



Draft Rule Change Report
Title: Reassessment of Allowable
Revenue during a Review Period

Ref: RC_2011_02

Standard Rule Change Process

Date: 16 December 2011

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EXECUTIVE SUMMARY

Proposed Amendments

Market Rule 2.22 and 2.23 establish the regulatory framework that provides governance over the establishment and approval of IMO's and System Management's (SM'S) budgets and market fees.

The Economic Regulatory Authority's (ERA') approval of the IMO's and SM's projected Allowable Revenue over each review period (3 years) provides the governance oversight over these market costs.

ERA has approved Allowable Revenue for the IMO and SM for two review periods 2006/07 to 2009/10 and 2010/11 to 2012/13.

As a result of the implementation of the Market Evolution Program (MEP) and the difficulty with the application of Market Rule 2.22 and 2.23 the Economic Regulation Authority (ERA) has proposed amendments to the Wholesale Electricity Market Rules (Market Rules) to address concerns around the determination and reassessment of Allowable Revenue and the definition of a Declared Market Project..

Once an Allowable Revenue has been approved for either the IMO or SM the current Market Rules provide for the two mechanisms for the ERA to undertake a further evaluation of the IMO and SM's budget. These mechanisms are:

1. If the annual budget proposal of either the IMO or SM is likely to result in the revenue recovery over the review period to exceed 15% then the IMO or SM is required to apply to ERA for a reassessment of their Allowable Revenue.
2. If a project involves a major change and function for either the IMO or SM or a major change of market systems, and the costs of implementing the project would cause the IMO's or SM's budget to exceed 15% then the IMO may declare the project a Declared Market Project and the ERA's approval is required before the project commences.

The essential difference between the ERA reassessment of the Allowable Revenue and the approval of a Declared Market Project is that a Declared Market Project requires ERA's approval prior to the project commencing.

The ERA's concerns with the current market rules are:

1. The ERA considers that the existing threshold value used as the trigger for a reassessment in these tests is too high, and should be reduced from 15% to 10% of approved Allowable Revenue.
2. The test to determine if the IMO or SM is required to seek a reassessment of the approved Allowable Revenue can produce inconsistent results, depending on the timing of the proposed operating expenditure within a Review Period and the period over which any capital cost is to be depreciated or amortised within the Review Period.
3. The test to determine whether an IMO or System Management project meets the criteria for a Declared Market Project can produce inconsistent results, depending on the commencement of any operating costs associated with the project within a Review Period and the period over which the capital costs of the project are to be depreciated or amortised. This can result in a project involving significant Capital Expenditures failing to trigger an ERA review. The Market Rules do not allow for the IMO or System Management to request an ERA review of a budget proposal if it does not automatically trigger a reassessment of the Allowable Revenue.

Consultation

- The Pre Rule Change Discussion Paper was discussed by the Market Advisory Committee at the March 2011 meeting. There was general support from MAC members for the proposal, although some minor enhancements were suggested and one attendee questioned whether a 10% threshold value might prove restrictive in future.
- The ERA formally submitted the Rule Change Proposal on 10 March 2011. The IMO published a notice calling for submissions on 14 March 2011.
- Submissions were received from Landfill Gas & Power (LGP), System Management and Synergy. All submissions received supported the proposed amendments. Synergy also suggested a number of minor changes to the drafting of the proposed amendments, to improve their clarity and to address an incorrect cross-reference.
- After reviewing the Rule Change Proposal and the initial draft of the Draft Rule Change Report the IMO has proposed additional amendments to the Amending Rules to simplify the change and to ensure it is workable. These additional amendments were developed in consultation with the ERA.

Assessment against Wholesale Market Objectives

The IMO has found the proposed amendments to promote Wholesale Market Objectives (a) and (d), and to be consistent with the remaining Wholesale Market Objectives.

Practicality and Cost of Implementation

No implementation costs have been identified for the proposal. However, the IMO, System Management and the ERA will incur some ongoing administration costs for the preparation and assessment of the additional capital expenditure proposals resulting from the changes. These costs are not expected to be material, with the bulk of these costs incurred by the ERA.

The IMO has not identified any issues with the practicality of implementing the proposed changes.

The IMO's Proposed Decision

The IMO's proposed decision is to accept the Rule Change Proposal as modified following the first submission period.

However, the IMO Board has some concerns with regard to the loss of operational flexibility imposed on the IMO Board by the reduction of the reassessment threshold to 10%.

Next steps

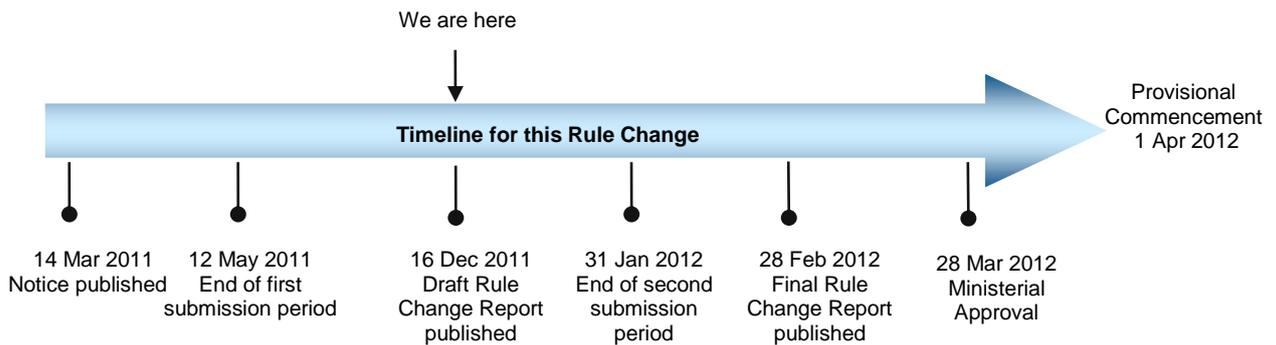
The IMO now invites interested stakeholders to make submissions on this Draft Rule Change Report by **5.00pm, Tuesday 31 January 2012**.

The IMO would appreciate stakeholder views on the potential impacts that the proposed reduction to a 10% threshold to trigger reassessment of the Allowable Review may impose on the IMO. In particular the IMO Board notes that the IMO is required to implement Market Rule changes and the associated systems changes from within the approved operational budget and the proposal to approve the IMO capital budget. The reduced reassessment threshold may impact the timely implementation of Market Rule changes.

1 RULE CHANGE PROCESS AND TIMETABLE

On 10 March 2011, the Economic Regulation Authority (ERA) submitted a Rule Change Proposal regarding amendments to clauses 2.22.8, 2.22.13 and 2.23.8 and new clauses 2.22.15 and 2.23.13 of the Wholesale Electricity Market Rules (Market Rules).

This proposal is being processed using the Standard Rule Change Process, described in section 2.7 of the Market Rules. In accordance with clause 2.5.10 of the Market Rules the IMO decided to extend the timeframes for the first submission period and for the preparation of the Draft Rule Change Report. Further details of the extensions are available on the IMO website. The key dates in processing this Rule Change Proposal, as amended in the extension notices, are:



Please note the commencement date is provisional and may be subject to change in the Final Rule Change Report.

2 CALL FOR SECOND ROUND SUBMISSIONS

The IMO invites interested stakeholders to make submissions on this Draft Rule Change Report.

The IMO would appreciate stakeholder views on the potential impacts that the proposed reduction to a 10% threshold to trigger reassessment of the Allowable Review may impose on the IMO. In particular the IMO Board notes that the IMO is required to implement Market Rule changes and the associated systems changes from within the approved operational budget and the proposal to approve the IMO capital budget. The reduced reassessment threshold may impact the timely implementation of Market Rule changes.

The submission period is 28 Business Days from the publication date of this report. Submissions must be delivered to the IMO by 5.00pm, **Tuesday 31 January 2012**.

The IMO prefers to receive submissions by email (using the submission form available on the IMO website: <http://www.imowa.com.au/rule-changes>) to: market.development@imowa.com.au

Submissions may also be sent to the IMO by fax or post, addressed to:

Independent Market Operator
Attn: Group Manager, Market Development
PO Box 7096
Cloisters Square, PERTH, WA 6850
Fax: (08) 9254 4399

3. PROPOSED AMENDMENTS

3.1 *The Rule Change Proposal*

In its Rule Change Proposal, the ERA noted three concerns over the operation of clauses 2.22.8, 2.22.13, and 2.23.8 of the Market Rules, which provide for a reassessment of Allowable Revenue for the IMO and System Management during a Review Period where an amount of un-forecast expenditure is proposed to be incurred.

Firstly, in their current form, the way in which clauses 2.22.8, 2.22.13 and 2.23.8 of the Market Rules apply to proposed Capital Expenditures of the IMO and System Management can result in inconsistencies. As a result, Capital Expenditures made by the IMO and System Management that involve material increases in the market fees¹ charged to Market Participants may or may not be subject to review by the ERA. The proposed changes to the relevant clauses differentiate between the concepts of Capital Expenditure and recurring expenditure and ensure it is Capital Expenditure that is taken into account in the threshold test, rather than recurring expenditure.

Secondly, the ERA considered that the existing 15% threshold value of incremental revenue that acts as a trigger for the declaration of a Declared Market Project (under 2.22.13) and the reassessment of approved Allowable Revenue (under 2.22.8 and 2.23.8) is too high. The ERA proposed that the threshold increase in revenue for a Review Period should be reduced to 10% of approved Allowable Revenue for the Review Period.

Thirdly, the Market Rules do not allow for the IMO or System Management to request that the ERA review a budget proposal that does not automatically trigger such a review under clauses 2.22.8, 2.22.13 and 2.23.8. As a result no mechanism is currently available to resolve uncertainty over whether the budget proposal satisfies the criteria in clause 2.22.12(b) or 2.23.12(b), and there is a risk that the ERA may not approve the associated Allowable Revenue for the next Review Period. The ERA proposed the inclusion of two new clauses in the Market Rules, allowing the IMO or System Management to request the ERA to review a proposed capital project and approve an increase to the Allowable Revenue, even where the budget proposal falls below the threshold for a mandatory review.

