

Via email: energymarkets@demirs.wa.gov.au

Submission in response to Rule Change Notices: Allowable Revenue Framework

Dear Jai,

Thank you for the opportunity to make a submission in response to the draft rule change report for the rule change about the Australian Energy Market Operator's (AEMO) Allowable Revenue Framework.

As you know, I am a member of the Expert Consumer Panel (ECP), and have also represented small use customers on the Market Advisory Committee (MAC). Both the ECP and MAC were briefed by AEMO on its rule change proposals, and I also contributed to the MAC's advice on the matter outlined in the Independent Chair's letter referred to in the Draft Report.

My submission in response to the first round of consultations on the rule change in November 2024 outlined the important role that the Economic Regulatory Authority (ERA) plays in providing expert, independent oversight over AEMO's strategy and financial management, as well as highlighting the risks and costs associated with the alternative, essentially self-regulatory model proposed by AEMO.¹ In summary:

- AEMO is a monopoly service provider like electricity and transmission networks, and should be subject to appropriate economic regulation in the place of competitive market pressure to operate efficiently.
- The costs of operating the Wholesale Electricity Market (WEM) have increased significantly in recent years, to now approach \$100m per year.²
- The ERA's oversight role is not one that can be outsourced to industry, or indeed consumer representatives, who do not have the capability or resourcing to assess AEMO's business plans, or indeed powers to compel it to produce information.
- The ERA's independent oversight is good for AEMO, as a clear line of accountability helps maintain community trust and confidence in an institution that has a unique role to manage the electricity system on behalf of households and businesses.

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https://www.wa.gov.au/system/files/2024-11/rc_2024_01_-_aemo_allowable_revenue_framework_-_submission_ecp_chris_alexander_0.pdf

² Australian Energy Market Operator's AR6 second in-period allowable revenue and forecast capital expenditure proposal Final determination, page 11, <https://www.erawa.com.au/cproot/24147/2/AR-6-2nd-In-period-CapEx-and-OpEx-submission-Final-determination.PDF>

I support your draft assessment to reject the rule change proposal. I agree however, there is a need to consider whether the framework can be refined to deliver better outcomes for the State in the context of an energy system in transition. Suspending the current Allowable Revenue Framework while a replacement framework can be developed is sensible.

A core issue is how to adapt the framework to create a stronger set of incentives for AEMO to operate efficiently and that the ERA can oversee, while also ensuring system security and environmental objectives are achieved. As the ERA noted in its final determination for AEMO's second in-period submission for the AR-6 period, as a not-for-profit entity with an expanding set of responsibilities, it is not incentivised in the same way as a typical profit-driven network service provider is, to seek out gains in efficiency.³

The challenge of regulating market operators in an energy transition is not unique to Western Australia. In the United Kingdom, the Office of Gas and Electricity Markets (Ofgem), which is our equivalent of the ERA is in the process of adapting the performance-based 'RIIO' framework (Revenue = Incentives + Innovation + Outputs) for the new, public-owned, National Electricity System Operator (NESO) that has been split off from (privately-owned) National Grid UK.⁴

As I understand it, one of the key changes Ofgem has made is to remove the financial incentives from the RIIO framework which were not considered to be appropriate for the now publicly-owned NESO (akin to AEMO's status as a not-for-profit). While I would caution against moving to a model where the ERA does not formally approve AEMO's budget, it is interesting that what Ofgem has done to stand-in for financial incentivisation is develop a much stronger set of transparency and reputational incentives.⁵ This starts with requiring the NESO to work to a set of clearly specified (and consulted on) performance objectives, with associated key performance indicators, major deliverables, targets and success measures. The draft business plan the NESO is currently consulting on includes, for example, commitments that go to both its role in making the energy market overall more efficient i.e., reducing system-wide balancing costs as part of achieving its overarching safety, reliability and efficiency performance objectives, as well as its own business operations via a quantified efficiency target.⁶ These and

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<https://www.erawa.com.au/cproot/24147/2/AR-6-2nd-In-period-CapEx-and-OpEx-submission-Final-determination.PDF>, page 32.

