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Rule Change Notice: Allowable Revenue Framework (RC_2024_01)

The Australian Energy Council (the “**AEC**”) welcomes the opportunity to make a submission on the Rule Change Notice: Allowable Revenue Framework (RC_2024_01)¹.

The AEC is the peak industry body for electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. Our members collectively generate the overwhelming majority of electricity in Australia, sell gas and electricity to millions of homes and businesses, and are major investors in renewable energy generation. The AEC supports reaching net-zero by 2050 as well as a 55 percent emissions reduction target by 2035, and is part of the Australian Climate Roundtable promoting climate ambition.

Background

The Australian Energy Market Operator (“**AEMO**”) performs a critical role in ensuring the secure and reliable supply of electricity in the Wholesale Electricity Market (“**WEM**”). AEMO currently recovers the costs of performing its functions via fees paid by market participants, based on expenditure approved by the Economic Regulation Authority (“**ERA**”) under the allowable revenue determination process outlined in the WEM Rules.

AEMO’s costs were relatively stable between 2016/17 and 2021/22² leading up to the ERA’s assessment of AEMO’s AR6 proposal. At the time, the ERA commissioned The Lantau Group to benchmark the costs of operating electricity markets in different jurisdictions. While the ERA later questioned the value of benchmarking³, The Lantau Group considered it a valuable exercise⁴ and found that in 2021, AEMO’s costs in Western Australia were higher than almost all other jurisdictions around the world on a megawatt-hours of consumption basis, with the exception being ISO New England in the United States.

AEMO’s costs have increased significantly since then with the approval of AR6 followed by two in-period submissions. The first in-period submission in 2023 saw AEMO receive an additional \$46.94 million in forecast capital expenditure, while the second in-period submission resulted in an additional \$58.29 million in allowable revenue and \$37.9 million in forecast capital expenditure.

¹ See [Rule Change Notice: Allowable Revenue Framework \(RC_2024_01\)](#)

² See p2, [2021 Report to ERA on AEMO Benchmarking](#)

³ See p2, [Australian Energy Market Operator’s AR6 second in-period allowable revenue and forecast capital expenditure proposal – Final determination](#)

⁴ See p18, [2021 Report to ERA on AEMO Benchmarking](#)

The ERA's Final Determination on the second in-period submission estimates the 2024/25 market fees will increase by \$1.04 per MWh (a 68 per cent increase) from \$1.53 per MWh in 2023/24 to \$2.57 per MWh for 2024/25.⁵ This increase in market fees would result in the cost to operate the WEM increasing from \$56.4 million in 2023/24 to \$96.0 million in 2024/25. The rapid change in costs means that there has been no certainty of forward-looking costs and fees for Market Participants and end customers.

Rule change proposal

AEMO contends that the pace of the energy transformation in the WEM combined with the existing regulatory regime makes it difficult to establish a three-year fixed budget. To address this, AEMO has proposed a rule change that removes the requirement for the ERA to determine AEMO's budget. In its place would be a new budget and fee design process featuring annual priorities, activities, budget and fee setting; major project delivery reporting; annual reporting; and review and oversight of the effectiveness of the new framework by the Coordinator of Energy as part of regular WEM effectiveness reporting.

The AEC is sympathetic to AEMO who has been tasked with implementing a large number of reforms and transition activities driven by the State Government and Energy Policy WA. Having said that, the AEC does not support this rule change proposal for the following reasons:

1. It reduces AEMO's accountability

AEMO suggests in its rule change proposal that it will be held accountable in the new budget and fee framework because it would be required to have direct engagement with Market Participants and interested stakeholders, giving them an opportunity to provide input on when AEMO plans, prioritises, costs and delivers major projects.⁶ The AEC welcomes more transparency, however this approach is unlikely to hold AEMO accountable.

The ERA's comments in its Final Determination on AEMO's second in-period submission highlights the challenges of keeping AEMO accountable. In its second in-period submission, AEMO had to seek funding for expenditure that had already been made, with the ERA estimating that \$15 million to \$18 million of the requested additional funding for labour costs had already been incurred by AEMO and it had been paid via debt financing. The ERA concluded that:

*"The regime also lacks measures to constrain AEMO from expending funds above its approved limit. The ERA expects that a regulated entity would raise concerns around significant overspending or underfunding at the time it becomes aware of the problem, irrespective of timelines around formal applications for adjustments. This has not occurred over AR6. While AEMO indicated it would likely require another adjustment at the time of the first in period submission, the magnitude of the overspend was not raised with the ERA. Clear communication between regulated entities and the regulator is important for the efficient functioning of the WEM."*⁷

The ERA, consistent with its functions under the ERA Act 2003, is regarded as an important and necessary safety net for Market Participants, who rely on the ERA's unique skillsets and capacity to assess AEMO's submissions, ensure they are operating efficiently and keep them accountable. However, the Final Determination for the second in-period funding demonstrates that even the ERA has limits on the extent to which it can keep AEMO accountable under the current framework. There is a risk that removing ERA oversight from the process will take the guardrails off AEMO.