The full details of the Rule Change Proposal are available in Appendix 1 of this report.

3.2 *The IMO's Initial Assessment of the Proposal*

The IMO decided to proceed with the proposal on the basis that Market Participants should be given an opportunity to provide submissions as part of the rule change process.

4. CONSULTATION

4.1 *Market Advisory Committee*

Mr Chris Brown presented the ERA's proposal as a Pre Rule Change Discussion Paper to the 9 March 2011 meeting of the MAC. Full minutes of the meeting can be accessed at http://www.imowa.com.au/MAC_36.

Mr Brown noted that while the IMO's budget for the Market Evolution Program (MEP) was in the order of \$7 million, under the current Market Rules the ERA had not been

¹ Market fees in this context can include IMO "Market Fees" and/or System Management "System Operation Fees".

required to review the proposed expenditure. This triggered a concern (shared by both the ERA and the IMO) that such a large amount of expenditure could be exempt from review, leading to the development of PRC_2011_02.

The Chair advised that when the IMO went to the ERA to seek approval for a Declared Market Project the ERA had advised that this was not in its jurisdiction. The IMO, however, still provided the ERA with all the information it would normally provide for such a review. The IMO supported the proposal as it provides both the market and the Minister with protection from the IMO or System Management embarking on major projects without review.

Mr Brown noted that in PRC_2011_02 the ERA proposed a reduction in the threshold level for the triggering of a review from 15% of Allowable Revenue in a Review Period to 10%. However, Mr Brown noted that this was based on a “gut feeling” and that the ERA wished to discuss the appropriate threshold level with MAC members.

Mr Brown noted that if the IMO or System Management exceeded their budget without ERA review and approval they were taking a risk in that the ERA might reject the additional expenditure in a future period. The ERA had proposed new rules allowing the IMO or System Management to ask the ERA for an assessment regardless of whether the expenditure threshold has been reached. This would provide in effect a pre-determination, giving certainty that the expenditure would not be rejected in future. Mr Brown noted that as the monetary amounts involved may be small, the ERA had sought discretion on whether to publicly consult on a review or not

The following points were raised by MAC members.

- Mr Corey Dykstra noted that regardless of where the threshold was set, there would always be situations where proposed expenditure fell under the threshold, and that the proposal would give the IMO and System Management the ability to gain approval for this expenditure early.
- Mr Peter Huxtable queried whether there would be a minimum level of expenditure applicable to these requests. Mr Brown responded that while there was not a fixed minimum the ERA had reserved the right not to make a determination in these situations. Mr Troy Forward considered that as the IMO and System Management would be unlikely to make a submission lightly it could be reasonable for the ERA to be obliged to make a determination.
- Mr Peter Mattner noted that the New Facilities Investment Test (NFIT) has a threshold, above which the ERA must make a determination and below which the ERA may make a determination. Mr Mattner noted that a determination was defined as a decision to approve or not approve a proposal, which could result in uncertainty where a proposal was not approved but where a proposal for a lesser amount may have been approved. After some discussion it was clarified that the ERA would still be required to make a determination on proposals over the 10% threshold.
- Mr Pablo Campillos queried whether the 10% threshold might prove restrictive for the IMO and System Management in future.
- Mr Mattner queried whether any time limit had been set for the ERA's determinations, considering that it could pose a risk to the IMO if no time limit existed. Mr Stephen MacLean noted that there was also an ERA resourcing issue to be considered. The Chair considered that there could be a problem if the market wants the IMO to progress a project quickly but the ERA was to take 3-6 months or more to make a determination. Mr Brown replied that the ERA would look into this issue. Mr MacLean noted that situations might arise where both the

IMO and System Management were making multiple submissions at the same time

4.2 Submissions received during the first submission period

The first submission period for this Rule Change Proposal was between 15 March 2011 and 12 May 2011.

The IMO received submissions from Landfill Gas & Power (LGP), System Management and Synergy. The full text of the submissions is available on the IMO website.

All the submissions received supported the proposed amendments, including the reduction of the threshold level to 10% of approved Allowable Revenue. Synergy also suggested a number of minor changes to the drafting of the proposed amendments, to improve their clarity and to address an incorrect cross reference.

The assessment by submitting parties as to whether the proposal would better the Wholesale Market Objectives is summarised below:

Submitter	Wholesale Market Objective Assessment
LGP	Supports (d) and is consistent with the other Wholesale Market Objectives
System Management	Betters (a), (b) and (d) and is consistent with the other Wholesale Market Objectives
Synergy	Betters (a) and (d) and is consistent with the other Wholesale Market Objectives

4.3 The IMO's response to submissions received during the first submission period

The IMO's response to each of the issues identified during the first submission period is presented in the table over the page:

Clause/Issue	Submitter	Comment/Change Requested	IMO's response
2.22.8(b)	Synergy	<p>Synergy supports the concept of expressing Capital Expenditure adjustments under clause 2.22.8 not as depreciation and amortisation expenses but as capital expenditures for the purpose of determining if the revenue recovery exceeds 10% of the Allowable Revenue.</p> <p>Synergy suggests that to avoid potential duplication of effort by the ERA (as this test would apply in each year of the Review Period) the IMO may wish to consider amending the clause as follows (shown in underlined italics):</p> <p>2.22.8(b) result in a sum of capital expenditures and recurring expenditures, <u>not previously approved by the ERA as satisfying the requirements of clause 2.22.12(b)</u>, such that if:</p>	<p>The IMO notes that the test specified in the proposed clause 2.22.8(b) by the ERA requires assessment of the expected revenue recovery over the Review Period if Capital Expenditures were fully recovered in the Review Period rather than recovered over time as depreciation and amortisation expenses.</p> <p>The IMO has made additional changes to the proposed Amending Rules to allow for the ERA to approve a Capital Expenditure amount for the review period separately. Please refer to section 5.1 for further details.</p>
2.22.13	Synergy	<p>Synergy suggests that for the avoidance of doubt and additional clarity, that the IMO may wish to consider amending the clauses as follows (shown in underlined italics):</p> <p>2.22.13(b)i depreciation and amortisation expenses in the current Review Period recovering the capital expenditures of the Declared Market Project are subtracted from recurring expenses <u>of the Declared Market Project (net recurring expenses)</u> and</p> <p>2.22.13(b)ii the capital expenditures <u>and net recurring expenses</u> of the Declared Market Project were to be fully recovered in the current Review Period;</p>	<p>Synergy's comments highlight the difficulty with establishing a criterion for determining a Declared Market Project that includes both Capital Expenditure and Operating costs with depreciation and amortisation as component parts.</p> <p>The IMO has further discussed with the ERA the intent behind its proposed amendments to clause 2.22.13. Following these discussions the IMO has proposed additional changes to this clause to simplify and incorporate the new separate Capital Expenditure approval by the ERA. Please refer to section 5.1 for further details.</p>
2.22.15(b)	Synergy	<p>As this clause essentially repeats the efficiency and prudence tests of clause 2.22.12(b), Synergy suggests the IMO may wish to consider, for the sake of brevity, referencing this new clause to clause 2.22.12(b) to reduce repetition.</p>	<p>The IMO agrees with Synergy. In the additional amendments the IMO has made a reference to clause 2.22.12(b) in the new clause 2.22.15(b) to ensure the Amending Rules has the correct cross reference..</p>

Clause/Issue	Submitter	Comment/Change Requested	IMO's response
2.23	Synergy	Comments from the above points similarly apply to the respective proposed amendments for clause 2.23.	Refer to the responses above.
2.23.13 (c)	Synergy	Clause 2.23.13 in sub clause (c) makes an incorrect reference to 2.22.13 – the correct reference is 2.23.13.	The IMO has updated the drafting, however the IMO notes because of the additional amendments this clause is now 2.23.14(a) and the cross reference is 2.23.14...

4.4 Further consultation with the ERA and System Management

In reviewing RC_2011_02 the IMO was concerned that the Amending Rules proposed by the ERA and further amended by the IMO in the initial Draft Rule Change Report resulted in proposed changes that were unworkable in practice.

These concerns centred on the following:

The original ERA rule change proposal appeared to have an underlying assumption that the ERA's approval of the IMO's and SM's Allowable Revenue included the approval of the proposed Capital Expenditure Budget. This assumption is inaccurate.

This issue was further compounded by a concept of "New Capital Expenditure" introduced in the initial draft of the Draft Rule Change Report.

Of further concern was the attempt to combine both Operating Expenses and Capital Expenditure in the criteria for Allowable Revenue reassessment and Declared Market Projects that required asset amortisation to be backed out of the criteria.

The absence of an initial ERA approval of the IMO's and SM's Capital Expenditure combined with the introduction of the "new capital expenditure" concept, and combining Operating Expenses and Capital Expenditure resulted in the changes proposed in the initial Draft Rule Change Report being unworkable.

As a result of these concerns the IMO facilitated a meeting with the ERA to discuss the ERA's reasoning and the principles underlying the Amending Rules with the aim of simplifying the proposal.

During the meeting the IMO and ERA agreed with the intent of the Rule Change Proposal and arrived at a mutually acceptable method of achieving the intent that was workable in practice.

The IMO subsequently re-drafted the proposed Amending Rules to reflect the outcome of the discussions with the ERA and forwarded the proposed Amending Rules to the ERA and System Management for comment.

The IMO incorporated comments received from the ERA and System Management into the drafting and finalised the proposed Amending Rules which can be found in section 7 of this report.

The IMO held a second meeting with the ERA to present the finalised proposed Amending Rules prior to preparing this report, and the ERA was supportive of the amendments. An explanation of the additional amendments can be found in section 5.1 of this report.

4.5 Public Forums and Workshops

No public forums or workshops were held in relation to this Rule Change Proposal.

5. THE IMO'S ASSESSMENT

In preparing its Draft Rule Change Report, the IMO must assess the Rule Change Proposal in light of clauses 2.4.2 and 2.4.3 of the Market Rules.

