a prudent independent system operator to continue to meet its regulatory obligations from what can be deferred on account of the likely impact of changes arising from the EMR. The 40% increase in proposed operating expenditures over that approved for the previous review period suggests this should be an area of close review for the Authority.

¹ System Management allowable revenue and forecast capital expenditure information, 1 July 2016 – 30 June 2019, Page 34.

More specific comments in regard to System Management's allowable revenue and capital expenditure proposal are:

- (1) A total of \$2.076M (comprising \$1.341M capital; \$0.735m operating) is forecast to be spent on the Dispatch Training Simulator, implemented in AR2. Given the AEMO merger, a question arises as to the extent to which consideration has been given to such training needs being met, potentially at lower cost, by leveraging AEMO's existing training capabilities and facilities.
- (2) IT Support costs are forecast to increase significantly – the total for AR3, combination of actual and forecast, is \$1.185M. In comparison, the proposed total for AR4 is \$3.642M, an increase exceeding 300% (equating to \$2.457M). Allowing a total of \$0.9M over the AR4 forecast period for unspecified IT costs not previously recovered from Western Power², the net increase of \$1.557M is still material and again raises the issue of whether the scope to leverage the IT and system synergies of System Management's merger with AEMO has been fully considered.
- (3) An additional 13 FTE positions are included for 2016/17, reducing to 9.3 in the following years, reflecting realisation of merger synergies. Some of the FTE increase is explained in System Management's information paper by reference to decisions to:
 - (i) establish a separate "security desk";
 - (ii) account for various tasks currently performed by Western Power network operations staff; and
 - (iii) reduce the incidence of material non-compliance with System Management's obligations embodied in Chapter 7 of the Market Rules, mainly relating to the late or non-issue of Dispatch Advisories.

Alinta posits scope may exist to take a broader perspective, than solely relying on increasing FTEs, to addressing some these concerns. For example, in regard to the timely issue of Dispatch Advisories, Alinta notes the 2015 System Management compliance audit suggests alternatives should be investigated for disseminating information to the market in a more efficient manner³. As well, with a view to improving staffing productivities, Alinta raises the question of whether consideration has been given to multi-skilling System Management staff, such that resources can be called upon when needed to assist in managing non-routine system security and operations events and circumstances as and when they arise.

- (4) In regard to the appropriateness of the escalation factors, for both labour and non-labour costs, Alinta notes the recent negative quarterly CPI (reducing the March quarter year on year Perth CPI to 0.7%) is significant will therefore likely be taken into account in the state budget forecasts to be tabled in May. This suggests the Authority should consider requesting the allowable revenue proposals be reforecast⁴, based on the forthcoming state budget's escalation parameters, to determine if the inflation downturn will have a material impact on those projected revenue requirements.

² Previously unrecovered Western Power costs were included in the forecast 2014/15 IT costs (refer Page 38 of System Management's submission) which exceeded the 2013/14 IT cost actuals by \$0.29M. Allowing \$0.3M per year to represent these costs, now included in the step change increment in AR4 IT costs, resolves to a total of \$0.9M for the three year period. Given the magnitude of these previously unrecovered costs, it is incumbent on System Management, now seeking to include them in its AR4 proposal, to inform the market of the relevant detail.

³ Refer to the Independent Assurance Report: Compliance of System Management with the Market Rules and Market Procedures, Final Report, PA Consulting Group, 4 November 2015, Page 24.

⁴ Noting that the proposed total AR4 Employee Benefit Costs for the IMO and System Management exceed \$52M, a small reduction in indexation would, due to compounding effects, result in a material reduction in costs. For example, a decrease of 0.75% in the labour indexation rate would result in a cumulative reduction in the order of \$1M of AR4 Employee Benefit Costs.

IMO – Proposed Allowable Revenue

Alinta acknowledges the transfer to AEMO of the majority of the IMO's functions complicates the assessment of the proposed allowable revenue for the AR4 period. In this regard Alinta notes the Authority's proposed approach not to base its assessment on a "business as usual basis" for the IMO, but rather to identify functions transferred to AEMO and determine and allocate an appropriate allowable revenue amount in respect of those functions⁵.

This is a sound approach and supported by Alinta. Specifically, in regard to the functions transferred to AEMO and the associated allocated revenue requirement, the proposal to compare the AR4 forecast amounts with costs incurred by the IMO for those functions in previous periods (suitably escalated) and also with those incurred by AEMO for provision of similar services in the National Electricity Market (NEM), should allow the Authority to determine whether the proposed functional expenditures:

- (i) are in line with previously approved levels for the IMO; and
- (ii) not overly dissimilar in magnitude to those incurred in the NEM (adjusting for, as far as possible, the economies of scale and scope efficiencies of the NEM),

and therefore include step increments that require additional justification.

Please contact me if you have any queries in relation to this submission.

Yours sincerely



John Rhodes
Wholesale Regulation Manager

⁵ It is understood the government plans to reassign the functions remaining with the IMO (administering and determining changes to the WEM Rules, and compliance and monitoring) to another agency. Presumably, a separate approval process will apply in respect of the funding these functions which will then be incorporated in the Market Fees recovered from participants.