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Economic Regulation Authority
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electronically lodged at: www.erawa.com.au/consultation

SUBMISSION TO THE ECONOMIC REGULATION AUTHORITY'S DRAFT FINDINGS REPORT ON THE AUSTRALIAN ENERGY MARKET OPERATOR'S IN-PERIOD FUNDING SUBMISSION FOR IMPLEMENTATION OF THE DISTRIBUTED ENERGY RESOURCES ROADMAP

Synergy welcomes the opportunity to make a submission in response to the Economic Regulation Authority's (**ERA's**) Draft Findings report (**Report**) on the Australian Energy Market Operator's (**AEMO's**) in-period funding submission for the implementation of the Distributed Energy Resources (**DER**) Roadmap (**Submission**).

This letter outlines our views on various key aspects of AEMO's Submission and is intended to assist the ERA in making an informed decision in relation to the efficiency of the proposed forecast expenditure and associated revenue recovery arrangements.

Background

Synergy supplies electricity to more than 1 million residential and commercial customers and as the state's largest electricity generator and retailer incurs around 43% of the Wholesale Electricity Market (**WEM**) fees which equates to approximately \$16M/a.

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..."

In addition, as part of this review, and under clause 1.20A.7 of the WEM Rules, the ERA:

- must determine AEMO's Allowable Revenue and Forecast Capital Expenditure as an amount that meets the requirements of clause 2.22A.11 of the WEM Rules, pertinently as:
 - an amount sufficient to cover the forward looking costs of providing market operation, system planning, market administration and system management services as described in clause 2.22A.1, and taking into account the prevailing cost recovery principles;
 - including only costs that would be incurred as a prudent service provider, acting efficiently, seeking to achieve the lowest practicably sustainable costs of the delivering the services, while effectively promoting the Wholesale Market Objectives; and
 - where costs incurred by AEMO relate to both the performance of functions in connection with the WEM Rules, and other functions, an amount that is allocated on a fair and reasonable basis;
- must have regard to information provided by AEMO in its Submission and to any information provided in response to any information requests issued by the ERA;
- may have regard to such other information as it reasonably considers necessary or desirable to inform its assessment of AEMO's Submission;
- must not have regard to or take into account the Allowable Revenue and Forecast Capital Expenditure already approved for the Review Period 1 July 2019 to 1 July 2022; and
- must determine and approve an adjustment on the basis that any WEM reform and constrained network access reform relating to the introduction of a distribution system operator or distribution market operator will not be completed before 1 July 2022 but will require a substantial commitment of AEMO resources during the Review Period ending on that date.

Assessment process

Synergy notes the transitional WEM Rules have been designed to expedite the regular processes undertaken by the ERA to provide funding certainty for DER activities and as an implementation partner appreciates rationale for this.

Synergy understands the timeframes have proved challenging for the ERA and in particular notes the ERA's Report does not take into account the second information request that AEMO responded to on the same day as the ERA released its report. For example, the ERA has published information comparing salaries of potential AEMO staff to current roles using job titles.

In making this submission Synergy has not had the benefit of the additional information provided by AEMO to the ERA. However, we trust the necessary information to undertake more accurate and robust analyses have been made in response to the ERA's information requests and notes the ERA must have regard to it when making its final determination.

While we appreciate the opportunity to comment on AEMO's Submission, we note that the ERA's Report only represents the ERA's initial view which is based on an incomplete suite of information. In the absence of more comprehensive disclosure and given the high level of the ERA's initial findings, our ability to provide material input is limited. However, we trust our commentary on the ERA's findings and efficiency of the Forecast Capital Expenditure is useful.

Synergy considers the ERA will present a full rationale for its decisions and the information made available to it in its final determination, so that all stakeholders can assess the robustness of the review process and efficiency of the final forecast.

Overview

Synergy supports the State Government's DER Roadmap (**Roadmap**). The actions detailed within it will allow Western Australia to meet the challenges that come with new ways of producing, managing and consuming electricity and we are proud to be a key implementation partner for several critical initiatives.