Clause 2.4.2 outlines that the IMO "*must not make Amending Rules unless it is satisfied that the Market Rules, as proposed to be amended or replaced, are consistent with the Wholesale Market Objectives*".

Additionally, clause 2.4.3 states, when deciding whether to make Amending Rules, the IMO must have regard to the following:

- any applicable policy direction from the Minister regarding the development of the market;
- the practicality and cost of implementing the proposal;
- the views expressed in submissions and by the MAC; and
- any technical studies that the IMO considers necessary to assist in assessing the Rule Change Proposal.

The IMO notes that there has not been any applicable policy direction from the Minister or any technical studies commissioned in respect of this Rule Change Proposal. A summary of the views expressed in submissions and by the MAC is available in section 4 of this report.

The IMO's assessment is outlined in the following sections.

5.1 Additional Amendments to the Proposed Amending Rules

The IMO, after considering the drafting proposed by the ERA in its Rule Change Proposal and modified by the IMO in their initial drafting of the Draft Rule Change Report identified that the resulting rule change was unworkable in practice. The IMO held further discussions with the ERA to clarify its intent with regard to the relevant clauses. Following these discussions the IMO has proposed some additional amendments to the drafting to better achieve the ERA's intent. An explanation of these changes is provided below. The additional amendments are available in Appendix 2 of this report.

Definition and treatment of Capital Expenditure

The ERA indicated in its Rule Change Proposal the concern that large Capital Expenditures incurred by the IMO or System Management were not triggering either a reassessment of the Allowable Revenue or meeting the criteria for a Declared Market Project to be considered by the ERA. This was largely due to the requirement to commence the depreciation or amortisation of capital expenditure when an asset is fully operational. Depending on the accounting policy adopted this amortisation can be spread over more than one Review Period.

The ERA expressed a preference that exceeding the total Capital Expenditure budget not the depreciation expense should be the trigger that should be applied when establishing whether the IMO or System Management had exceeded its 10% threshold and a reassessment of Allowable Revenue is required.

The IMO supports this concept but notes that Capital Expenditure from the IMO and SM are not currently subject to ERA approval. Only the depreciated or amortised expense is considered in the ERA approval of the Allowable Revenue.

The IMO has proposed in its additional amendments that for future Review Periods, the IMO and System Management must seek ERA approval for both its Allowable Revenue and total Capital Expenditure.

It is proposed that these will be two separate approvals. This structure eliminates the problem of applying a test for additional Capital Expenditure against Allowable Revenue. The proposed drafting includes a separate 10% threshold test on both the IMO's and SM's Allowable Revenue as well as the approved Capital Expenditure in the relevant

Review Period as per clauses 2.22.8, 2.22.8A, 2.23.8 and 2.23.8A. There is a worked example in section 5.2.1 which explains the threshold test.

The rule amendments proposed require the ERA to approve Forecast Capital Expenditure for a Review Period for both the IMO and SM.

The IMO has updated sections 2.22 and 2.23, using a defined term (“Capital Expenditures”) to reflect the need for Capital Expenditure to be approved by the ERA for a Review Period.

Declared Market Project Test

The IMO has amended clause 2.22.13 which provides guidelines for the IMO to declare a project a Declared Market Project (DMP). The IMO proposes that expenditure for a project should satisfy the test for a DMP if the capital expenditure plus the directly associated recurring expenses increases the combined approved Allowable Revenue and Capital Expenditure for the current period by 10% or more.

There is a worked example in section 5.2.2 which explains this combined threshold test. Once a project qualifies as a Declared Market Project, ERA approval is required before the project commences.

The IMO considers the additional amendments to clause 2.22.13 are in line with the new definition and treatment of Capital Expenditure and simplify the definition of the test.

Minor Changes

The IMO has also proposed the following additional amendments.

- The incorrect clause reference identified by Synergy in clause 2.23.13(c) has been corrected.
- Some minor updates have been made to the punctuation of the clauses.

5.2 A worked example of the definition and treatment of capital expenditure

5.2.1 Worked Example – Reassessment of Forecast Capital Expenditure

Suppose the IMO or SM submitted a budget proposal for \$30 million Allowable Revenue and \$6 million Capital Expenditure for a Review Period.

Under the proposed rule change the ERA would determine (if it accepted the budget proposal) both an Allowable Revenue and Forecast Capital Expenditure in the Review Period of \$30 million and \$6 million respectively.

During year two of the Review Period the IMO or SM estimates that its total Capital Expenditure for Review Period was likely to exceed the approved Forecast Capital Expenditure by \$2 million (total Capital Expenditure now projected at \$8 million for the Review Period) due to additional software requirements. Applying the proposed rule change:

“The IMO or SM must apply to the Economic Regulation Authority to approve the Capital Expenditure for that Review Period if the budget proposal is likely to result in Capital Expenditure over the relevant period, being at least 10% greater than the Capital Expenditure approved by the Economic Regulation Authority”

the IMO would be required to apply to the ERA for a reassessment of the Forecast Capital Expenditure.

5.2.2 Worked Example – New criteria Declared Market Project

Suppose the IMO or SM submitted a budget proposal for \$30 million Allowable Revenue and \$6 million Capital Expenditure for a Review Period.

Under the proposed rule change the ERA would determine (if it accepted the budget proposal) both an Allowable Revenue and Forecast Capital Expenditure in the Review Period of \$30 million and \$6 million respectively.

During the Review Period the IMO or SM proposed a project with an estimated cost of \$5 million (incorporating Capital Expenditure and additional operating costs).

The cost of this project would exceed the combined Allowable Revenue and Forecast Capital Expenditure (combined total \$36 million) by more than 10%.

This would breach the threshold required to qualify as a Declared Market Project, and if declared a Declared Market Project would require ERA approval before the project commenced.

5.3 Wholesale Market Objectives

The IMO considers that the Market Rules as a whole, if amended, will be consistent with the Wholesale Market Objectives. Further, the IMO considers that the Market Rules if amended would not only be consistent with the Wholesale Market Objectives but also allow the Market Rules to better address Wholesale Market Objectives (a) and (d).

The IMO's assessment is presented below:

(a) to promote the economically efficient, safe and reliable production and supply of electricity and electricity related services in the South West Interconnected System

The additional level of governance and oversight provided by the proposed amendments will help ensure that the costs incurred by IMO and System Management are subject to appropriate regulatory approval.

This will promote the economically efficient production and supply of electricity and electricity related services in the South West interconnected system.

(d) to minimise the long-term cost of electricity supplied to customers from the South West interconnected system

The proposed amendments will increase the level of scrutiny applied to the costs incurred by the IMO and System Management, helping to avoid excessive or inappropriate expenditure. By providing additional oversight and governance over these costs, which are recovered through Market Fees and are ultimately passed through to consumers, the amendments will better address Wholesale Market Objective (d).

The IMO considers that the proposed changes are consistent with the remaining Wholesale Market Objectives.

5.4 Practicality and Cost of Implementation

Cost:

No implementation costs have been identified for the proposal. However, the IMO, System Management and the ERA will incur some ongoing administration costs for the preparation and assessment of the additional capital expenditure proposals resulting from the changes. These costs are not expected to be material, with the bulk of these costs incurred by the ERA.

No other costs to participants were identified in the submissions received on the proposal.

Practicality:

The IMO has not identified any issues with the practicality of implementing the proposed changes.

6. THE IMO BOARD'S PROPOSED DECISION

The IMO's Board's proposed decision is to accept the Rule Change Proposal as modified by the amendments outlined in section 5.1 and specified in Appendix 2 of this report.

The IMO Board notes that during the discussion on RC_2011_02 at the March 2011 MAC meeting the issue of whether the proposed 10% threshold of approved Allowable Revenue might prove restrictive for the IMO and System Management in the future.

The IMO Board also has concerns that this reduced threshold may impact on its ability to independently govern the IMO. While the IMO Board supports the proposed adoption of the Rule Change Proposal as modified in this report, it wishes to seek the views of interested parties on the potential impacts this reduction to 10% may impose on the IMO with regard to the ability of the Independent Board of the IMO managing the IMO budget.

The IMO Board will take these views into account when making its final decision on RC_2011_02.

6.1 *Reasons for the decision*

The IMO has made its decision on the basis that the Amending Rules:

- will allow the Market Rules to better address Wholesale Market Objectives (a) and (d);
- are consistent with the remaining Wholesale Market Objectives;
- have the general support of the MAC; and
- have the in principle support of submissions received during the first submission period.

The IMO notes that a number of potential enhancements to the proposed amendments were discussed at the March 2011 MAC meeting, including:

- the setting of a minimum level of expenditure for requests made under clauses 2.22.15 and 2.23.13;
- removing the discretion of the ERA to not make a determination on a proposal submitted under clauses 2.22.15 or 2.23.13; and
- the setting of a time limit for the ERA to make a determination under clauses 2.22.15 or 2.23.13.

The IMO considers that there is insufficient evidence available to indicate a need for these enhancements at this time.

Additional detail outlining the analysis behind the IMO's reasons is outlined in section 5 of this Draft Rule Change Report.

