

The background of the lower half of the page is a photograph of a wind farm and power lines, overlaid with a semi-transparent blue filter. On the left, several large white wind turbines are visible, their blades extending outwards. On the right, a tall, lattice-structured power transmission tower stands prominently. The overall scene is set against a clear sky.

Independent Market Operator

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

RC_2011_02

Standard Rule Change Process

Date: 5 April 2012

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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.

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.
- During the first submission period, 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. Further consultation was held with ERA and System Management to clarify new terms defined in the Amending Rules.
- During the second submission period, a submission was received from System Management. System Management reiterated its support for the Rule Change Proposal. System Management listed issues around the IMO's discretion on declaring a Declared Market Project, the potential inconsistent usage of Capital Expenditure and Forecast Capital Expenditure and the timeframes for ERA's determination on System Management's budget proposal.

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 Board's Decision

The IMO Board's decision is to accept the Rule Change Proposal as modified following the first and second submission periods.

Next steps

The Amending Rules resulting from RC_2011_02 will commence on 1 July 2013 in line with the next Review Period, with the exception of the requirement for the IMO and System

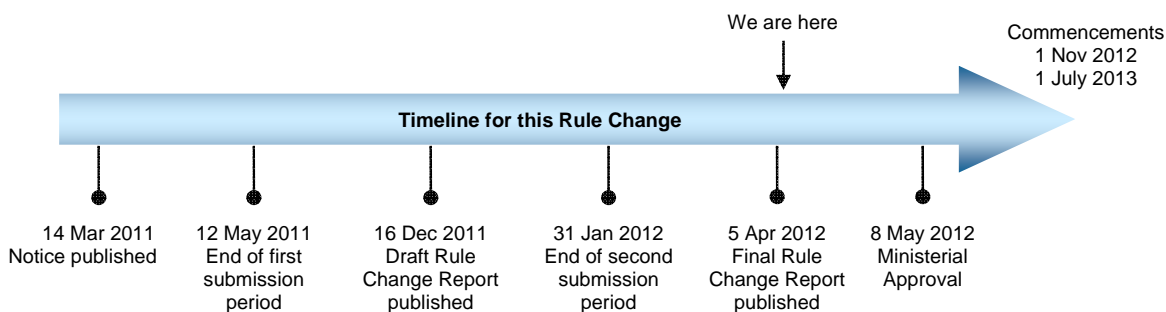


Management to submit Forecast Capital Expenditures for the 2013/14 to 2015/16 Review Period which will commence 1 November 2012 to facilitate the IMO's and System Management's Allowable Revenue submissions to the ERA on 30 November 2012.

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 was processed using the Standard Rule Change Process, described in section 2.7 of the Market Rules. In accordance with clause 2.5.10, the IMO extended the time frame for publishing the Draft Rule Change Report to allow the IMO Board sufficient time to finalise its decision for this Rule Change Proposal. In accordance with clause 2.7.6, the Draft Rule Change report was published on 16 December 2011 and submissions were invited for the second submission period with the closing date being 31 January 2012. A submission was received from System Management. Further details are available on the IMO website. In accordance with clause 2.5.10 of the Market Rules, the IMO extended the time frame for publishing the Final Rule Change Report to allow the IMO Board sufficient time to complete the review process for this Rule Change Proposal. The key dates in processing this Rule Change Proposal are:



2. PROPOSED AMENDMENTS

2.1 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.

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



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.

For full details of the Rule Change Proposal please refer to the IMO Website: http://www.imowa.com.au/RC_2011_02

2.2 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.

3. CONSULTATION

3.1 The 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. The Pre Rule Change Discussion Paper was discussed by the Market Advisory Committee at this 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 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

The ERA formally submitted the Rule Change Proposal on 10 March 2011. The IMO published a notice calling for submissions on 14 March 2011.

Full minutes of the discussion held with MAC members can be accessed at http://www.imowa.com.au/MAC_36.

3.2 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. A copy of all submissions in full received during the first submission period is available on the following IMO Web Page: http://www.imowa.com.au/RC_2011_02

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.

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

In response to submissions, the IMO made changes to the proposed Amending Rules to allow for the ERA to approve a capital expenditure amount for the review period instead of the depreciated or amortised expense. The IMO further proposed that for future Review Periods, the IMO and System Management must seek ERA approval for both its Allowable Revenue and total Capital Expenditure.

The IMO's response to submissions received during the first submission period are detailed in a tabular form in the Draft Rule Change Report available on the following IMO Web Page: http://www.imowa.com.au/RC_2011_02



3.4 Submissions received during the second submission period

Following publication of the Draft Rule Change Report, the second submission period was between 15 December 2011 and 31 January 2012.

