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## **Australian Energy Market Operator’s allowable revenue and forecast capital expenditure proposal for the period 1 July 2022 to 30 June 2025: Draft determination**

The Australian Energy Council (the “**AEC**”) welcomes the opportunity to make a submission to the Economic Regulation Authority (“**ERA**”) on its Draft Determination (“**Draft Determination**”) relating to Australian Energy Market Operator’s (“**AEMO**”) proposed allowable revenue and forecast capital expenditure for the sixth allowable revenue period from 1 July 2022 to 30 June 2025 (“**AR6**”).

The AEC is the industry body representing 20 electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. These businesses collectively generate the overwhelming majority of electricity in Australia and sell gas and electricity to over 10 million homes and businesses.

The AEC commends the ERA for its engagement with stakeholders on AR6 and for considering the feedback it received on the Australian Energy Market Operator’s allowable revenue and forecast capital expenditure proposal for the period 1 July 2022 to 30 June 2025: Issues Paper (“**Issues Paper**”).<sup>1</sup> The AEC makes the following comments on the Draft Determination.

### **Allowable revenue**

In its AR6 proposal, AEMO sought total allowable revenue for their Wholesale Electricity Market (“**WEM**”) functions of \$156.2 million and forecast capital expenditure of \$69.4 million. This represents a 57 per cent increase in allowable revenue compared to the allowable revenue approved by the ERA for AR5.<sup>2</sup>

The AEC welcomes the ERA for the work it undertook to analyze AEMO’s proposed allowable revenue. As a result of this detailed investigation, the Draft Determination concluded that:

*“The ERA’s draft decision is to approve \$135.9 million in allowable revenue, which is \$20.3 million or 13 per cent lower than the \$156.2 million proposed by AEMO. The ERA has rejected certain costs that did not meet the requirements of the WEM Rules<sup>3</sup> ...*

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<sup>1</sup> [Australian Energy Market Operator’s allowable revenue and forecast capital expenditure proposal for the period 1 July 2022 to 30 June 2025 Issues paper](#)

<sup>2</sup> See p1-2, [Australian Energy Market Operator’s allowable revenue and forecast capital expenditure proposal for the period 1 July 2022 to 30 June 2025 Issues paper](#)

<sup>3</sup> See page iv, [Australian Energy Market Operator’s allowable revenue and forecast capital expenditure proposal for the period 1 July 2022 to 30 June 2025 Draft determination](#)

*The ERA's draft determination is to approve \$52.0 million in forecast capital expenditure, which is \$17.4 million or 25 per cent lower than the \$69.4 million proposed by AEMO.*"<sup>4</sup>

The AEC supports this outcome and welcomes any approach that improves efficiency and keeps market fee increases to a minimum.

### **Labour costs**

The Issues Paper notes that "at 46.9 per cent, labour costs are the largest proportion of overall allowable revenue costs in AR6. AEMO is estimating labour costs of \$73.2 million in AR6, an increase of \$24.5 million (50 per cent) over approved labour costs in AR5. This increase is primarily due to a forecast increase in permanent staff."<sup>5</sup>

In its submission to the Issues Paper, the AEC encouraged the ERA to thoroughly review the labour cost estimates and satisfy itself that these positions are justified.

The ERA stated in the Draft Determination:

*"Included in AEMO's proposed labour costs are 33 new permanent staff positions. The ERA has not approved \$7.4 million in proposed labour costs, equivalent to nearly three-quarters of those new permanent positions. AEMO has not made a strong enough case to demonstrate that its current staffing levels were insufficient, and that it had taken all steps to improve the efficiency of its processes and systems, before proposing to hire new staff. Unless AEMO provide further evidence to fully justify increased staffing, the ERA sees no reason to shift from this position in its final determination."*<sup>6</sup>

The AEC appreciates the ERA's review of the labour costs and supports this outcome.

### **Project scope**

The Issues Paper points out that "more than a third (\$3.6 million) of AEMO's cost estimate to fund its DER capital expenditure program (\$9.4 million) is not directly related to AEMO's obligations arising from the DER roadmap."<sup>7</sup> This is due to two projects on market visibility and DER data access and management.