7. PROPOSED AMENDING RULES

Subject to further deliberations on the concerns raised by the IMO Board as outlined in section 6 of this report, the IMO proposes to implement the following amendments to the Market Rules (~~deleted text~~, added text):

- 2.22.3. For the Review Period, the IMO must seek the approval of its Allowable Revenue and Forecast Capital Expenditure from the Economic Regulation Authority for each of the services described in clause 2.22.1 in accordance with the following:
- (a) by 30 November of the year prior to the start of the Review Period, the IMO must submit a proposal for its Allowable Revenue and Forecast Capital Expenditure over the Review Period;
 - (b) the Economic Regulation Authority must undertake a public consultation process in approving the IMO's Allowable Revenue and Forecast Capital Expenditure ~~for the IMO~~ for a Review Period, which must include publishing an issues paper and issuing an invitation for public submissions; and
 - (c) by 31 March of the year in which the Review Period commences, the Economic Regulation Authority must determine the IMO's Allowable Revenue and approve the Forecast Capital Expenditure of the IMO for the Review Period for each of the services described in clause 2.22.1.
- 2.22.4. Where the Economic Regulation Authority does not make a determination by the date specified in clause 2.22.3(c), the Allowable Revenue and Capital Expenditure from the previous Review Period, or the budget determined by the Minister under clause 2.22.2, as applicable, will continue to apply until the Economic Regulation Authority makes a determination.
- 2.22.6. Following the first determination of the IMO's Allowable Revenue ~~of the IMO~~ by the Economic Regulation Authority under clause 2.22.3 and subject to clauses 2.22.7 and 2.22.8, the budget proposal must be consistent with the Allowable Revenue determined by the Economic Regulation Authority for the relevant Review Period.
- 2.22.8. The IMO must apply to the Economic Regulation Authority to determine the IMO's Allowable Revenue for the current Review Period if, ~~Where~~ taking into account any adjustment under clause 2.22.7, the budget proposal is likely to result in revenue recovery, over the relevant Review Period, being at least 10% ~~more than 15%~~ greater than the Allowable Revenue determined by the Economic Regulation Authority.

~~, the IMO must apply to the Economic Regulation Authority to reassess the Allowable Revenue. The IMO must endeavour to make such an application in sufficient time to allow its budget proposal to be approved under clause 2.22.9 before the commencement of the Financial Year to which it relates. The Economic Regulation Authority may amend a determination under clause 2.22.3(c) if the IMO makes an application under this clause 2.22.8. Clause 2.22.3(b) applies in the case of an application under this clause 2.22.8.~~

2.22.8A The IMO must apply to the Economic Regulation Authority to approve the Capital Expenditure for the current Review Period if the budget proposal is likely to result in Capital Expenditure, over the relevant Review Period, being at least 10% greater than the Capital Expenditure approved by the Economic Regulation Authority.

2.22.8B The IMO must endeavour to make an application under clause 2.22.8 or 2.22.8A in sufficient time to allow its budget proposal to be approved under clause 2.22.9 before the commencement of the Financial Year in which it relates. The Economic Regulation Authority may amend a determination under clause 2.22.3(c) if the IMO makes an application under clause 2.22.8 or 2.22.8A. Clause 2.22.3(b) applies in the case of an application made under clause 2.22.8 or 2.22.8A.

2.22.12. The Economic Regulation Authority must take the following into account when determining the IMO's Allowable Revenue and approving Forecast Capital Expenditure or an adjustment to the Allowable Revenue or Forecast Capital Expenditure in accordance with clause 2.22.14 and 2.22.15 of the IMO:

- (a) the Allowable Revenue must be sufficient to cover the forward looking costs of providing the services described in clause 2.22.1 and performing its functions and obligations under these Market Rules in accordance with the following principles:
 - i. recurring expenditure requirements and payments are recovered in the year of the expenditure;
 - ii. Capital Expenditures ~~capital expenditures~~ are to be recovered through the depreciation and amortisation of the assets acquired by the Capital Expenditures ~~capital expenditures~~ in a manner that is consistent with generally accepted accounting principles;
 - iii. costs incurred by the IMO that are related to market establishment, as designated by the Minister, are to be recovered over a period determined by the Minister from Energy Market Commencement; and
 - iv. notwithstanding paragraphs (i), (ii) and (iii), expenditure incurred, and depreciation and amortisation charged, in relation

to any Declared Market Project are to be recovered over the period determined for that Declared Market Project.

- (b) the Allowable Revenue and Forecast Capital Expenditure must include only costs which would be incurred by a prudent provider of the services described in clause 2.22.1, acting efficiently, seeking to achieve the lowest practicably sustainable cost of delivering the services described in clause 2.22.1 in accordance with these Market Rules, while effectively promoting the Wholesale Market Objectives.
- (c) where possible, the Economic Regulation Authority should benchmark the Allowable Revenue and Capital Expenditure against the costs of providing similar services in other jurisdictions.

2.22.13. Subject to clause 2.22.14 and 2.23.13, the IMO may declare a project to be a Declared Market Project if:

- (a) the project involves:
 - i. a major change to a function of the IMO or System Management under these Market Rules; or
 - ii. a major change to any of the computer software or systems that the IMO or System Management uses in the performance of any of its functions under these Market Rules; and
- (b) the IMO estimates that, ~~the cost to implement the change would cause for either the IMO's budget or System Management~~ the sum of:
 - i. the recurring expenditure associated with the change; and
 - ii. the Capital Expenditure required to implement the change

would increase the combined Allowable Revenue determined and Capital Expenditure approved by the Economic Regulation Authority for the current Review Period by more than 10%.

~~'s budgets during the current Review Period to exceed their respective approved Allowable Revenue by more than 15%.~~

2.22.14. Before the IMO commences a Declared Market Project the IMO must obtain approval from the Economic Regulation Authority for an increase in the Allowable Revenue relevant to the Declared Market Project, including the period over which the incremental Allowable Revenue and Capital Expenditure will apply.

2.22.15 During a Review Period, the IMO may seek the approval of an adjustment to its determined Allowable Revenue and approved Forecast Capital Expenditure for that Review Period from the Economic Regulation Authority for each of the services described in clause 2.22.1 in accordance with the following:

- (a) the Economic Regulation Authority may, but is not required to, engage in public consultation before making a determination under clause 2.22.15; and
- (b) a determination under clause 2.22.15 is binding on the Economic Regulation Authority, but a decision not to make such a determination creates no presumption that future expenditure will not meet the relevant criteria under clause 2.22.12(b).

2.23.3. For each Review Period, System Management must seek the approval of its Allowable Revenue and Forecast Capital Expenditure from the Economic Regulation Authority in accordance with the following:

- (a) by 30 November of the year prior to the start of the Review Period, System Management must submit a proposal for its Allowable Revenue and Forecast Capital Expenditure ~~costs~~ over the Review Period;
- (b) the Economic Regulation Authority must undertake a public consultation process in approving System Management's Allowable Revenue and Forecast Capital Expenditure for a Review Period, which must include publishing an issues paper and issuing an invitation for public submissions; and
- (c) by 31 March of the year in which the Review Period commences, the Economic Regulation Authority must determine System Management's the Allowable Revenue and approve the Forecast Capital Expenditure of System Management for the Review Period for the services described in clause 2.23.1.

2.23.4. Where the Economic Regulation Authority does not make a determination by the date specified in clause 2.23.3(c), the Allowable Revenue and Capital Expenditure from the previous Review Period, or the budget determined by the Shareholding Minister under clause 2.33.1, as applicable, will continue to apply until the Economic Regulation Authority makes a determination.

2.23.5. Following the first determination of System Management's ~~the~~ Allowable Revenue ~~of System Management~~ by the Economic Regulation Authority in accordance with clause 2.23.3, by 30 April each year System Management must prepare a budget proposal for the services described in clause 2.23.1 for the coming Financial Year.

2.23.8. System Management must apply to the Economic Regulation Authority to determine Allowable Revenue for the current Review Period if, Where taking into account any adjustment under clause 2.23.7, the budget proposal is likely to result in revenue recovery, over the relevant Review Period, being at least 10% more than 15% greater than the Allowable Revenue determined by the Economic Regulation Authority.

~~, System Management must apply to the Economic Regulation Authority to reassess the Allowable Revenue. System Management must endeavour to make such an application in sufficient time to meet its obligation under clause 2.23.9. The Economic Regulation Authority may amend a determination under clause 2.23.3(c) if System Management makes an application under this clause 2.23.8. Clause 2.23.3(b) applies in the case of an application under this clause 2.23.8.~~

2.23.8A System Management must apply to the Economic Regulation Authority to approve the Capital Expenditure for the current Review Period if the budget proposal is likely to result in Capital Expenditure, over the relevant Review Period, being at least 10% greater than the Capital Expenditure approved by the Economic Regulation Authority.

2.23.8B System Management must endeavour to make an application under clauses 2.23.8 or 2.23.8A in sufficient time to meet its obligations under clause 2.23.9. The Economic Regulation Authority may amend a determination under clause 2.23.3(c) if System Management makes an application under clauses 2.23.8 or 2.23.8A. Clause 2.23.3(b) applies in the case of an application under clauses 2.23.8 and 2.23.8A.

2.23.9. System Management must provide a copy of its budget proposal to the IMO by 30 April each year. The IMO must review the budget proposal and submit a report containing advice on whether System Management's budget is consistent with the Allowable Revenue and Capital Expenditure approved ~~determined~~ by the Economic Regulation Authority, including the reasons why, to the Minister by 31 May.

2.23.12. The Economic Regulation Authority must take the following into account when determining System Management's the Allowable Revenue of System Management and approving Forecast Capital Expenditure or an adjustment to the Allowable Revenue or Forecast Capital Expenditure in accordance with 2.23.13 and 2.23.14:

- (a) the Allowable Revenue must be sufficient to cover the forward looking costs of providing the services described in clause 2.23.1 and performing its functions and obligations under these Market Rules in accordance with the following principles:
 - i. recurring expenditure requirements and payments are recovered in the year of the expenditure;
 - ii. Capital Expenditures ~~capital expenditures~~ are to be recovered through the depreciation and amortisation of the assets acquired by the Capital Expenditures ~~capital expenditures~~ in a manner that is consistent with generally accepted accounting principles;

- iii. costs incurred by System Management that are related to market establishment, as designated by the Minister, are to be recovered over a period determined by the Minister from Energy Market Commencement; and
 - iv. notwithstanding paragraphs (i), (ii) and (iii), expenditure incurred, and depreciation and amortisation charged, in relation to any Declared Market Project are to be recovered over the period determined for that Declared Market Project.
- (b) the Allowable Revenue and Capital Expenditure must include only costs which would be incurred by a prudent provider of the services described in clause 2.23.1, acting efficiently, in accordance with good electricity industry practice, seeking to achieve the lowest practicably sustainable cost of delivering the services described in clause 2.23.1 in accordance with these Market Rules, while effectively promoting the Wholesale Market Objectives; and
- (c) where possible, the Economic Regulation Authority should benchmark the Allowable Revenue against the costs of providing similar services in other jurisdictions.