The IMO received one submission from System Management. System Management reiterated its support for the Rule Change Proposal. System Management listed issues around the IMO's discretion on declaring a Declared Market Project, the potential inconsistent usage of Capital Expenditure and Forecast Capital Expenditure and the timeframes for ERA's determination on System Management's budget proposal.

A copy of System Management's submission in full is available on the following IMO Web Page: http://www.imowa.com.au/RC_2011_02

3.5 The IMO's response to submissions received during the second submission period

The IMO's responses to submissions are detailed in Appendix 1 of this Final Rule Change Report.

3.6 Public Forums and Workshops

No public forums and workshops were held in relation to this Rule Change proposal.

4. THE IMO'S DRAFT ASSESSMENT

The IMO's draft assessment, against clauses 2.4.2 and 2.4.3 of the Market Rules, and analysis of the Rule Change Proposal can be viewed in the Draft Rule Change Report (available on the IMO's website). After closure of the first submission period, further consultation was undertaken with the ERA and System Management. Details of the consultation are available in the Draft Rule Change Report on the following IMO Web Page: http://www.imowa.com.au/RC_2011_02

5. THE IMO BOARD'S PROPOSED DECISION

The IMO Board's proposed decision was to accept the Rule Change Proposal as modified by the amendments outlined in section 5.1 of the Draft Rule Change Report.

The IMO Board noted 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 had concerns that this reduced threshold may impact on its ability to independently govern the IMO. While the IMO Board supported the proposed adoption of the Rule Change Proposal as modified in this report, it wished 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. No submissions were received in response to this specific request by the IMO Board.

The wording of the relevant Amending Rules was presented in section 7 of the Draft Rule Change Report.



The IMO Board 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 also noted 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.

However, the IMO considered that there was insufficient evidence available to indicate a need for these enhancements at that time.

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

6. THE IMO'S FINAL ASSESSMENT

In preparing its Final 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 in respect of this Rule Change nor has it commissioned a technical review in respect of this Rule Change Proposal. A summary of the views expressed in submissions and by the MAC is available in section 3 of this Final Rule Change Report.



Details of the IMO Board's consideration of the Allowable Revenue threshold is presented in section 6.1 of this report. The additional amendments to the Amending Rules from those presented in the Draft Rule Change Report that have been made by the IMO are presented in section 6.2 below. The IMO's assessment of the Rule Change Proposal, inclusive of the further amendments made following the first and second submission periods, is outlined in the following sub-sections.

6.1 The IMO Board's consideration of the Allowable Revenue Threshold

In considering the Draft Rule Change Report for RC_2011_02 the IMO Board noted the discussion during the March 2011 MAC meeting, that the proposed 10% threshold of approved Allowable Revenue included in this rule change might prove too restrictive for the IMO and System Management in the future.

In the Draft Rule Change Report the IMO Board sought the views of interested parties on the potential impacts that the lower threshold may impose on the IMO with regard to the ability of the Independent Board of the IMO to manage the budget. The IMO received no feedback on this matter during the second submission period.

In considering the Final Rule Change Report for RC_2011_02 the IMO Board has concluded that the lowering of the threshold from 15% to 10% for Allowable Revenue was unnecessary and may impede the Independent Board of the IMO to manage the budget and operations of the IMO.

In making this assessment, the IMO Board notes that the rule change includes:

- the ERA's Allowable Revenue approval now extended to Forecast Capital Expenditure;
- introducing a 10% threshold over Forecast Capital Expenditure whereby the IMO must apply to the ERA to approve an adjusted Forecast Capital Expenditure;
- the lowering of the hurdle for declaring a Declared Market Project to 10% of the sum of Allowable Revenue and Forecast Capital Expenditure approved by the ERA; and
- the strengthening of the relationship between the capital costs required to implement a Declared Market Project and the Allowable Revenue and Forecast Capital Expenditure approved by the ERA.

The IMO Board further notes that these changes significantly enhanced the governance over an approval of the IMO's and System Management's budgets and would appear to address the ERA's concerns with regard to the Market Evolution Project (MEP) not qualifying as a Declared Market Project.

The proposed Amending Rules have been modified to reflect the retention of the 15% threshold over Allowable Revenue whereby the IMO and System Management are required to apply to the ERA to reassess the Allowable Revenue.

6.2 Additional Amendments to the Amending Rules

Following the second submission period and the IMO Board's final assessment, the IMO has made some additional changes to the proposed Amending Rules to:



- Reflect suggestions received during the second submission period;
- Reflect further deliberations of the IMO Board, as presented in section 6.1 of this report; and
- Incorporate a number of minor and typographical amendments to improve the overall integrity of the Amending Rules

The further changes the IMO made to the Amending Rules, as were presented in the Draft Rule Change Report, are outlined in detail in Appendix 2 of this Final Rule Change Report.