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<https://www.gov.uk/government/news/new-publicly-owned-national-energy-system-operator-to-pave-the-way-to-a-clean-energy-future#:~:text=The%20National%20Energy%20System%20Operator%20has%20been%20established,under%20the%20Energy%20Act%202023>.

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https://www.ofgem.gov.uk/sites/default/files/2024-08/Consultation_on_the_performance_incentive_framework_for_BP3.pdf page 12

⁶ <https://www.neso.energy/about/strategic-priorities/our-riio-2-business-plan> - in relation to lowering balancing costs, see page 29, and the efficiency target, see p19.

other commitments in the business plan will be tracked by the regulator and an independent performance panel through in-period and end-of-period monitoring and reporting.⁷

There are a few other things to note about how Ofgem intends this framework to work in practice and how it differs from the current ERA model, and what some stakeholders are suggesting.

A feature of the Ofgem approach is that it seeks to strike a balance between setting a clear strategic direction and flexibility around delivery. Whereas each RIIO period runs for five years as it does for electricity and gas networks, it is further broken down into a series of two-year 'business plan periods' for a subset of the elements of the determination. Within these two-year periods, Ofgem stated intention is not to bind the NESO to highly-prescriptive, mechanistic KPIs, that would leave it little room to respond to changing circumstances, rather:

“[t]he evaluation criteria broadly consider whether NESO has delivered its business plan deliverables on time; the quality of those delivered outputs; evidence from stakeholders; performance against specific metrics; and its demonstration of value for money.”⁸

A problem with the current ERA process for AEMO is that it is almost exclusively ex-ante, with less clarity about what is to be delivered over the period, and what is achieved at its conclusion than the Ofgem approach. To the extent there is a 'look back', it is as context for forward-looking assessments about budgets for the next regulatory period, rather than an explicit review of performance in past periods. The UK's National Energy System Operator's Independent Performance Panel (IPP), and Ofgem's in-period reporting is informed by six-monthly reports published by the NESO itself. Among other things, this more regular reporting by the NESO and interrogated first by the IPP and then Ofgem, would seem to mitigate the risk that the market operator spends in excess of its allowed budget to deliver its role, leaving the regulator with little option but to approve the sum to be collected from consumers to keep it whole in the next regulatory period.

Importantly, the information published by the NESO is layered and very granular. For example, sitting beneath the regular quarterly and other set-piece reports is a 'RIIO Deliverables Tracker' in Excel format, that shows progress against (more than 500) milestones, and commentary about the work underway and explain delays etc..⁹ As an advocate armed with this kind of information, I can imagine being able to work with the market operator, and the regulator, in a much more informed and targeted way than is usually possible in contexts where a huge

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https://www.ofgem.gov.uk/sites/default/files/2024-08/Consultation_on_the_performance_incentive_framework_for_BP3.pdf

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https://www.ofgem.gov.uk/sites/default/files/2024-08/Consultation_on_the_performance_incentive_framework_for_BP3.pdf page 13

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<https://www.neso.energy/about/strategic-priorities/our-riio-2-business-plan/how-were-performing-under-riio-2>

amount of time is required to answer threshold questions about how the organisation is performing, rather than focussing on higher order questions.

Finally, NESO's licence conditions will link executive remuneration to performance against its business plan in the next reporting period (April 2025-March 2026).¹⁰ This is an option that EPWA should consider adopting within the SWIS as part of its review of the framework.

A fit-for-purpose regulatory framework for Western Australia's market operator, will of course differ to one designed for the United Kingdom market. The comparison can however help inform thinking about the principles around transparency, performance, and flexibility that should guide the end framework.

Please do not hesitate to get in touch if you would like to discuss this submission further.

Yours sincerely,

Chris Alexander
Expert Consumer Panel

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https://www.ofgem.gov.uk/sites/default/files/2024-11/Decision_on_the_Performance_Incentives_Framework_for_BP3.pdf page 16