2.23.13 Before System Management commences a Declared Market Project System Management must obtain approval from the Economic Regulation Authority for an increase in the Capital Expenditure relevant to the Declared Market Project, including the period over which the incremental Allowable Revenue and Capital Expenditure will apply.

2.23.14 During a Review Period, System Management may seek the approval of an adjustment to its determined Allowable Revenue and approved Forecast Capital Expenditure for that Review Period from the Economic Regulation Authority for each of the services described in clause 2.23.1 in accordance with the following:

- (a) the Economic Regulation Authority may, but is not required to, engage in public consultation before making a determination under clause 2.23.14; and
- (b) a determination under clause 2.23.14 is binding on the Economic Regulation Authority, but a decision not to make such a determination creates no presumption that future expenditure will not meet the relevant criteria under clause 2.23.12(b).

Glossary

Capital Expenditure: With respect to the IMO, the total Capital Expenditure that the IMO incurs as a result of a capital asset, capital project or capital upgrade of an existing asset for the Review Period. With Respect to System Management, the total Capital Expenditure that System Management incurs as a result of a capital asset, capital project or capital upgrade of an existing asset for the Review Period.

Forecast Capital Expenditure: With respect to the IMO, the predicted sum of Capital Expenditure required for a Review Period. With respect to System Management, the predicted sum of Capital Expenditure for a Review Period.

APPENDIX 1: THE ERA'S RULE CHANGE PROPOSAL

Change Proposal No: RC_2011_02

Received date: 10 March 2011

Change requested by:

Name:	Chris Brown
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Fax:	
Email:	chris.brown@erawa.com.au
Organisation:	Economic Regulation Authority
Address:	
Date submitted:	10 March 2011
Urgency:	2-medium
Change Proposal title:	Reassessment of Allowable Revenue during a Review Period
Market Rules affected:	Clauses 2.22.8, 2.22.13, 2.22.15 (new), 2.23.8 and 2.23.13 (new)

Details of the proposed Market Rule Change

1. Describe the concern with the existing Market Rules that is to be addressed by the proposed Market Rule change:

The Economic Regulation Authority (ERA) has three concerns over the operation of clauses 2.22.8, 2.22.13 and 2.23.8 of the *Wholesale Electricity Market Rules (Market Rules)*, which provide for a reassessment of Allowable Revenue for the Independent Market Operator (IMO) and System Management during a Review Period where an amount of un-forecast expenditure is proposed to be incurred.

First, in their current form, the way in which clauses 2.22.8, 2.22.13 and 2.23.8 of the Market Rules apply to proposed capital expenditures of the IMO and System Management can result in inconsistencies, depending on the timing of the expenditure and the period over which the cost is to be depreciated or amortised, in:

- whether a project of a given total cost meets the criteria for a Declared Market Project (clause 2.22.13); and
- whether a reassessment of approved Allowable Revenue by the ERA is triggered.

As a result of these inconsistencies, capital expenditures made by the IMO and System Management that involve material increases in the market fees² charged to Market Participants may or may not be subject to review by the ERA.

Secondly, the existing threshold value of incremental revenue that acts as a trigger for the declaration of a Declared Market Project (under 2.22.13) and the reassessment of approved Allowable Revenue (under 2.22.8 and 2.23.8) is too high. This creates the

² Market fees in this context can include IMO 'Market Fees' (IMO) and/or System Management 'System Operation Fees'.

potential for material increases in fees to occur without review by the ERA of whether the additional expenditure meets the criteria specified in clauses 2.22.12(b) or 2.23.12(b) of the Market Rules.

Thirdly, the Market Rules do not allow for the IMO or System Management to request that the ERA review a budget proposal that does not automatically trigger such a review under clauses 2.22.8, 2.22.13 and 2.23.8. As a result no mechanism is currently available to resolve uncertainty over whether the budget proposal satisfies the criteria in clause 2.22.12(b) or 2.23.12(b), and there is a risk that the ERA may not approve the associated Allowable Revenue for the next Review Period.

The purpose and operation of the Market Rules for which changes are being proposed

Under the Market Rules, the IMO and System Management submit proposed expenses for the forthcoming three-year Review Period, including capital expenditures, for the purposes of allowing the ERA to determine their respective approved Allowable Revenue. Allowable Revenue is recovered from Market Participants through Market Fees (IMO) or System Operation Fees (System Management).

The Market Rules recognise that budget proposals involving expenditure that was not anticipated by the IMO or System Management at the time that proposed expenses were submitted to the ERA as part of the Revenue Determination process may need to be incurred during a Review Period.

Two provisions in the Market Rules can be used to recover such expenditures through the fees payable by Market Participants.

- Clauses 2.22.7 and 2.23.7 require the IMO or System Management to increase (decrease) revenue from Market Fees or System Operation Fees in the current year's budget when their expenditure in the previous Financial Year was greater than (less than) revenue in that year.
- Clauses 2.22.8 and 2.23.8 provide for the ERA to reassess Allowable Revenue if, taking into account adjustments under 2.22.7 or 2.23.7, revenue recovery for the whole of the Review Period is likely to be greater than 15 per cent of approved Allowable Revenue for the Review Period.

Clauses 2.22.8 and 2.23.8 ensure that expenditure proposals involving a significant departure from approved Allowable Revenue for the Review Period, or a series of expenditure proposals that in aggregate constitute a significant departure from approved Allowable Revenue, are subject to appropriate scrutiny by the ERA. Expenditure proposals are approved only when the ERA considers that the underlying expenditures meet the criteria specified in clauses 2.22.12(b) or 2.23.12(b).

Clause 2.22.13 provides for the IMO to determine that particular capital projects are Declared Market Projects. A Declared Market Project must involve:

- a major change to a function of the IMO or System Management under these Market Rules; or
- a major change to any of the computer software or systems that the IMO or System Management uses in the performance of any of its functions under these Market Rules; and
- an estimated cost to implement the changes would cause either the IMO's budget or System Management's budgets during the current Review Period to exceed their respective approved Allowable Revenue by greater than 15 per cent.

Clause 2.22.14 requires the IMO to receive ERA approval for the incremental Allowable Revenue associated with a Declared Market Project prior to commencing that project.

Declared Market Projects represent significant changes to the operation of the IMO or System Management in the Wholesale Electricity Market (**WEM**), with potential consequences for Market Participants that include the additional fees required to recover the cost of the project, adjustment costs and changes to the competitiveness of the WEM. It is therefore appropriate that the ERA considers the merits of a Declared Market Project, applying the criteria specified in clauses 2.22.12(b) or 2.23.12(b).³

Issue 1 - Inconsistencies in the treatment of capital expenditures

The ERA is concerned that, under the current Market Rules, a budget proposal involving capital expenditure that will result in the IMO or System Management recovering Allowable Revenue in excess of 15 per cent of approved Allowable Revenue for the current Review Period may or may not trigger an assessment of that expenditure by the ERA depending on the timing of the expenditure and the period over which the expenditure is to be depreciated or amortised. These two dependencies are illustrated in Table 1 and Table 2, respectively.

Table 1 illustrates how, for the same capital project, the year in which the project occurs can determine the outcome of the threshold test under either clauses 2.22.8 (for the IMO) or 2.23.8 (for System Management) of the Market Rules.

Table 1. Impact of a capital expenditure – expenditure in different years of a Review Period

	Current Review Period				Next Review Period			
	Year 1	Year 2	Year 3	Total	Year 1	Year 2	Year 3	Total
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Approved Allowable Revenue	25	25	25	75	25	25	25	75
Capital project – incremental revenue								
Scenario 1	5	5	5	15				
Scenario 2		5	5	10	5			5

Under scenario one, the capital project has a cost (expressed as three years of amortisation allowances) of \$15 million, equivalent to 20 per cent of previously approved Allowable Revenue for the current Review Period of \$75 million. The project cost is

³ Clause 2.22.12(b) states "the [IMO] Allowable Revenue must include only costs which would be incurred by a prudent provider of the services described in clause 2.22.1, acting efficiently, seeking to achieve the lowest practicably sustainable cost of delivering the services described in clause 2.22.1 in accordance with these Market Rules, while effectively promoting the Wholesale Market Objectives.". Clause 2.23.12(b) states "the [System Management] Allowable Revenue must include only costs which would be incurred by a prudent provider of the services described in clause 2.23.1, acting efficiently, in accordance with good electricity industry practice, seeking to achieve the lowest practicably sustainable cost of delivering the services described in clause 2.23.1 in accordance with these Market Rules, while effectively promoting the Wholesale Market Objectives..."

written off by depreciation over three years.⁴ The depreciation allowances are recovered through an increase in revenue generated by fees of \$15 million levied on Market Participants over the current Review Period. As revenue raised over the current Review Period is now expected to be greater than 15 per cent of approved Allowable Revenue, a review of the proposed expenditure by the ERA is triggered (under clauses 2.22.8 or 2.23.8, or under 2.22.14 if the project meets the necessary criteria for a Declared Market Project under 2.22.13).

Under scenario two, the project is undertaken in the second year of the current Review Period but is otherwise identical to the project in scenario one. As the additional revenue that will be raised in the current review period is expected to be less than 15 per cent of approved Allowable Revenue, the Market Rules do not trigger a review of the proposed expenditure by the ERA.

The ERA's view is that this outcome is an anomaly and that the year of the Review Period in which a capital expenditure is incurred should have no bearing on whether expenditure triggers a reassessment of Allowable Revenue by the ERA.

As part of the Allowable Revenue determination for the next Review Period, the ERA will review the proposed depreciation allowance in the first year of that triennium and could elect not to approve this expense. However, this would not be a satisfactory outcome as, if the cost were determined to not satisfy the criteria of the Market Rules, a substantial part of the cost would already have been met by Market Participants through market Fees.

Table 2 shows how the length of time over which a capital expenditure is depreciated, or in the case of an intangible asset, amortised, can partly determine the outcome of the threshold test.