6.3 Wholesale Market Objectives

The IMO considers that the Market Rules as a whole, if amended as presented in Section 6.1, will 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 IMO and System Management perform their services efficiently and do not incur excessive or unnecessary costs. 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 IMO considers that the proposed amendments will increase the level of scrutiny applied to the costs incurred by the IMO and System Management, reducing the risk of 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).

6.4 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.



7. THE IMO BOARD'S FINAL DECISION

Based on the matters set out in this report, the IMO Board's final decision is to accept the Rule Change Proposal as modified following the first and second submission periods.

7.1 Reasons for the IMO Board's Decision

The IMO Board 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;
- will ensure that the IMO Board can manage the budget and operations of the IMO;
- enhance the governance over the approval of the IMO's and System Management's budgets; and
- have the in principle support of submissions received during the first and second submission period.

Additional detail outlining the analysis behind the IMO Board's decision is outlined in section 5 and 6 of this Final Rule Change Report.

8. AMENDING RULES

8.1 Commencement

The majority of the amendments to the Market Rules resulting from this Rule Change Proposal will commence at **8:00 am** on 1 July 2013 with the exception of clauses 2.22.3; 2.22.4; 2.22.6; 2.22.12; 2.23.3; 2.23.4; 2.23.5; 2.23.9; 2.23.12 and the Glossary which will commence on 1 November 2012.

8.2 Amending Rules

The IMO Board has decided to implement the following Amending 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. 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 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 adjusted Forecast 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 clauses 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 clauses 2.22.8 or 2.22.8A. Clause 2.22.3(b) applies in the case of an application made under clauses 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 a reassessment to the Allowable Revenue or Forecast Capital Expenditure in accordance with clauses 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~~ clauses 2.22.12(a)(i), 2.22.12(a)(ii) and 2.22.12(a)(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 Forecast Capital Expenditure against the costs of providing similar services in other jurisdictions.

2.22.13. Subject to clauses 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 Forecast Capital Expenditure required to implement the change would be greater than the sum of Allowable Revenue determined and Forecast 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 Forecast 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. 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 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 adjusted Forecast 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 Forecast 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 a reassessment to the Allowable Revenue or Forecast Capital Expenditure in accordance with clauses 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~~ clauses 2.23.12(a)(i), 2.23.12(a)(ii) and 2.23.12(a)(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 2.23.1, 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 and Forecast Capital Expenditure 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 Forecast Capital Expenditure relevant to the Declared Market Project, including the period over which the incremental Allowable Revenue and Forecast 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 required for a Review Period.



APPENDIX 1: RESPONSES TO SUBMISSIONS RECEIVED DURING THE SECOND SUBMISSION PERIOD

	Submitter	Comment/Change requested	IMO Response
1	System Management	The IMO's authority to declare a project to be a Declared Market Project in accordance with clause 2.22.13 is discretionary even if all the criteria within clause 2.22.13 are met. To improve the integrity of the process associated with the application of the discretion under clause 2.22.13, consideration should be given to providing clarification in the Market Rules of the circumstances under which the IMO should or should not exercise this discretion (this could be done by exception).	The IMO notes this concern. However, the IMO highlights that the issues listed in this Rule Change Proposal do not relate to the IMO's ability to exercise discretion regarding declaring a Declared Market Project. The clauses relating to declaring a Declared Market Project remain unchanged. Additionally, the IMO notes that it is not possible to anticipate all of the specific circumstances under which the IMO would declare (or not declare) a Declared Market Project and so does not consider that further consideration of this matter is warranted.
2	System Management	Consideration should also be given to including an express provision in the Market Rules providing System Management with the ability to recommend that a project be a Declared Market Project.	The IMO notes this concern. However, the IMO considers that the Market Rules require System Management to submit their annual budget to the IMO, within which System Management has the ability to recommend a project as a Declared Market Project. The Market Rules are consistent with current practice in this regard. The IMO also notes that System Management is required to seek approval from the ERA for the incremental Capital Expenditure required to fund a Declared Market Project.
3	System Management	For the purposes of determining a Declared Market Project proposed clause 2.22.13(b) applies the 10% threshold to the combined total of approved Allowable Revenue and approved Capital Expenditure. This is inconsistent with clauses 2.23.8 and 2.23.8A which individually apply the 10% threshold to Allowable Revenue and Capital Expenditure. It is recommended that all three clauses be reviewed to ensure that the application of the 10% threshold is consistent throughout the proposed amendments.	The IMO notes System Management's concerns. The distinction between how Capital and Recurring Expenditures are treated for a Declared Market Project is due to the finite and contained nature of a project and is designed to capture the total cost/expenditure. It is not appropriate from an accounting perspective to combine Capital and Recurring expenditures from an Allowable Revenue perspective. The triggers for a review by the ERA apply even in the event that a project does not trigger the Declared Market Project threshold. For example if the Capital Expenditure is greater than 10% of the approved Capital Expenditure for the review period, System Management must seek a review by the ERA.
4	System Management	The application of the new defined terms 'Capital Expenditure' and 'Forecast Capital	The IMO agrees for the integrity of the Market Rules to be upheld the terms 'Capital Expenditure' and 'Forecast Capital Expenditure' must be consistent

