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3<sup>rd</sup> March 2022

Dear Ms. O'Connor

**RESPONSE TO ISSUES PAPER – AUSTRALIAN ENERGY MARKET OPERATOR'S ALLOWABLE REVENUE AND FORECAST CAPITAL EXPENDITURE PROPOSAL FOR THE PERIOD 1 JULY 2022 TO 30 JUNE 2025**

Bluewaters welcomes the opportunity to provide comments on the Economic Regulation Authority's (ERA) issues paper. Bluewaters understands the rationale for ongoing reform, however reiterates its position that the costs of reforming and supporting the Wholesale Electricity Market (WEM) have grown excessive relative to any quantifiable or communicated benefit they provide. Considering the makeup of the WEM, which is a net settled and heavily bilaterally contracted market with relatively few participants, the benefit gained from creating and maintaining such a complex system is difficult to justify. The cost of implementing reform has far exceeded earlier estimates when cost-benefit analysis were undertaken, such that there are serious questions regarding the value-for-money of the reform process. A bottom-up review of the appropriateness of the WEM and the AEMO's role in its operation is now an imperative to provide confidence to the participants who fund them.

Bluewaters is concerned with the lack of cost pressure applicable to AEMO. The funding proposal appears to contain little or no incentive, or indeed governance processes, for AEMO to strive for cost reductions or efficiency gains. Also, there is no evidence that the ever-expanding employee count is efficient. AEMO is victim of having to manage a continuous evolution of the WEM, which itself has been driven by external policy influences rather than internal strategic development. There has been no ability to properly plan for a fit-for-purpose organisational and governance structure. It is likely the current structure is inefficient.

The cost flowing to Market Participants from AEMO's allowable revenue proposal (covering both AR6 and forecast for AR7) is significant and trending upwards. Lamentably, the ERA's authority to assess and comment on whether EPWA policy direction is "in the long term interests of WA consumers" has been diminished over time. Bluewaters still considers the ERA's role in the allowable revenue process: i.e. independently assessing whether the costs proposed by AEMO are prudent and efficient, is crucial to keeping WEM costs to the lowest practicably sustainable level; and in maintaining Market Participants' confidence in the funding mechanism itself.

## Response to Questions:

### 1. Which, if any, aspects of AEMO's proposal are of most concern to stakeholders and why?

Bluewaters considers the upward trajectory of market fees a serious and unsustainable concern. Bluewaters is specifically concerned that there does not appear to be any forecast or plan for these fees to plateau and then reduce. Rather there seems to be an understanding that future increases are likely. This should indicate to authorities that something is wrong with the current WEM governance structure.

### 2. Do stakeholders have any comments on the reasonableness of AEMO's estimate of the number and cost of the additional resources required to undertake its functions over the AR6 period?

In order to question the reasonableness of AEMO's estimate, Bluewaters asks the ERA to scrutinise what additional benefit the market is expected to receive for the increase in cost and appropriateness of these increases, such as those outlined by the ERA in its issues paper relating to DER. Specifically, AEMO should be required to articulate each new forecasted FTE role and the cost of staffing these roles. It is not good enough for managers to simply assume that increased complexity equates to increased staffing requirements<sup>1</sup>.

### 3. Do stakeholders have any comments on the key assumptions underlying AEMO's proposal of its allowable revenue and/or forecast capital expenditure for AR6?

Bluewaters does not consider that AEMO has provided sufficient information at the individual project level in its AR6 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.

Bluewaters notes that there is a proportionately large value of additional labour expenditure (\$24.5m) compared to the additional number of labour FTEs (~31) and requests the ERA examine the costs set aside for these positions.

In considering AEMO's proposal, Bluewaters 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 (AR7).

### 7. Is the process by which AEMO can seek more funding for incomplete projects in AR5, through AR6 appropriate? If not, why not?

Bluewaters encourages the ERA to continue questioning prudence, efficiency or deliverability of the key programs of work. It should be noted, however, that there is a trade-off between the accuracy of the forecast expenditure and revenue requirement and the certainty and consistency of WEM fees. Bluewaters highlights that in-period adjustments are difficult for Market Participants to budget for.

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<sup>1</sup> Firstly, increased complexity should be justified by a demonstrable cost-benefit outlook. Additionally, if the system is required to deviate so far from its origins in design complexity, this should flag to authorities that the structure of the operating entity must be reviewed from the bottom-up to assess if fit-for-purpose.

**11. Do stakeholders have any feedback on AEMO's governance processes to test, challenge and scrutinise its proposal, as outlined in section 3.2.1 of this paper?**

Bluewaters does not believe there are appropriate governance structures in place at AEMO. Bluewaters makes the observation that there are unlikely to be many Market Participants that would be able to justify, via a board process, the level of additional expenditure the AEMO is seeking given the scant detail or cost-benefit analysis provided in the AEMO proposal.

In summary, Bluewaters again notes that the ERA can make only limited determination whether AEMO's cost for implementing various WEM Reform programs are prudent, but there is no ability for the ERA to review the prudence of the proposal in the first place. Bluewaters considers the disjoint between energy policy and the cost of reform implementation of serious concern. AEMO is tasked with designing and implementing reforms but there are no reviews the cost of reform, and iterations of cost benefit analysis.

Furthermore, Bluewaters is yet to see a cost benefit which provides comfort to Market Participants that costly future reforms, namely SMS, should proceed. In other words, the WEM may continue to introduce poor value-for-money reform at the expense of Market Participants and, ultimately, consumers.

Bluewaters believes it is now critical for an independent review of the appropriateness of the AEMO's structure and governance of its WEM operations be conducted in order to maintain its credibility. This would include a bottom-up review of the organisation's structure, resources and governance.

Should you have any questions regarding this submission please contact Dimitri Lorenzo on 08 9261 2826 or [dimitri.lorenzo@bluewatersps.com.au](mailto:dimitri.lorenzo@bluewatersps.com.au).

Yours sincerely,



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