Table 2. Impact of a capital expenditure – different depreciation/amortisation periods

	Current Review Period				Next Review Period			
	Year 1	Year 2	Year 3	Total	Year 1	Year 2	Year 3	Total
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Approved Allowable Revenue	25	25	25	75	25	25	25	75
Capital project – incremental revenue								
Scenario 1	5	5	5	15				
Scenario 2	3	3	3	9	3	3		6

Under scenario two the capital expenditure is depreciated over five years, rather than the three years under scenario one. The longer time period under scenario two would be appropriate under the Market Rules as long as it is consistent with generally accepted accounting principles for the depreciation or amortisation of the type of asset being acquired.⁵

⁴ The IMO's and System Management's capital projects predominantly consist of systems enhancements and computer equipment for which a three-year depreciation schedule is consistent with generally accepted accounting standards.

⁵ As required under clauses 2.22.12 (a) ii. and 2.23.12 (a) ii of the Market Rules.

The capital expenditures under both scenarios are of the same amount. However, the longer time period for depreciation under scenario two means that the additional revenue required during the current Review Period is equivalent to only 12 per cent of approved Allowable Revenue. A reassessment of Allowable Revenue by the ERA, or an assessment of the project by the ERA under the rules for Declared Market Projects would not be triggered under this scenario.

The ERA seeks to address these inconsistencies in the treatment of capital expenditures through redrafting clauses 2.22.8, 2.22.13 and 2.23.8 of the Market Rules.

In seeking to rectify these inconsistencies in clauses 2.22.8 (for the IMO) and 2.23.8 (for System Management) of the Market Rules, the ERA has sought to preserve the primary intent of these clauses. In particular, the ERA has sought to ensure that the redrafted clauses will continue to trigger a reassessment of Allowable Revenue when:

- a single budget proposal will result in revenue exceeding the threshold in the Market Rules; or
- the combined revenue associated with more than one budget proposal exceeds the threshold in the Market Rules.

To achieve this outcome the proposed changes to the relevant clauses differentiate between the concepts of capital expenditure and recurring expenditure. In the interest of consistency the ERA has also applied these concepts in the proposed redrafting of clause 2.22.13 of the Market Rules (i.e. regarding the IMO proposing a Declared Market Project).

A capital expenditure refers to expenditure where the benefits are spread across several accounting periods such as the acquisition of new assets and improvements or extensions to existing assets. This term capital expenditure appears in clauses 2.22.12(a)(ii) and 2.23.12(a)(ii) of the Market Rules.

Recurring expenditure requirements consists of expenditure incurred in only one accounting period where the benefit of that expenditure is enjoyed only in that period. It includes depreciation and amortisation expenses that recoup capital expenditures made in previous periods. Recurring expenditure is analogous to the concept of 'recurring expenditure requirements and payments' in clauses 2.22.12(a)(i) and 2.23.12(a)(i) of the Market Rules.

The proposed revised clauses 2.22.8 and 2.23.8 of the Market Rules have been drafted to ensure that it is the capital expenditure that is taken into account in the threshold test, rather than the resulting depreciation (or amortisation) expenses. This eliminates any influence of the timing of the capital expenditure within a Review Period or the time over which that expenditure is depreciated or amortised.

To avoid double counting in the application of the threshold test, the redrafted rules exclude any depreciation or amortisation expenses that will be incurred during the Review Period. These redrafted clauses of the Market Rules also seek to ensure that decisions to capitalise or not capitalise particular expenditures associated with a project cannot influence whether a reassessment of Allowable Revenue is triggered.

The proposed treatment of capital expenditure partly reflects the arrangements set out in clause 6A.7.1 of the *National Electricity Rules* for the reopening of a revenue determination for the capital expenditure of a transmission network service provider. Among other requirements, this clause includes a threshold test that 'the total of the un-forecast capital expenditure required in the regulatory control period must exceed five

per cent of the value of the regulatory asset base of the transmission network service provider in the first year of the relevant regulatory control period’.

Issue 2 - The level of the threshold exceeds the appropriate level for the triggering of a reassessment of Allowable Revenue by the ERA.

In the ERA’s opinion, the 15 per cent threshold specified in clauses 2.22.8, 2.22.13 and 2.23.8 prevents the appropriate degree of scrutiny of proposed changes to the IMO’s and System Management’s costs within a Review Period. Given the current level of the threshold, Market Participants could not be confident that material increases in the market fees they are required to pay reflect costs that meet the principles outlined in clauses 2.22.12(b) and 2.23.12(b) of the Market Rules.

Table 3 shows the dollar value of the 15 per cent threshold under the approved Allowable Revenue for the IMO and System Management for the first and second Review Periods.

Table 3. IMO and System Management Allowable Revenue and reassessment threshold triggers

	IMO		System Management	
	1 st Review Period	2 nd Review Period	1 st Review Period	2 nd Review Period
	\$m	\$m	\$m	\$m
Approved Allowable Revenue	29.7	33.9	14.4	21.2
15 per cent threshold	4.5	5.1	2.2	3.2

The ERA observes that the IMO and System Management were able to manage the variation between actual and approved expenditure to within five per cent of approved Allowable Revenue in the first Review Period. This is in spite of the uncertainty in projected costs submitted to the ERA as part of the assessment of Allowable Revenue for the First Review Period.

The ERA accepts that the appropriate level of the threshold is largely a matter of judgement as to the necessary balance between:

- providing the IMO and System Management with the flexibility to respond to changing circumstances (e.g. cost increases or need for additional expenditure) during a Review Period; and
- providing for accountability of the IMO and System Management to ensure that Allowable Revenue includes only those costs that would be incurred by a prudent provider acting efficiently, seeking to achieve the lowest practicably sustainable cost of delivering the required services, while effectively promoting the wholesale market objectives.

The ERA proposes that the threshold increase in revenue for a Review Period should be reduced to ten per cent of approved Allowable Revenue for the Review Period. However, the ERA also considers that the views of stakeholders should be sought as to the appropriate level as part of the rule change process.

Issue 3 - The need for a rule providing for a power to request the ERA to review a budget proposal for capital expenditure

The ERA considers that the assessment of proposed capital expenditure against the provisions of clauses 2.22.12(b) and 2.23.12(b) often involves an element of judgement.

As a result, in circumstances where the Market Rules do not create the requirement for the ERA to assess a proposed capital expenditure, the IMO or System Management may elect to delay a project due to the risk that the ERA may not approve the Allowable Revenue recovering depreciation or amortisation expenses in the next Review Period. Capital projects that are consistent with the attainment of the Market Objectives may be delayed as a result.

The inclusion of a clause in the Market Rules allowing the IMO or System Management to request that the ERA review a proposed capital project has a precedent. Section 80 of Part 9 of the *National Gas Rules* provides for the Australian Energy Regulator to make an advance determination with regard to future capital expenditure at the request of a service provider.

2. Explain the reason for the degree of urgency:

The proposed rule changes are considered to be of a moderate level of urgency given that the issues with the existing rules prompting these changes do not put at risk the safe, effective and reliable operation of the WEM. The proposed rule changes cannot reasonably be considered to be of a high level of urgency for this reason.

However, proposals for previously un-forecast capital expenditure may result in either the IMO or System Management incurring depreciation and/or amortisation expenses over a period of time that exceed 15 per cent of allowable revenue in the Review Period in which the capital item is purchased could occur at any time during the current Review Period. In the absence of the proposed rule changes the costs of these capital expenditures may be recovered from Market Participants without the appropriate scrutiny of expenditure by the ERA. The ERA's view is that the potential for this to occur means that the proposed rule changes should not be considered to be of a low level of urgency.

3. Provide any proposed specific changes to particular Rules: (for clarity, please use the current wording of the Rules and place a **strikethrough** where words are deleted and **underline** words added)

2.22.8. Where, taking into account any adjustment under clause 2.22.7, the budget proposal is likely to:

(a) result in revenue recovery, over the ~~relevant current~~ Review Period, ~~more than 15%~~ at least 10% greater than the Allowable Revenue determined by the Economic Regulation Authority; ~~or~~

(b) result in a sum of capital expenditures and recurring expenditures such that if:

i. depreciation and amortisation expenses in the current Review Period recovering the capital expenditures are subtracted from recurring expenditures; and

ii. the capital expenditures were to be fully recovered in the current Review Period;

then revenue recovery would be at least 10% greater than the Allowable Revenue determined by the Economic Regulation Authority,

the IMO must apply to the Economic Regulation Authority to reassess the Allowable Revenue. The IMO must endeavour to make such an application in sufficient time to allow its budget proposal to be approved under clause 2.22.9 before the commencement of the Financial Year to which it relates. The Economic Regulation Authority may amend a determination under clause 2.22.3(c) if the IMO makes an application under this clause 2.22.8. Clause 2.22.3(b) applies in the case of an application under this clause 2.22.8.

...

2.22.13. Subject to clause 2.22.14, the IMO may declare a project to be a Declared Market Project if:

- (a) the project involves:
 - i. a major change to a function of the IMO or System Management under these Market Rules; or
 - ii. a major change to any of the computer software or systems that the IMO or System Management uses in the performance of any of its functions under these Market Rules; and

(b) the IMO estimates ~~that the cost~~ a sum of capital expenditures and recurring expenditures required by the IMO or System Management to implement the changes such that if:

- i. depreciation and amortisation expenses in the current Review Period recovering the capital expenditures of the Declared Market Project are subtracted from recurring expenditures; and
- ii. the capital expenditures of the Declared Market Project were to be fully recovered in the current Review Period;

would cause either the IMO's budget or System Management's budgets during the current Review period to exceed their respective approved Allowable Revenue by ~~more than 15%~~ at least 10%.

...