In particular, Synergy is a key implementation partner for 'Project Symphony' – the DER orchestration pilot – established under the Roadmap to test how Synergy can combine and coordinate DER systems such as rooftop solar, batteries and electric vehicles. This pilot project will enable Synergy to provide information from a household and small-business perspective that will shape the development of the program and test the systems and processes to ensure they are fit-for-purpose ahead of broader industry participation.

As the Market Participant responsible for paying a large proportion of the WEM fees, Synergy supports the ERA conducting adequate due diligence before approving any additional Forecast Capital Expenditure and Allowable Revenue. As a key implementation partner in the State Government's reform program, we seek for this due diligence to be balanced with a sense of reasonableness and expedition. Each of the implementation partners rely on AEMO gaining access to the necessary funding required to undertake its functions and the broader market relies on the pilot project along with other actions in the Roadmap being successful.

Synergy therefore supports AEMO's application for additional Forecast Capital Expenditure and Allowable Revenue to undertake these DER Roadmap activities provided the costs are prudent and efficient and seek to achieve the lowest practicably sustainable costs of the delivering the activities while effectively promoting the Wholesale Market Objectives.

Synergy has reviewed the ERA's high-level findings and makes observations on four key areas raised by the ERA:

- the ERA's approach to the capitalisation of assets;
- the allocation of costs of the National Electricity Market (**NEM**);

- the cost of subject matter expertise in the WEM; and
- the inclusion of contingency in the forecasts.

Each of these areas are discussed in the sections below, together with our views on the matters that require further consideration by the ERA and AEMO to ensure the Forecast Capital Expenditure and Allowable Revenue related to the DER Roadmap activities can be considered efficient.

Approach to capitalisation of assets

Synergy supports AEMO's use of traditional accounting principles to decide whether expenses should be treated as capital or operating costs. We would therefore expect that costs incurred in the development of assets would be capitalised and depreciated in the manner proposed by AEMO as per previous Allowable Revenue and Forecast Capital Expenditure determinations.

Synergy is concerned that any other treatment of such costs could set a precedent with the treatment of previously incurred costs and could reallocate capital to operating expenditure such that the WEM fees in the current period would increase.

Treating costs used to develop the assets as capital expenditure would allow AEMO to incur these costs through the current Allowable Revenue Period (2019-2022) and then start depreciating them when the asset was in use, increasing the WEM fees slightly during the current period. Should any of these costs be treated as operating costs, our understanding is that the expenditure would be included in the WEM fee calculation in the year in which the costs are incurred and therefore affect the WEM fees immediately.

Synergy understands capitalising the expenditure may only serve to defer the WEM fee impact into future periods. However, if fees are destined to increase, our preference is that the impact be spread over a longer timeframe and there is opportunity to scrutinise AEMO's ongoing actual costs.

It is unclear whether the ERA has taken into account the in-period impact on WEM fees if the DER Roadmap costs are expensed. The Report does not present a comparative impact on fees across the current and future periods if the DER Roadmap expenditure is capitalised or expensed. To help fully-inform stakeholders, Synergy would welcome such analysis and consideration in the ERA's determination.

Allocation of costs to the NEM

The ERA considers some of the costs associated with the DER Roadmap activities should be allocated to NEM participants. If the ERA determines there are material benefits to the NEM from the DER Roadmap activities in the WEM, or that there is a substantial cross-subsidy, then it is correct to consider the matter.

However, Synergy recommends in this instance, the ERA tests whether the administrative overheads and additional uncertainty generated by having to allocate DER Roadmap costs to the NEM, outweighs the benefits of accuracy. We assume the value of the intellectual property

flagged by the ERA as a cause for concern is relatively small and would be difficult to quantify at this time.

