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28 April 2022

Sara O'Connor
Assistant Director, Market Regulation
Economic Regulation Authority
PO Box 8469 PERTH BC WA 6849

via email to: publicsubmissions@erawa.com.au

Dear Sara

DRAFT DETERMINATION ON AUSTRALIAN ENERGY MARKET OPERATOR'S ALLOWABLE REVENUE AND FORECAST CAPITAL EXPENDITURE PROPOSAL FOR THE PERIOD 1 JULY 2022 TO 30 JUNE 2025

Synergy welcomes the opportunity to make a submission in response to the Economic Regulation Authority's (**ERA's**) draft determination on the Australian Energy Market Operator's (**AEMO's**) sixth allowable revenue (**AR6**) proposal covering the period from 2022/23 to 2024/25.

Synergy supplies electricity to more than 1 million residential and commercial customers and, as the state's largest electricity generator and retailer, incurs around 45% of the Wholesale Electricity Market (**WEM**) Fees.

As Synergy noted in its 8 March 2022 submission, the ERA is required under section 26 of the Economic Regulation Authority Act 2003, amongst other matters, 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 relevantly under clause 2.22A.5(b) of the WEM Rules to take into account:

“only costs which would be incurred by a prudent provider of the services provided by AEMO in performing its functions, acting efficiently, to achieve the lowest practicably sustainable cost of performing AEMO's functions, while effectively promoting the Wholesale Market Objectives”.

Synergy welcomes and supports the ERA's draft determination on AEMO's proposal and considers it reflects an appropriate balance between the establishment of the new market arrangements and continued evolution of the WEM, and the cost implications for Market Participants. Nevertheless, Synergy remains concerned about the significantly high level of investment proposed for the AR6 period and associated contingency, and considers the level of independent investment scrutiny needs to be enhanced.

Taking into consideration AEMO's proposal and the ERA's draft determination, Synergy makes the following observations:

- There are significant issues in AEMO's investment planning and forecasting processes that need to be addressed. Increased stakeholder transparency and independent oversight are both required to ensure AEMO's proposed work program is prudent and efficient. Synergy has formed this view on the basis of the ERA's draft AR6 determination which cites:
 - almost 20% of expenditure incurred by AEMO in the last three years was spent on projects not specifically included in the AR5 submission¹, and five of 18 projects were not started²;
 - a significant re-profiling of expenditure forecasts foreshadowed in a stakeholder forum³ only three months after AEMO submitted its initial proposal;
 - the focus of AEMO's 'top-down challenge' of its expenditure forecasts being on justifying proposed expenditure rather than challenging its prudence and efficiency⁴;
 - ERA findings of limited justification of the prudence and/or efficiency of several key projects⁵, assessment of alternative options⁶ and ongoing budget and financial governance; and
 - multiple systems being developed in-house rather than purchasing third-party solutions without the ability for the ERA to assess whether the decision to internalise systems or key functions is prudent or efficient.⁷
- AEMO has used the roll-forward method to calculate most of its operating expenditure (**opex**), advising the use of this method results in forecasts that meet the prudence and efficiency tests in the WEM Rules. However, the roll-forward method only results in efficient forecasts if the most recent year's actuals can be demonstrated as efficient

¹ Economic Regulation Authority, March 2022, *Australian Energy Market Operator's allowable revenue and forecast capital expenditure proposal for the period 1 July 2022 to 30 June 2025 – Draft determination*, page 10.

² Ibid. page 11.

³ AEMO, March 2022, *WA Electricity Consultative Forum – 2 March 2022*, Agenda Item 4.

⁴ Economic Regulation Authority, March 2022, *Australian Energy Market Operator's allowable revenue and forecast capital expenditure proposal for the period 1 July 2022 to 30 June 2025 – Draft determination*, page iv.

⁵ For example, the \$7.6 million incurred by AEMO for its Digital Roadmap activities. This was \$3.1 million higher than allowed by the ERA, and was not supported by evidence of the benefits to WA Market Participants.

⁶ Economic Regulation Authority, March 2022, *Australian Energy Market Operator's allowable revenue and forecast capital expenditure proposal for the period 1 July 2022 to 30 June 2025 – Draft determination*, section 4.2.1, page 25.

⁷ Ibid. page 26

– under all other regulatory determinations this occurs through the inclusion of an opex incentive scheme.⁸ AEMO does not have an equivalent incentive scheme, and while revenue is ‘trued-up’ to reflect actual opex, AEMO has no incentive to seek efficiencies or cost savings on behalf of Market Participants. An incentive scheme design could take the form of AEMO being paid an efficient benchmark of \$/MWh value for evidenced efficiencies.

- The forecast contingency amounts calculated under AEMO’s new contingency calculator are higher than those amounts Market Participants would consider reasonable for similar projects and programs of work undertaken by commercial organisations. Synergy considers the level of contingency applied to a project (or perhaps more relevantly a program of work) should reflect the key project scope and financial risks. Synergy supports the ERA’s requirement for AEMO to recalculate the contingency amounts, including to remove the impact of unknown, unjustified and immaterial risks. Synergy also recommends AEMO and the ERA take a high level view of the portfolio of work to review and standardise the risk assessment and contingency amounts applied to each project.