The AEC's submission on the Issues Paper suggested that projects created by AEMO's own initiative should not automatically receive funding and may not be warranted during AR6 given the significant increase in WEM market participant fees.

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<sup>4</sup> See page v, [Australian Energy Market Operator's allowable revenue and forecast capital expenditure proposal for the period 1 July 2022 to 30 June 2025 Draft determination](#)

<sup>5</sup> See p8, [Australian Energy Market Operator's allowable revenue and forecast capital expenditure proposal for the period 1 July 2022 to 30 June 2025 Issues paper](#)

<sup>6</sup> See page iv, [Australian Energy Market Operator's allowable revenue and forecast capital expenditure proposal for the period 1 July 2022 to 30 June 2025 Draft determination](#)

<sup>7</sup> See p26, [Australian Energy Market Operator's allowable revenue and forecast capital expenditure proposal for the period 1 July 2022 to 30 June 2025 Issues paper](#)

The ERA stated in the Draft Determination that:

*“The ERA considers the evidence provided is not sufficient to conclude the necessity for the market visibility and DER data access and management projects. Neither project is necessary for the successful completion of the in-flight projects, or the commencement of other projects required by the DER Roadmap. In its proposal, AEMO indicated that these projects are driven by system and market needs; however, based on stakeholder feedback to the issues paper, it appears there is limited support from market participants for these projects.*

*For the reasons outlined above, the ERA considers the costs proposed by AEMO for these two projects do not meet the requirements of the WEM Rules. Following clause 2.22A.6(c) and (d), the ERA rejects the costs for these two projects.”<sup>8</sup>*

The AEC considers this a prudent approach and supports this outcome.

### **Decision to internalise systems and functions**

The ERA stated in the Draft Determination that:

*“AEMO’s AR6 proposal identified multiple systems that are being developed in-house, rather than by purchasing a third-party solution, such as a settlement system. Third-party systems usually enable a degree of customisation and can be maintained and updated through a service level or maintenance agreement with the third-party supplier or licenced support contractors.*

*...the decision to bring system development or a main process in-house may not be clear in AEMO’s three-yearly funding proposal. Consequently, the ERA cannot assess whether the decision to internalise system development or an important function is prudent or efficient. Once funding is approved, the ERA has no oversight of the economic efficiency of these critical decisions.”<sup>9</sup>*

The AEC supports the ERA’s recommendation that these critical decisions and cost implications should be shared with industry. The AEC further recommends that the mechanisms for requiring and sharing this information should be the financial reporting and guidelines as required by sections 2.22A.8 and 9 of the WEM Rules. The AEC advocates the ERA publishing its guidelines for public comment and concluding them prior to the publication of AEMO’s financial report on 31 October 2022.

### **Contingency**

Contingency forms a major part of forecast expenditure in AR6 and deserves close scrutiny. This is particularly the case because AEMO does not need to spend the approved contingency costs on the projects the funds are approved for.<sup>10</sup> This occurred in AR5 where \$6.3 million of allocated contingency was not required and could be spent however AEMO wished.

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<sup>8</sup> See p58, [Australian Energy Market Operator’s allowable revenue and forecast capital expenditure proposal for the period 1 July 2022 to 30 June 2025 Draft determination](#)

<sup>9</sup> See p26, [Australian Energy Market Operator’s allowable revenue and forecast capital expenditure proposal for the period 1 July 2022 to 30 June 2025 Draft determination](#)

<sup>10</sup> See p64, [Australian Energy Market Operator’s allowable revenue and forecast capital expenditure proposal for the period 1 July 2022 to 30 June 2025 Draft determination](#)

The ERA carefully considered AEMO's proposed contingency in AR6 and noted in the Draft Determination that:

*“Based on the ERA’s principles-based approach to assessing AEMO’s contingency calculations (Appendix 12) and the base cost estimates set out in the sections above, the ERA’s draft determination on AEMO’s proposed contingency costs is \$8.2 million. This is \$6.5 million or 44 per cent lower than the \$14.7 million in contingency costs proposed by AEMO. The ERA considers AEMO has not sufficiently justified the prudence or efficiency of all proposed contingency costs as required by the WEM Rules.”<sup>11</sup>*

The AEC appreciates the thorough assessment undertaken by the ERA and supports this outcome.