2.22.15 During a Review Period, the IMO may seek the approval of an adjustment of its approved Allowable Revenue for that Review Period from the Economic Regulation Authority for each of the services described in clause 2.22.1 in accordance with the following:

(a) the Economic Regulation Authority may, on application by the IMO under clause 2.22.15, make a determination to the effect that, if capital expenditure is made in accordance with a proposal made by the IMO and specified in the determination, then approved Allowable Revenue for the relevant Review Period is increased by an amount equal to the associated depreciation or amortisation expenses over the Review Period;

(b) any proposal under clause 2.22.15 must include only costs which would be incurred by a prudent provider of the services described in clause 2.22.1, acting efficiently, seeking to achieve the lowest practicably sustainable cost of delivering the services described in

clause 2.22.1 in accordance with these Market Rules, while effectively promoting the Wholesale Market Objectives;

(c) the Economic Regulation Authority may, but is not required to, engage in public consultation before making a determination under clause 2.22.15; and

(d) a determination under clause 2.22.15 is binding on the Economic Regulation Authority, but a decision not to make such a determination creates no presumption that future expenditure will not meet the relevant criteria under clause 2.22.15(b).

...

2.23.8. Where, taking into account any adjustment under clause 2.23.7, the budget proposal is likely to:

(a) result in revenue recovery, over the relevant Review Period, more than 45% at least 10% greater than the Allowable Revenue determined by the Economic Regulation Authority; or

(b) result in a sum of capital expenditures and recurring expenditures such that if:

i. depreciation and amortisation expenses in the current Review Period recovering the capital expenditures are subtracted from recurring expenditures; and

ii. the capital expenditures were to be fully recovered in the current Review Period;

then revenue recovery would be at least 10% greater than the Allowable Revenue determined by the Economic Regulation Authority.

System Management must apply to the Economic Regulation Authority to reassess the Allowable Revenue. System Management must endeavour to make such an application in sufficient time to meet its obligation under clause 2.23.9. The Economic Regulation Authority may amend a determination under clause 2.23.3(c) if System Management makes an application under this clause 2.23.8. Clause 2.23.3(b) applies in the case of an application under this clause 2.23.8.

...

2.23.13 During a Review Period, System Management may seek the approval of an adjustment of its approved Allowable Revenue for that Review Period from the Economic Regulation Authority for each of the services described in clause 2.23.1 in accordance with the following:

(a) the Economic Regulation Authority may, on application by System Management under clause 2.23.13, make a determination to the effect that, if capital expenditure is made in accordance with a proposal made by System Management and specified in the determination, then approved Allowable Revenue for the relevant Review Period is increased by an amount equal to the associated depreciation or amortisation expenses over the Review Period;

- (b) any proposal under clause 2.23.13 must include only costs which would be incurred by a prudent provider of the services described in clause 2.23.1, acting efficiently, in accordance with good electricity industry practice, seeking to achieve the lowest practicably sustainable cost of delivering the services described in clause 2.23.1 in accordance with these Market Rules, while effectively promoting the Wholesale Market Objectives;
- (c) the Economic Regulation Authority may, but is not required to, engage in public consultation before making a determination under clause 2.22.13; and
- (d) a determination under clause 2.23.13 is binding on the Economic Regulation Authority, but a decision not to make such a determination creates no presumption that future expenditure will not meet the relevant criteria under clause 2.23.13(b).

4. Describe how the proposed Market Rule change would allow the Market Rules to better address the Wholesale Market Objectives:

The objectives of the market defined in section 1.2.1 of the Market Rules are:

- a) to promote the economically efficient, safe and reliable production and supply of electricity and electricity related services in the South West interconnected system;
- b) to encourage competition among generators and retailers in the South West interconnected system, including by facilitating efficient entry of new competitors;
- c) to avoid discrimination in that market against particular energy options and technologies, including sustainable energy options and technologies such as those that make use of renewable resources or that reduce overall greenhouse gas emissions;
- d) to minimise the long-term cost of electricity supplied to consumers from the South West interconnected system; and
- e) to encourage the taking of measures to manage the amount of electricity used and when it is used.

The ERA's view is that the proposed rule changes will:

- promote the economically efficient production and supply of electricity and electricity related services in the South West interconnected system by helping to ensure that proposed significant capital expenditures of the IMO and System Management during a Review Period are assessed by the ERA in the same manner as capital expenditures that are part of proposed costs for the three-yearly Allowable Revenue Determination.
- contribute to the minimisation of the long-term cost of electricity supplied to consumers from the SWIS by increasing the level of scrutiny of costs incurred by the IMO and System Management that are ultimately passed on to consumers by Market Participants.

The ERA is of the view that the proposed changes will not reduce the extent to which the Market Rules address the other objectives of the WEM.

5. Provide any identifiable costs and benefits of the change:

The ERA notes that the costs and benefits of the changes being proposed are difficult to quantify.

The only direct cost resulting from these changes are the costs associated with the preparation of a proposal by the IMO or System Management and the ERA's assessment of those proposals.

In practice, the information that the ERA requires to make an assessment of a proposed expenditure is the same information that should be prepared to inform Board or senior management consideration of such proposals. On this basis, we would not anticipate that the proposed rule changes would add materially to the costs incurred by the IMO or System Management.

Overall, we consider that the additional direct costs would be no more than a few tens of thousands of dollars for the most complex capital expenditure proposals. The bulk of these costs would be incurred by the ERA.

APPENDIX 2: ADDITIONAL AMENDMENTS MADE BY THE IMO FOLLOWING THE FIRST SUBMISSION PERIOD

The IMO has made some amendments to the Amending Rules following its assessment of the first submission period responses. These changes are as follows (~~deleted text~~, added text):

- 2.22.3. For the Review Period, the IMO must seek the approval of its Allowable Revenue and Forecast Capital Expenditure from the Economic Regulation Authority for each of the services described in clause 2.22.1 in accordance with the following:
- (a) by 30 November of the year prior to the start of the Review Period, the IMO must submit a proposal for its Allowable Revenue and Forecast Capital Expenditure over the Review Period;
 - (b) the Economic Regulation Authority must undertake a public consultation process in approving the IMO's Allowable Revenue and Forecast Capital Expenditure ~~for the IMO~~ for a Review Period, which must include publishing an issues paper and issuing an invitation for public submissions; and
 - (c) by 31 March of the year in which the Review Period commences, the Economic Regulation Authority must determine the IMO's Allowable Revenue and approve the Forecast Capital Expenditure of the IMO for the Review Period for each of the services described in clause 2.22.1.
- 2.22.4. Where the Economic Regulation Authority does not make a determination by the date specified in clause 2.22.3(c), the Allowable Revenue and Capital Expenditure from the previous Review Period, or the budget determined by the Minister under clause 2.22.2, as applicable, will continue to apply until the Economic Regulation Authority makes a determination.
- 2.22.6. Following the first determination of the IMO's Allowable Revenue ~~of the IMO~~ by the Economic Regulation Authority under clause 2.22.3 and subject to clauses 2.22.7 and 2.22.8, the budget proposal must be consistent with the Allowable Revenue determined by the Economic Regulation Authority for the relevant Review Period.
- 2.22.8. The IMO must apply to the Economic Regulation Authority to determine the IMO's Allowable Revenue for the current Review Period if, ~~Where,~~ taking into account any adjustment under clause 2.22.7, the budget proposal is likely to:
- ~~(a) result in revenue recovery, over the current Review Period, being at least 10% greater than the Allowable Revenue determined by the Economic Regulation Authority; ~~or~~~~
 - ~~(b) result in a sum of capital expenditures and recurring expenditures such that if:~~

- i. ~~depreciation and amortisation expenses in the current Review Period recovering the capital expenditures are subtracted from recurring expenditures; and~~
- ii. ~~the capital expenditures were to be fully recovered in the current Review Period;~~

~~then revenue recovery would be at least 10% greater than the Allowable Revenue determined by the Economic Regulation Authority,~~

~~the IMO must apply to the Economic Regulation Authority to reassess the Allowable Revenue. The IMO must endeavour to make such an application in sufficient time to allow its budget proposal to be approved under clause 2.22.9 before the commencement of the Financial Year to which it relates. The Economic Regulation Authority may amend a determination under clause 2.22.3(c) if the IMO makes an application under this clause 2.22.8. Clause 2.22.3(b) applies in the case of an application under this clause 2.22.8.~~

2.22.8A The IMO must apply to the Economic Regulation Authority to approve the Capital Expenditure for the current Review Period if the budget proposal is likely to result in Capital Expenditure, over the relevant Review Period, being at least 10% greater than the Capital Expenditure approved by the Economic Regulation Authority.

2.22.8B The IMO must endeavour to make an application under clause 2.22.8 or 2.22.8A in sufficient time to allow its budget proposal to be approved under clause 2.22.9 before the commencement of the Financial Year in which it relates. The Economic Regulation Authority may amend a determination under clause 2.22.3(c) if the IMO makes an application under clause 2.22.8 or 2.22.8A. Clause 2.22.3(b) applies in the case of an application made under clause 2.22.8 or 2.22.8A.

2.22.12. The Economic Regulation Authority must take the following into account when determining the IMO's Allowable Revenue and approving Forecast Capital Expenditure or an adjustment to the Allowable Revenue or Forecast Capital Expenditure in accordance with clause 2.22.14 and 2.22.15 of the IMO:

- (a) the Allowable Revenue must be sufficient to cover the forward looking costs of providing the services described in clause 2.22.1 and performing its functions and obligations under these Market Rules in accordance with the following principles:
 - i. recurring expenditure requirements and payments are recovered in the year of the expenditure;
 - ii. Capital Expenditures ~~capital expenditures~~ are to be recovered through the depreciation and amortisation of the assets acquired by the Capital Expenditures ~~capital expenditures~~ in a manner that is consistent with generally accepted accounting principles;

- iii. costs incurred by the IMO that are related to market establishment, as designated by the Minister, are to be recovered over a period determined by the Minister from Energy Market Commencement; and
- iv. notwithstanding paragraphs (i), (ii) and (iii), expenditure incurred, and depreciation and amortisation charged, in relation to any Declared Market Project are to be recovered over the period determined for that Declared Market Project.

(b) the Allowable Revenue and Forecast Capital Expenditure must include only costs which would be incurred by a prudent provider of the services described in clause 2.22.1, acting efficiently, seeking to achieve the lowest practicably sustainable cost of delivering the services described in clause 2.22.1 in accordance with these Market Rules, while effectively promoting the Wholesale Market Objectives.