Each of these three issues relate to project planning, expenditure forecasting and financial management. Synergy considers transparency in these areas will also help Market Participants better understand the implications on WEM Fees and the cost decisions AEMO is making. Accordingly, Synergy strongly recommends these issues be addressed on an ongoing basis via the new reporting and guideline requirements introduced into the WEM Rules in December 2021. The new rules require:

(a) AEMO to publish by 31 October each year on the WEM Website:

“... a financial report showing AEMO’s actual financial performance against its budget for the previous Financial Year (including, without limitation, the actual amount paid to a Delegate compared to the budgeted amount). The report must be in accordance with the Regulatory Reporting Guidelines issued by the Economic Regulation Authority from time to time in accordance with clause 2.22A.9.”⁹

(b) the ERA to issue proposal guidelines that:

“...must consider how future projects that carry a risk of not proceeding or for which the associated costs are not able to be quantified may be dealt with, and provide clarity and guidance to AEMO and Market Participants regarding the level of detail about projects, functions and costs expected in AEMO’s proposal; ...”¹⁰

Synergy considers it is in AEMO’s and Market Participants’ interests to better understand investments AEMO must make to establish and continue to evolve the WEM.

⁸ For example, the ERA’s Gain Sharing Mechanism and AER’s Efficiency Benefit Sharing Schemes.

⁹ Refer WEM Rule 2.2A.8 [Wholesale-Electricity-Market-Rules-12-April-2022.pdf \(www.wa.gov.au\)](https://www.wa.gov.au/publications/2022/04/wholesale-electricity-market-rules-12-april-2022)

¹⁰ Refer WEM Rule 2.22A.9 [Wholesale-Electricity-Market-Rules-12-April-2022.pdf \(www.wa.gov.au\)](https://www.wa.gov.au/publications/2022/04/wholesale-electricity-market-rules-12-april-2022)

Synergy anticipates the required regulatory and financial reporting and guidelines will provide the necessary transparency of AEMO's performance and ensure stakeholders have more ability to input into future projects such as the Energy Transformation Strategy (Stages 1 and 2) as well as addressing the following key concerns raised in response to AEMO's AR6 proposal:

1. The ERA has no oversight over how contingency costs are spent once approved.
2. The ERA has no oversight over where approved forecast capital expenditure was spent or proposed to be spent against projects that were not specifically included in the AR5 submission until AEMO lodged AR6.

Synergy would like to see the ERA's new reporting and guideline requirements akin to the Regulatory Information Notices (**RINs**) that apply to relevant businesses on the east coast of Australia.¹¹ Synergy considers this would provide an appropriate balance of transparency, accountability and the associated administrative costs. The Australian Energy Regulator's (**AER's**) RIN requires, for example, annual reporting of the variance between actual and approved capital projects and opex categories, and the identification of and expenditure associated with any new or amended capex projects or opex categories.

In Synergy's 8 March 2022 submission, it recommended the ERA considers a requirement for AEMO to publish, prior to the AR6 draft determination, a transparent regulated revenue model for AR6, equivalent to that provided by Western Power to support its fifth access arrangement proposal. Synergy considers this requirement could be included in the new guideline.

Synergy expects the ERA could apply a materiality threshold in the guidelines to ensure it is an appropriately balanced reporting regime and is not overly burdensome to AEMO and the ERA. The AR6 period is one of significant expenditure and critical to ensure project outcomes are delivered on time and within forecast budgets. Synergy therefore considers the implementation of this new reporting and guideline regime is timely and urges effective engagement with Market Participants during the drafting process.

To bridge the period between the ERA's final determination and the implementation of the new reporting arrangements, Synergy recommends the ERA publishes its final determination in a format that establishes a baseline to facilitate effective annual reporting. This includes highlighting the strengths and weaknesses in AEMO's forecasting method and investment/project governance approach, in-housing strategy and providing constructive feedback and context (positive and negative) on what improvements can be made. As the independent economic regulator, Synergy considers the ERA is best placed to make this objective assessment.

¹¹ The AER uses RINs to undertake its regulatory functions, including monitoring outcomes against the determinations, developing performance reports and preparing for future determinations.

Synergy recognises the challenges facing AEMO with regard to accurately forecasting and delivering a program as large and complex as the WEM Reform Program, and Energy Transformation Strategy more broadly. Synergy acknowledges that as the market and system operator, AEMO is best placed to understand and ultimately control the costs associated with the establishment of the new market arrangements and continued evolution of the WEM. It is therefore appropriate AEMO be given opportunity to adjust and improve its governance processes, and that the regulatory regime placed upon it does not impede AEMO's ability to deliver market development activities on time or in full.

Synergy also recommends the ERA establishes targets around market project outcomes and financial performance.¹² In doing so, Synergy advocates light-handed regulation in the first instance and suggests more rigorous investment governance oversight be considered if AEMO's performance is not improved through greater accountability and transparency in reporting through the AR6 and AR7 periods.

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

Yours sincerely

A solid black rectangular box used to redact the signature of Simon Thackray.

SIMON THACKRAY
MANAGER REGULATION AND COMPLIANCE

¹² As suggested in Australian Energy Council, March 2022, *Australian Energy Market Operator's allowable revenue and forecast capital expenditure proposal for the period 1 July 2022 to 30 June 2025: Issues Paper*, pages 2 and 3.