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Economic Regulation Authority
PO Box 8469
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via email to: publicsubmissions@erawa.com.au

Dear Ms Cusworth

AUSTRALIAN ENERGY MARKET OPERATOR – ALLOWABLE REVENUE SUBMISSION FOR 2019/20 TO 2021/22 (PROPOSAL)

Synergy welcomes the opportunity to make a submission in response to the Economic Regulation Authority's (**ERA**'s) issues paper on the Australian Energy Market Operator's (**AEMO**'s) fifth allowable revenue (**AR5**) submission covering the financial years from 2019/20 to 2021/22.

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.

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(b) 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 assist the ERA in making its decision on the forecast capital expenditure and allowable revenue proposed by AEMO, by identifying aspects of the proposal that may warrant consideration and require additional supporting information.



General comments

In principle, Synergy accepts the basis for each of the components of AEMO's proposal. This includes investment in:

- new systems to support the WA Government's constrained access and WEM reforms;
- the upgrade and consolidation of AEMO's core IT platform, systems and data through the Digital Roadmap program; and
- the maintenance and upgrade of existing systems.

However, Synergy does not consider that AEMO has provided sufficient information at the individual project level in its AR5 submission to allow Market Participants or the ERA to determine that the forecast expenditure is consistent with the requirements of clause 2.22A.11(b) of the WEM Rules or section 26(1) of the ERA Act.

In considering AEMO's proposal, Synergy encourages the ERA to have regard to the impact of the proposed expenditure on future WEM fees including those years beyond the next allowable revenue period (**AR6**).

Synergy notes AEMO is proposing to undertake higher levels of capital expenditure than in previous allowable revenue periods. This has a material impact on current and future WEM fees. The impact of these known projects alone will see WEM fees increase by 8.7% in AR5 and 14% in AR6. This results in WEM fees reaching well above historical levels. Additionally, there will necessarily be additional projects (not yet factored into the proposal, including but not limited to the State Government's distributed energy resources roadmap and whole of system plan) undertaken in both these periods that will further increase fees for Market Participants.

Synergy therefore recommends the ERA seeks further information from AEMO:

- to form a view as to what additional benefit the market is expected to receive for the increase in cost;
- to form a view whether AEMO's request is in the long-term interests of consumers in relation to the price, quality and reliability of goods and services provided in relevant markets;
- on the appropriateness of AEMO's forecast timing of investments, including within the context of external influences and factors such as State Government priorities;
- on AEMO's ability to deliver a complex and interrelated suite of IT investments within the expected timeframes; and
- on the efficiency of all proposed expenditure, including where possible benchmarking costs against other relevant similar projects.

If, once this information is sought, the ERA continues to evidence the prudence, efficiency or deliverability of the key programs of work, Synergy recommends the ERA maintains the approach taken in AR4, whereby the AEMO proposed and the ERA considered expenditure

and allowable revenue in a staged manner as and when enough information and project certainty is provided.

It should be noted, however, that there is a trade-off between the accuracy of the forecast expenditure and revenue requirement (and the associated oversight by the ERA), and the certainty and consistency of WEM fees. Synergy highlights that in-period adjustments are difficult for Market Participants to budget for, and therefore may compromise their ability to recover the associated costs from customers.

Synergy is concerned that the limited project level information provided in AEMO's proposal, coupled with the shortened consultation time, is not conducive to effective stakeholder engagement or decision making. Synergy therefore looks forward to providing further comments through the second consultation period, once additional information has been provided by AEMO to support the expenditure plans proposed.

Forecast capital expenditure

As noted above, Synergy supports the WEM reform and Digital Roadmap programs in principle but has reservations with the magnitude of total capital expenditure requested for AR5. AEMO's proposed AR5 capital expenditure of \$78.5 million is \$67.8 million higher than that approved by the ERA for AR3¹.

In the event there is a delay in the WEM reform program or the ramp-up may be slower than expected by AEMO this could result in AEMO failing to spend the full AR5 amount proposed and collected from Market Participants. AEMO recognises this in its proposal, stating that:

- "...detailed design of the reformed market and the systems/processes required to support it is not complete at the time of making this submission..."²; and
- "...there has already been some delay due to slower progress on elements of market design..."³.