⁵ See p10, [Australian Energy Market Operator's AR6 second in-period allowable revenue and forecast capital expenditure proposal – Final determination](#)

⁶ See p4, [Rule Change Notice: Allowable Revenue Framework \(RC 2024 01\)](#)

⁷ See p3, [Australian Energy Market Operator's AR6 second in-period allowable revenue and forecast capital expenditure proposal – Final determination](#)

The AEC is concerned that the new framework relies too heavily on Market Participants to keep AEMO accountable.⁸ Market Participants, despite having limited access to information, will need to interrogate AEMO information and provide informed feedback, and then AEMO will need to feel compelled to act. The challenge with this approach is that:

1. Unlike the ERA, Market Participants cannot compel AEMO to share information or respond to questions;
2. Many Market Participants do not have the resources or skills to provide the same level of assessment as the ERA⁹; and
3. There is nothing driving AEMO to act on feedback from Market Participants, noting that the ERA and other existing mechanisms (such as annual reports, stakeholder meetings etc.) already have limited ability to hold AEMO accountable.

The AEC also observes differing trends for AEMO accountability across the country. While the AEC expects that this rule change proposal will lead to less accountability for AEMO in WA, there is now pressure on AEMO to have more accountability in the NEM. The Senate Select Committee on Energy Planning and Regulation in Australia has been having hearings over the last few weeks, with a focus on the regulation of AEMO and adding more accountability. It was notable that the Chair of those hearings asked AEMO: “Do you not think that there’s scope to change AEMO structure such that it ... had some greater accountability to the people of Australia?”¹⁰ It would be unfortunate if AEMO in WA moved to a NEM-like model with no regulatory oversight only for AEMO in the NEM to shift the other way and be held more accountable.

2. It does not address the main cause of the cost increases

In recent years, AEMO has been required to implement a large number of projects to address the energy transition underway in the WEM. The volume of these projects being given to AEMO is outstripping their capacity. To compound the problem, many of these early-stage policies are given to AEMO to implement without:

1. A budget being developed;
2. Policy makers having sufficiently considered whether the reforms generate an adequate benefit for the cost;
3. Thought given to whether the policy is actually a priority; and
4. Consideration as to how the reform interacts with other projects, and whether it might create a duplication of efforts.

The rule change proposal will indeed make it easier for AEMO to deal with the volume of reforms it is implementing because it will now have more flexibility to recover costs and expand internal resources to handle the transition activities.¹¹ However, the rule change proposal won’t address the main cause of AEMO’s increasing costs – that is, the volume of projects that AEMO is being required to implement without decision makers having first put together a budget, undertaken a cost/benefit analysis, or assessed its priority. For example, many Market Participants have little support in pursuing 5MS whereas Relevant Level

⁸ The rule change proposal states on p6: “*AEMO ... proposes under the new framework that the external governance role shifts to the organisations who ultimately pay the fees resulting from AEMO’s activities – Market Participants.*”

⁹ This was raised by attendees in the July meeting of the Market Advisory Committee.

¹⁰ See p7, [Select Committee on Energy Planning and Regulation in Australia](#)

¹¹ The rule change proposal states on p4: “*Certainty of the recovery of AEMO’s reasonable costs of providing those services is critical to ensure AEMO has confidence in and access to the funding it needs to deliver projects in an efficient and timely manner, without unnecessary project risk*”

Method changes, which is supported and has already received \$16m in funding, is being pushed out to the 2028 capacity cycle by AEMO.

The AEC suggests that:

1. A gate process is implemented, where projects are screened, and costs and priorities are more robustly considered, before projects arrive at AEMO; and
2. AEMO establishes a WEM Reform Implementation roadmap, similar to what AEMO prepares in the NEM, so that Energy Policy WA can coordinate the timing and interaction of reforms and Market Participants have a better understanding of future work that will impact on costs and fees.