(c) where possible, the Economic Regulation Authority should benchmark the Allowable Revenue and Capital Expenditure against the costs of providing similar services in other jurisdictions.

2.22.13. Subject to clause 2.22.14 and 2.23.13, the IMO may declare a project to be a Declared Market Project if:

- (a) the project involves:
 - i. a major change to a function of the IMO or System Management under these Market Rules; or
 - ii. a major change to any of the computer software or systems that the IMO or System Management uses in the performance of any of its functions under these Market Rules; and

(b) the IMO estimates ~~that, for either a sum of capital expenditures and recurring expenditures required by the IMO or System Management to implement the changes such that if~~ the sum of:

- i. the recurring expenditure associated with the change depreciation and amortisation expenses in the current Review Period recovering the capital expenditures of the Declared Market Project are subtracted from recurring expenditures; and
- ii. the Capital Expenditure required to implement the change the capital expenditures of the Declared Market Project were to be fully recovered in the current Review Period;

would increase the combined Allowable Revenue determined and Capital Expenditure approved by the Economic Regulation Authority for the current Review Period by more than ~~cause either the IMO's budget or System Management's budgets during the current Review period to exceed their respective approved Allowable Revenue by at least 10%.~~

- 2.22.14. Before the IMO commences a Declared Market Project the IMO must obtain approval from the Economic Regulation Authority for an increase in the Allowable Revenue relevant to the Declared Market Project, including the period over which the incremental Allowable Revenue and Capital Expenditure will apply.
- 2.22.15 During a Review Period, the IMO may seek the approval of an adjustment of its ~~determined~~ approved Allowable Revenue and approved Forecast Capital Expenditure for that Review Period from the Economic Regulation Authority for each of the services described in clause 2.22.1 in accordance with the following:
- ~~(a)~~ ~~the Economic Regulation Authority may, on application by the IMO under clause 2.22.15, make a determination to the effect that, if capital expenditure is made in accordance with a proposal made by the IMO and specified in the determination, then approved Allowable Revenue for the relevant Review Period is increased by an amount equal to the associated depreciation or amortisation expenses over the Review Period;~~
 - ~~(b)~~ ~~any proposal under clause 2.22.15 must include only costs which would be incurred by a prudent provider of the services described in clause 2.22.1, acting efficiently, seeking to achieve the lowest practicably sustainable cost of delivering the services described in clause 2.22.1 in accordance with these Market Rules, while effectively promoting the Wholesale Market Objectives;~~
 - ~~(ea)~~ the Economic Regulation Authority may, but is not required to, engage in public consultation before making a determination under clause 2.22.15; and
 - ~~(eb)~~ a determination under clause 2.22.15 is binding on the Economic Regulation Authority, but a decision not to make such a determination creates no presumption that future expenditure will not meet the relevant criteria under clause 2.22.125(b).
- 2.23.3. For each Review Period, System Management must seek the approval of its Allowable Revenue and Forecast Capital Expenditure from the Economic Regulation Authority in accordance with the following:
- (a) by 30 November of the year prior to the start of the Review Period, System Management must submit a proposal for its Allowable Revenue and Forecast Capital Expenditure ~~costs~~ over the Review Period;
 - (b) the Economic Regulation Authority must undertake a public consultation process in approving System Management's Allowable Revenue and Forecast Capital Expenditure for a Review Period, which must include publishing an issues paper and issuing an invitation for public submissions; and

(c) by 31 March of the year in which the Review Period commences, the Economic Regulation Authority must determine System Management's the Allowable Revenue and approve the Forecast Capital Expenditure of System Management for the Review Period for the services described in clause 2.23.1.

2.23.4. Where the Economic Regulation Authority does not make a determination by the date specified in clause 2.23.3(c), the Allowable Revenue and Capital Expenditure from the previous Review Period, or the budget determined by the Shareholding Minister under clause 2.33.1, as applicable, will continue to apply until the Economic Regulation Authority makes a determination.

2.23.5. Following the first determination of System Management's the Allowable Revenue of System Management by the Economic Regulation Authority in accordance with clause 2.23.3, by 30 April each year System Management must prepare a budget proposal for the services described in clause 2.23.1 for the coming Financial Year.

2.23.8. System Management must apply to the Economic Regulation Authority to determine Allowable Revenue for the current Review Period if, Where, taking into account any adjustment under clause 2.23.7, the budget proposal is likely to:

(a) — result in revenue recovery, over the relevant Review Period, being at least 10% greater than the Allowable Revenue determined by the Economic Regulation Authority; ~~or~~

(b) — result in a sum of capital expenditures and recurring expenditures such that if:

i. — depreciation and amortisation expenses in the current Review Period recovering the capital expenditures are subtracted from recurring expenditures; and

ii. — the capital expenditures were to be fully recovered in the current Review Period;

~~then revenue recovery would be at least 10% greater than the Allowable Revenue determined by the Economic Regulation Authority,~~

~~System Management must apply to the Economic Regulation Authority to reassess the Allowable Revenue. System Management must endeavour to make such an application in sufficient time to meet its obligation under clause 2.23.9. The Economic Regulation Authority may amend a determination under clause 2.23.3(c) if System Management makes an application under this clause 2.23.8. Clause 2.23.3(b) applies in the case of an application under this clause 2.23.8.~~

2.23.8A System Management must apply to the Economic Regulation Authority to approve the Capital Expenditure for the current Review Period if the budget proposal is likely to result in Capital Expenditure, over the relevant Review

Period, being at least 10% greater than the Capital Expenditure approved by the Economic Regulation Authority.

2.23.8B System Management must endeavour to make an application under clauses 2.23.8 or 2.23.8A in sufficient time to meet its obligations under clause 2.23.9. The Economic Regulation Authority may amend a determination under clause 2.23.3(c) if System Management makes an application under clauses 2.23.8 or 2.23.8A. Clause 2.23.3(b) applies in the case of an application under clauses 2.23.8 and 2.23.8A.

2.23.9. System Management must provide a copy of its budget proposal to the IMO by 30 April each year. The IMO must review the budget proposal and submit a report containing advice on whether System Management's budget is consistent with the Allowable Revenue and Capital Expenditure approved ~~determined~~ by the Economic Regulation Authority, including the reasons why, to the Minister by 31 May.

2.23.12. The Economic Regulation Authority must take the following into account when determining System Management's the Allowable Revenue of System Management and approving Forecast Capital Expenditure or an adjustment to the Allowable Revenue or Forecast Capital Expenditure in accordance with 2.23.13 and 2.23.14:

- (a) the Allowable Revenue must be sufficient to cover the forward looking costs of providing the services described in clause 2.23.1 and performing its functions and obligations under these Market Rules in accordance with the following principles:
 - i. recurring expenditure requirements and payments are recovered in the year of the expenditure;
 - ii. Capital Expenditures ~~capital expenditures~~ are to be recovered through the depreciation and amortisation of the assets acquired by the Capital Expenditures ~~capital expenditure~~ in a manner that is consistent with generally accepted accounting principles;
 - iii. costs incurred by System Management that are related to market establishment, as designated by the Minister, are to be recovered over a period determined by the Minister from Energy Market Commencement; and
 - iv. notwithstanding paragraphs (i), (ii) and (iii), expenditure incurred, and depreciation and amortisation charged, in relation to any Declared Market Project are to be recovered over the period determined for that Declared Market Project.
- (b) the Allowable Revenue and Capital Expenditure must include only costs which would be incurred by a prudent provider of the services described in clause 2.23.1, acting efficiently, in accordance with good

electricity industry practice, seeking to achieve the lowest practicably sustainable cost of delivering the services described in clause 2.23.1 in accordance with these Market Rules, while effectively promoting the Wholesale Market Objectives; and

- (c) where possible, the Economic Regulation Authority should benchmark the Allowable Revenue against the costs of providing similar services in other jurisdictions.

2.23.13. Before System Management commences a Declared Market Project System Management must obtain approval from the Economic Regulation Authority for an increase in the Capital Expenditure relevant to the Declared Market Project, including the period over which the incremental Allowable Revenue and Capital Expenditure will apply.

2.23.14. During a Review Period, System Management may seek the approval of an adjustment of its determined approved-Allowable Revenue and approved Forecast Capital Expenditure for that Review Period from the Economic Regulation Authority for each of the services described in clause 2.23.1 in accordance with the following:

- ~~(a) the Economic Regulation Authority may, on application by System Management under clause 2.23.13, make a determination to the effect that, if capital expenditure is made in accordance with a proposal made by System Management and specified in the determination, then approved Allowable Revenue for the relevant Review Period is increased by an amount equal to the associated depreciation or amortisation expenses over the Review Period;~~
- ~~(b) any proposal under clause 2.23.13 must include only costs which would be incurred by a prudent provider of the services described in clause 2.23.1, acting efficiently, in accordance with good electricity industry practice, seeking to achieve the lowest practicably sustainable cost of delivering the services described in clause 2.23.1 in accordance with these Market Rules, while effectively promoting the Wholesale Market Objectives;~~
- ~~(ca) the Economic Regulation Authority may, but is not required to, engage in public consultation before making a determination under clause 2.23.142-22-13; and~~
- ~~(cb) a determination under clause 2.23.143 is binding on the Economic Regulation Authority, but a decision not to make such a determination creates no presumption that future expenditure will not meet the relevant criteria under clause 2.23.123(b).~~

Glossary

Capital Expenditure: With respect to the IMO, the total Capital Expenditure that the IMO incurs as a result of a capital asset, capital project or capital upgrade of an existing asset for the Review Period. With Respect to System Management, the total Capital

Expenditure that System Management incurs as a result of a capital asset, capital project or capital upgrade of an existing asset for the Review Period.

Forecast Capital Expenditure: With respect to the IMO, the predicted sum of Capital Expenditure required for a Review Period. With respect to System Management, the predicted sum of Capital Expenditure for a Review Period.