Synergy seeks further guidance on whether AEMO has built enough time into program schedules to cater for the significant and complex investment program proposed. As per the 'Key Project Linkages' chart provided in AEMO's proposal⁴, there are clear dependencies between the key projects proposed. There would therefore appear to be a material risk that any delay in an early stage of one of these activities could delay later activities (WEM reforms or core system upgrades).

¹ Australian Energy Market Operator's allowable revenue and forecast capital expenditure proposal for the period 2019/20 to 2021/22 – Issues Paper, ERA, 2019, page 10

² 2019-22 allowable revenue and forecast capital expenditure submission to the Economic Regulation Authority, AEMO, 2019 page 4

³ 2019-22 allowable revenue and forecast capital expenditure submission to the Economic Regulation Authority, AEMO, 2019 page 78

⁴ 2019-22 allowable revenue and forecast capital expenditure submission to the Economic Regulation Authority, AEMO, 2019 Figure 16, page 71

Synergy encourages the ERA to place significant emphasis on ensuring the efficiency of all proposed capital expenditure proposed by AEMO. This will contribute to efficient costs through minimisation of depreciation costs in future allowable revenue periods and covers the following relevant factors:

- Consistent and appropriate use of contingencies in project estimates. In its Final Decision on AEMO's 2018/19 proposed capital expenditure adjustment, the ERA noted that "...the ERA is not satisfied that AEMO has a consistent process for determining project contingencies..." and that "...AEMO was unable to explain why some project contingencies were different between projects, or why contingencies changed over time..."⁵. It appears AEMO has adopted a similar approach and scale of contingencies in its AR5 proposal.
- An appropriate allocation of national Digital Roadmap program costs to the WEM. Little information has been provided by AEMO as to how the overall cost has been estimated, or how WA specific costs have been apportioned for this program. Given many of these systems are already used within AEMO's other markets it is unclear whether, or to what extent, existing costs (e.g. depreciation of assets) have been allocated to WA. There is also no discussion of how AEMO's experience of implementing these systems in other markets has been used to inform the WEM forecast expenditure.
- The reasonableness of expenditure forecasts for key business as usual projects, including market rule changes. Much of the expenditure included in AEMO's proposal reflects forecasts of projects started during AR4. Synergy notes AEMO has not provided costs incurred to date on these projects, and therefore Market Participants and the ERA cannot deduce the accuracy of project forecasts or appropriateness of total project expenditure. Synergy therefore does not have adequate information to comment on whether the total project costs meet the requirements of the WEM Rules or ERA Act as efficient costs.
- Any synergies between the investments proposed. It is clear that there will necessarily be some overlap between Digital Roadmap program, WEM reform activities and AEMO's ongoing system development and maintenance work. However, it is unclear whether AEMO has considered these overlaps, or coordinated project timelines or expenditure to ensure that a reasonable estimate of the overall, optimised program is recovered from Market Participants.

Other matters the ERA should consider

It appears from AEMO's proposal that its operating expenditure forecasts have been determined using a bottom-up build forecasting method. This does not reflect the best

⁵ Australian Energy Market Operator - Allowable Revenue and Forecast Capital Expenditure for 2016/17 to 2018/19 - Forecast Capital Expenditure Adjustment – Final Determination, ERA, 2018, page 2

practice, base-step-trend methodology. This may result in higher than required operating expenditure and therefore allowable revenue. If the same forecasting methodology was used to develop the capital expenditure forecasts, the overall expenditure program is likely to be over-stated.

The AEMO proposal highlights that depreciation is a key factor in the increase in WEM fees proposed in AR5 and indicative for AR6, and as Synergy highlights, expected for AR7. However, little information has been provided as to how depreciation is determined (e.g. the economic lives used to determine depreciation amounts). If IT assets are depreciated over only five years (as per System Management's AR4 proposal) then depreciation, and therefore allowable revenue, and WEM fees, could be expected to start decreasing in AR7. However, if the asset lives are longer than these, high market fees may continue into AR7 and beyond. This could mean that the impact of AEMO's proposed forecast expenditures is under-stated in its AR5 proposal.

Synergy confirms that this submission can be made publicly available. Please contact me should you require further information regarding any of the comments made in this submission.

Yours sincerely

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SIMON THACKRAY
MANAGER REGULATION AND COMPLIANCE