Synergy also notes while the ERA highlights costs that could be recovered from the NEM, AEMO also specifies that knowledge and assets developed in the NEM are inputs to DER Roadmap activities in the WEM. If AEMO is required to adopt a beneficiary-pays approach within the NEM and WEM parts of its organisation, there is a risk that:

- AEMO may not be able to recover WEM costs from NEM participants under the NEM framework, therefore potentially financially affecting AEMO and preventing it from effectively operating the WEM; and
- the approach opens the door for significant, wide and varying costs (including those which may require in-period adjustments in the future) to be similarly passed on to WEM participants without any scope for oversight of costs or ability to dispute those additional costs.

On balance Synergy considers a beneficiary-pays approach would pose greater financial risk to WEM participants than financial benefits in this instance.

Synergy is concerned given the rate of change in the electricity industry at present, the industry should be encouraging knowledge and information sharing, rather than inadvertently creating barriers to innovation through stringent accounting treatments. Synergy therefore seeks the ERA consider in its determination whether the effort and risk associated with allocating intellectual property costs between the NEM and WEM is commensurate with the benefits.

Cost of subject matter experts in the WEM

Synergy notes the ERA's analysis in relation to the cost of resources in AEMO's Submission. We are not sufficiently informed on the AEMO's basis for forecast resource costs to comment on whether the market rates proposed by AEMO are required to attract suitable expertise to fill the variety of roles to undertake the DER Roadmap activities.

We acknowledge, as has been stated publicly, in a period of such change, many subject matter experts are in high demand, which in-turn drives up costs. We also note that clause 1.20A.7(e)(i) of the WEM Rules recognises that the AEMO will require a substantial commitment of resources during the period and that the ERA is required to make its assessment in light of that.

Synergy highlights the purpose of this Submission is to prepare a reasonable forecast to secure the necessary funding for AEMO to undertake the DER Roadmap activities. The WEM fees are adjusted for only those costs actually incurred and it is likely that the labour rates AEMO actually secures will be driven by market conditions at the time of recruitment. As a result, the actual labour rates will necessarily vary from forecast.

Synergy therefore suggests a more effective way to assess the labour cost forecast is for ERA to consider whether the number of resources is appropriate, rather than attempting to adjust the forecast labour rates of each of those resources. This is because AEMO would have more

discretion on the number of resources it appoints than it would over the rate it ultimately pays for each individual resource.

Approach to contingency

AEMO has included various amounts for contingency in each of its DER roadmap activities. These contingency amounts appear reasonable and in line with previous contingency allowances.

Synergy notes the ERA considers the contingency amounts can be accommodated within the 10% allowance provided for in clause 2.22A.9 of the WEM Rules. In principle, we consider the ERA's position is reasonable and that the 10% allowance automatically provides a reasonable amount of contingency.

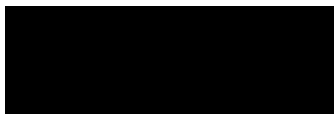
However, it is unclear from the drafting of the transitional WEM Rules (namely the clauses in section 1.20A) whether the overspend allowance applies to this standalone Forecast Capital Expenditure adjustment process, or whether the ERA can have regard to contingency amounts already improved in the current period. This is a grey area, and while we support use of the provisions of 2.22A.9 of the WEM Rules where permissible, we recommend the ERA clarifies its thinking and rationale on this matter.

As highlighted earlier, Synergy supports the DER Roadmap actions and notes that AEMO's ability to deliver and fund its activities are a prerequisite for Synergy (and Western Power) to deliver its DER Roadmap activities. We therefore request the ERA consider whether:

1. not having any provision for contingency would lead to continued funding uncertainty that may inhibit delivery of the DER Roadmap actions; and
2. any reduction of forecast capital expenditure below what it would cost to fully deliver the DER Roadmap activities would mean that the State Government's program as a whole would be detrimentally affected.

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.

Yours sincerely



SIMON THACKRAY
MANAGER REGULATION AND COMPLIANCE