	Submitter	Comment/Change requested	IMO Response
		Expenditure' should be reviewed throughout the proposed amendments to ensure they are correctly applied.	throughout the proposed Amending Rules. The IMO further clarifies that the purpose of the Amending Rules is to allow ERA to approve Capital Expenditure that is forecasted to be incurred in the future. It is not appropriate for the ERA to approve Capital Expenditure retrospectively.
4a	System Management	Should the single reference to "Capital Expenditure" in proposed clause 2.23.9 be replaced with "Forecast Capital Expenditure" as this clause is referring to the amount of forecast expenditure that has been approved by the ERA under clause 2.23.3?	Refer to the IMO's response in (4). Appropriate changes in the Amending Rules have been made. Refer to Appendix 2.
4b	System Management	Proposed clause 2.23.12 refers to "... Forecast Capital Expenditure in accordance with 2.23.13 and 2.23.14..." Proposed clause 2.23.13 does not use the term "Forecast Capital Expenditure" but refer to "Capital Expenditure". Clause 2.23.14 refers solely to "Forecast Capital Expenditure".	Refer to the IMO's response in (4). Appropriate changes in the Amending Rules have been made. Refer to Appendix 2.
5	System Management	Consideration should be given to including express decision and timeframe requirements on the ERA in the proposed amendments in respect to applications made under 2.23.8, 2.23.8A and 2.23.14 (Corresponding amendments could also be made for the equivalent IMO related clauses).	<p>The IMO notes this concern; however this issue is outside the scope of the current Rule Change Proposal. This issue exists in the existing Market Rules and is not introduced by this Rule Change Proposal. It is possible for large unforeseen expenditure to occur at any stage during the financial year, and the current Market Rules are designed to allow the IMO or System Management the ability to apply for a reassessment at any stage during the financial year. The IMO considers that specifying approval dates into the Market Rules would reduce this flexibility.</p> <p>The ERA has indicated that it will work with the IMO or System Management to approve the additional expenditure required within desired time frames.</p>

APPENDIX 2: FURTHER AMENDMENTS TO THE PROPOSED AMENDING RULES

The IMO has made some amendments to the Amending Rules as proposed in the Draft Rule Change Report following the second submission period. These changes are as follows (~~deleted text~~, added text):

- 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 40% 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.
- 2.22.8A. The IMO must apply to the Economic Regulation Authority to approve the adjusted Forecast 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 clauses 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 clauses 2.22.8 or 2.22.8A. Clause 2.22.3(b) applies in the case of an application made under clauses 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~~ reassessment to the Allowable Revenue or Forecast Capital Expenditure in accordance with clauses 2.22.14 and 2.22.15:
- (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:
 - ...
 - iv. notwithstanding ~~paragraphs~~ clauses 2.22.12(a)(i), 2.22.12(a)(ii) and 2.22.12(a)(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.
 - ...
 - (c) where possible, the Economic Regulation Authority should benchmark the Allowable Revenue and Forecast Capital Expenditure against the costs of providing similar services in other jurisdictions.

- 2.22.13. Subject to clauses 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 the IMO or System Management the sum of:
 - i. the recurring expenditure associated with the change; and
 - ii. the Forecast Capital Expenditure required to implement the changewould ~~increase~~ be greater than the combined sum of Allowable Revenue determined and Forecast Capital Expenditure approved by the Economic Regulation Authority for the current Review Period by more than 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 Forecast 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:
- ...
- 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 40% 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.
- 2.23.8A. System Management must apply to the Economic Regulation Authority to approve the adjusted Forecast 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 Forecast Capital Expenditure approved 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 Allowable Revenue and approving Forecast Capital Expenditure or ~~an adjustment~~ reassessment to the Allowable Revenue or Forecast Capital Expenditure in accordance with clauses 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:
 - ...
 - iv. notwithstanding ~~paragraphs~~ clauses 2.23.12(a)(i), 2.23.12(a)(ii) and 2.23.12(a)(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 2.23.1, 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 and Forecast Capital Expenditure 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 Forecast Capital Expenditure relevant to the Declared Market Project, including the period over which the incremental Allowable Revenue and Forecast 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:

...

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.

