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Economic Regulation Authority
PO Box 8469
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AUSTRALIAN ENERGY MARKET OPERATOR – ALLOWABLE REVENUE AND FORECAST CAPITAL EXPENDITURE FOR 2016/17 TO 2018/19 – FORECAST CAPITAL EXPENDITURE ADJUSTMENT (PROPOSAL)

Synergy welcomes the opportunity to make a submission in response to the Economic Regulation Authority's (**ERA**) issues paper in relation to the above.

Synergy supplies electricity to more than 1 million residential and commercial customers and, as the state's largest electricity generator and retailer, incurs around 65 per cent of wholesale electricity market (**WEM**) fees.

Overarching comments

As Synergy has noted in previous submissions, the ERA is required under section 26 of the *Economic Regulation Authority Act 2003*:

> *"to have regard to the need to promote regulatory outcomes that are in the public interest and the long-term interests of consumers in relation to the price, quality and reliability of goods and services…"*

The ERA also has an obligation under clause 2.22A.11 of the WEM Rules to take into account:

> *"only costs which would be incurred by a prudent service provider…. acting efficiently, seeking to achieve the lowest practicably sustainable cost of delivering [those services]".*

The purpose of this submission is to support the ERA in making an informed decision on the adjusted capital expenditure proposed by AEMO, by identifying aspects of the proposal that may warrant particular consideration and require additional AEMO supporting information.

General comments

In principle, Synergy accepts the basis for each of the components of AEMO's proposal. However, Synergy has concerns with the magnitude and timing of the proposed capital expenditure relating to:

- implementation of the rule change relating to the reduction of prudential exposure (RC_2017_06);
- the WEM reforms; and
- associated expenditure on new facilities.

These are discussed later in this submission.

Synergy notes AEMO is proposing to undertake significant levels of capital expenditure on IT systems and infrastructure that is expected to remain in use beyond the commencement of new market systems in 2022 (i.e. the e-terra energy management system and upgrades to Market Operations IT infrastructure). As the future design of the WEM is not yet settled, the ERA may seek to obtain information from AEMO to provide assurance that the expenditure is prudent at this point in time. For example, that:

- the amount of re-work required to implement changes to the WEM is likely to be minimal, regardless of the future market design; and/or
- if significant re-work or replacement is likely to be required, the proposed capital expenditure is justified based on the benefits that will accrue in the meantime.

Synergy also notes it has concerns with the magnitude of capital expenditure requested for 2018/19, the uncertainty about the future WEM design and the possibility that AEMO will not actually spend the full amount in this time period. Therefore, Synergy supports the ERA's intention to seek further information from AEMO where proposed capital expenditure may influence, or be influenced by, proposed allowable revenue or forecast capital expenditure in the next Allowable Revenue period[1].

In considering AEMO's proposal, Synergy requests the ERA have regard to the impact on future market participant fees.

While the additional capital expenditure requested by AEMO will not have any immediate impact on market fees, it represents a significant (12 per cent) increase in underlying fees over the coming three years. With the current WEM reform program just commencing, it is likely AEMO will seek further increases in its next Allowable Revenue period, which will add to this increase in underlying fees and could see overall WEM fees reach levels well above those experienced to date.

Market rule changes

While Synergy acknowledges AEMO is required to implement the two particular rule changes named in its proposal, it is concerned at the amount requested to implement the rule change relating to the reduction of prudential exposure (RC_2017_06).

This proposed total cost of $5.1 million cost is around $2.4 million, almost 90 per cent, higher than the estimated cost provided by AEMO and included in the Rule Change Panel's final report[2] published in May 2018. Synergy recommends the ERA seek further information

[1] As stated on page 10 of the ERA's issues paper.

from AEMO to clarify the cause of this increase and confirm its reasonableness and appropriateness.

WEM reforms

Synergy is concerned the level of proposed expenditure on staff to undertake work on the WEM reform program in 2018/19 seems high given the nature of the activities to occur in this period and progress to date.

Minimal system development and implementation work is likely in 2018/19, with most WEM reform work associated with market and regulatory design activities being led by the Public Utilities Office. Based on information provided by AEMO and the Public Utilities Office at an industry forum on 20 September 2018, detailed design and development of the WEM reforms is only just getting underway, indicating the project ramp up may be slower than AEMO initially expected.

Synergy supports the ERA seeking clarification of the scale and composition of the increase in staff costs ($4.3 million) and also recommends the ERA assess the reasonableness of this amount and likely timing of the expenditure, including:

- in light of costs already incurred or committed by AEMO for this work; and
- if possible, by benchmarking this cost against the costs incurred in supporting the previous Government's reform program.

New facilities

Synergy accepts AEMO will need to provide accommodation and equipment for the additional staff and contractors required to deliver the work outlined in its proposal. Synergy notes that AEMO expects it will need to accommodate an additional headcount of 38, plus expert consultants. This headcount increase seems high and appears to be largely driven by the resourcing needs of the WEM reform program.

Synergy requests the ERA seek the necessary information from AEMO to confirm that this level of additional headcount will actually need to be accommodated and that the proposed lease arrangements are prudent having regard to matters such as the time period over which the accommodation will be required, the timing and duration of the expected peak in headcount numbers and any permanent increase in headcount that AEMO considers may be required.

Other matters the ERA should consider

As demonstrated in AEMO's submission, it has significantly underspent previously approved capital expenditure during the 2016/17 and 2017/18 financial years. This is particularly the case for AEMO's System Management function, which has recorded capital expenditure of $6.2 million out of the approved $12.2 million over these two years[3]. While Synergy supports all efforts by AEMO to minimise expenditure, this trend does raise questions as to AEMO's ability to spend the $11.1 million requested for System Management for 2018/19 in a single year. Synergy requests the ERA consider whether the amounts requested by AEMO are reasonable in this context.

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[2] Rule Change Panel, Final Rule Change Report: Reduction of the prudential exposure in the Reserve Capacity Mechanism (RC_2017_06), 31 May 2018, page 31, available at https://www.erawa.com.au/rule-change-panel/market-rule-changes/rule-change-rc_2017_06

[3] Derived from Table 1 on page 10 of AEMO's proposal.

Synergy also requests the ERA seek information from AEMO to substantiate its view that the proposed System Management systems transfer is "estimated as at least cost neutral or better"[4].

We acknowledge delays in reforms, the change of government and the inevitable uncertainty around the scope and timing of rule changes have made it difficult for AEMO to accurately forecast its likely allowable revenue and capital expenditure requirements.

Notwithstanding this, Synergy considers the ERA should work with AEMO to identify an appropriate way of better forecasting its funding requirements before making its submission for the fifth Allowable Revenue period, to minimise the likelihood of future in-period adjustments. In period adjustments are difficult for market participants to budget for, and this uncertainty may compromise participants' ability to recover the associated costs from customers.

Synergy confirms that this submission can be made publicly available. Should you require further information regarding any of the comments made in this submission, please contact me on 6282 7622. .

Yours sincerely

[redacted]

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MANAGER REGULATION AND COMPLIANCE

[4] Page 27 of AEMO's proposal.