3. It still does not incentivise AEMO to reduce costs

A concern many Market Participants have with the current framework is that AEMO costs and fees have increased significantly in a short period of time. The rise in fees makes it difficult for Market Participants to have certainty and recover these costs in their contracts. AEMO has acknowledged this issue.¹²

The AEC suggests that one cause of the cost increases has been the volume of new projects that AEMO has been required to implement. Other issues consistently raised by the ERA are AEMO's forecasting of its operating and project costs, and the fact that it is not incentivised to operate efficiently.

The ERA addressed these issues in its Final Determination on AEMO's second in-period submission:

"AEMO is not incentivised in the same way as a typical profit-driven network service provider to seek out gains in efficiency ... While AEMO attempts to operate at the lowest sustainable cost, it must prioritise delivery of reform and transition activities to deadlines set in the WEM Rules and by the State Government and Energy Policy WA. As a result, AEMO is incentivised to prioritise the timely delivery and full scope of reform work, over limiting cost pressures. This trade-off between time and scope with costs appears to be the basis for this second in-period submission, and the implementation of the new WEM more broadly.

...In addition to the issues outlined above, the ERA is reliant on the quality and depth of the information provided by AEMO to make its determination. The ERA experienced considerable challenges receiving a clear explanation from AEMO regarding increases to operational labour costs between the original AR6 and the second in-period submission. The supplementary information provided since the draft determination has demonstrated gaps in AEMO's processes and systems, often making justifications incomplete and difficult for the ERA reach a clear understanding of AEMO's position and need for additional funds."¹³

The AEC does not have the capacity to assess all of the information provided by AEMO and relies on the expertise of the ERA. However, it is concerning that the regulator has pointed out gaps in AEMO's processes and systems, insufficient information being provided, and a prioritisation of delivery over cost management. The AEC cannot see how the rule change proposal satisfactorily addresses these issues. Indeed, AEMO states in its rule change proposal that it intends to provide that same quality and depth of information: "The robustness of the information provision requirements under the current allowable revenue process will be retained under the proposed new framework."¹⁴

In addition, it is important to note that in Western Australia network operators, under the Electricity Network Access Code 2004, have a regulated requirement to efficiently minimise costs. In other words, demonstrate to the ERA that they do not incur any more costs than a prudent service provider, acting efficiently, in

¹² See p3, [Rule Change Notice: Allowable Revenue Framework \(RC_2024_01\)](#)

¹³ See p32, [Australian Energy Market Operator's AR6 second in-period allowable revenue and forecast capital expenditure proposal – Final determination](#)

¹⁴ See p6, [Rule Change Notice: Allowable Revenue Framework \(RC_2024_01\)](#)

accordance with good electricity industry practice, seeking to achieve the lowest sustainable cost of delivering services and without reducing service standards below the service standard benchmarks set in the access arrangement or contract for services. Therefore, it would be reasonable for Market Participants to expect that AEMO operate to similar standards.

The AEC suggests that AEMO should consider how it will:

1. Improve the quality and depth of the information it provides;
2. Enhance its processes and systems so that it can more accurately forecast operating and project costs;
3. Better manage the trade-off between implementing reforms and controlling costs. Without this, costs will continue to escalate and the Wholesale Market Objectives of promoting the economic efficient supply of electricity and minimising the long-term cost of electricity supplied to customers will be undermined.
4. Describe how it will implement controls to efficiently minimise costs.

Engagement of an independent consultant

The Allowable Revenue framework, and AEMO's increasing costs and fees, are priority issues for the AEC. To this end, the AEC recently engaged Rennie Advisory to provide an independent report on the causes of the rising costs and fees, and whether the rule change proposal adequately addresses these issues. As part of their engagement, Rennie Advisory will:

1. Create an issues tree to perform a root cause analysis of AEMO's current escalating and unpredictable costs;
2. Validate the root cause analysis with research and AEC member feedback;
3. Consider whether AEMO's rule change proposal does/doesn't address the validated root causes, and the potential outcomes that could result from the proposal; and
4. Put forward a range of potential solutions. These may include approaches used elsewhere in similar contexts, or new ideas for consideration.

The AEC considers that this will be a valuable exercise that may help to inform Energy Policy WA's response to the rule change proposal. The AEC will forward key findings and the final report as they become available in the coming weeks.

Conclusion

The AEC appreciates this opportunity to provide feedback on the rule change proposal and encourages Energy Policy WA to consider the issues raised above.

Please do not hesitate to contact Graham Pearson, Western Australia Policy Manager by email on graham.pearson@energycouncil.com.au or by telephone on 0455 233 346 should you wish to discuss this further.

Yours sincerely,

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