The AEC also suggested in its submission on the Issues Paper that AEMO should be required to disclose to the market as part of their AR6 proposal how it would seek to spend the contingency balance should it not fully use the approved AR6 contingency on the identified projects in its proposal. The AEC considers that this information should be provided in advance by AEMO in their AR6 proposal, and not retrospectively through the annual true-up process and AEMO's reporting obligations after the funds have already been spent as indicated in the Draft Determination.

### **Performance standards**

The AEC recommended in its submission on the Issues Paper that the ERA consider whether AEMO's allowable revenue proposal should contain key performance indicators and/or service standard benchmarks in relation to the services AEMO provides in the electricity and gas markets in Western Australia. The AEC considers that it is reasonable for market participants who are paying for AEMO's services to obtain visibility of its service standard performance.

The Draft Determination included this matter in the summary of submissions<sup>12</sup>, however it was not addressed in detail. The AEC encourages the ERA, in the performance of its allowable revenue determination functions, to consider whether it is in the long term interests of consumers for the WEM rules to include service standard mechanisms applicable to AEMO in the performance of its WEM functions for which it seeks to recover costs from market participants in the form of market fees.

### **In-period submissions**

The WEM rules allow the ERA to recommend to AEMO in the determination that some of the costs be considered through an in-period application for additional funds.<sup>13</sup> The ERA has made this recommendation several times throughout the Draft Determination.<sup>14</sup>

AEMO has foreshadowed that they intend to make an in-period funding submission for projects relating to the introduction of five-minute settlement and implementing DER aggregator participation. The possible costs associated with these projects range from \$32 million to \$64 million, and there is the prospect that these costs could ultimately be higher as happened with the WEM reform costs in AA5. The indicative costs put forward by AEMO for these projects is a substantial quantity but the total amount sought by AEMO following price creep and the addition of other in-period submissions is likely to be much higher.

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<sup>11</sup> See p70, [Australian Energy Market Operator’s allowable revenue and forecast capital expenditure proposal for the period 1 July 2022 to 30 June 2025 Draft determination](#)

<sup>12</sup> See p94, [Australian Energy Market Operator’s allowable revenue and forecast capital expenditure proposal for the period 1 July 2022 to 30 June 2025 Draft determination](#)

<sup>13</sup> See Rule 2.22A.6(d), [Wholesale Electricity Market Rules \(WA\)](#)

<sup>14</sup> For example, see p5, p43, p44, p46, p58, p84, p90, p91, p92, p114, [Australian Energy Market Operator’s allowable revenue and forecast capital expenditure proposal for the period 1 July 2022 to 30 June 2025 Draft determination](#)

The AEC broadly supports deferring projects with uncertain costs or outcomes to an in-period submission. This approach will minimise contingency costs and allow the ERA to scrutinise the projects when they are better defined.

However, deferring projects to an in-period submission is not without drawbacks and it is concerning that market participants could face significant unknown costs through AR6. The main issue is that there is no way for market participants to accurately include these unknown future costs in their long-term contracts. Market participants risk impacting their competitiveness if the costs they include are too high, and if they defer including the costs then their future contracts may not reflect all of the market fees. To assist with this, the AEC strongly encourages AEMO to continually refine the potential costs and give regular updates to assist market participants in their forecasting.

## **Conclusion**

The AEC sincerely appreciates the ERA's review of AEMO's proposed forecast allowable revenue for AR6 and for the related consultation process. The AEC encourages the ERA to consider the issues raised above.

Any questions about our submission should be addressed to Graham Pearson, Western Australia Policy Adviser by email to [graham.pearson@energycouncil.com.au](mailto:graham.pearson@energycouncil.com.au) or by telephone on 0466 631 776.

Yours sincerely,

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