

# Application to adjust the Allowable Revenue and Forecast Capital Expenditure for the Australian Energy Market Operator for 2016/17 to 2018/19

Consultation Paper

March 2017

Economic Regulation Authority

WESTERN AUSTRALIA

## Economic Regulation Authority

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## Introduction

The Economic Regulation Authority (**ERA**) is required to approve the amount of revenue the Australian Energy Market Operator can recover from market participants for market operation and system management of the Wholesale Electricity Market (**WEM**). Typically, determinations are made every three years. However, if AEMO considers it requires additional expenditure, it may apply to the ERA for an adjustment to the amount approved.

The ERA's most recent determination for the three year period from 1 July 2016 to 30 June 2019 (**AR4**) was published on 16 December 2016.

AEMO's proposal for AR4<sup>1</sup> included:

- Business as usual costs to provide services in their current form.
- System Management transfer costs. These were the costs of transferring the system management function from Western Power to AEMO. This reflected additional expenditure arising from separating the functions from Western Power and creating an independent market and system operator in the WEM. This included setting up a security desk in the new AEMO Perth office.
- New office fitout costs. Costs for AEMO to move to a new office facility, capable of housing all employees and the necessary infrastructure to provide the workspace and environment for it to develop standalone systems and prepare for the new market structures.
- Market reform. These were the planning and establishment costs associated with AEMO's development and implementation of new procedures and systems to comply with the amended WEM requirements being developed by the Electricity Market Review.

The ERA's determination excluded market reform expenditure as there was insufficient time to adequately review the proposed expenditure by the statutory deadline of 16 December 2016.<sup>2</sup> On 17 February 2017, AEMO submitted an application to adjust the approved allowable revenue and forecast capital expenditure. AEMO's application states the proposal includes expenditure to enable it to:

- implement market reform initiatives that have already been addressed through WEM rule amendments;
- continue with market reform development work during 2017; and
- proceed with critical changes that AEMO considers need to be progressed irrespective of whether or not the reform program proceeds.

AEMO's proposal states:

Once clarification has been obtained about the underpinning market reform legislation (expected after the WA State election), AEMO intends to make a further adjustment proposal in the third or fourth quarter of 2017 for funding to the end of the current AR4 period, for the implementation of the full market reform program.

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<sup>1</sup> Submitted to the ERA in September 2016 <https://www.erawa.com.au/cproot/14530/2/Attachment%20-%202016-2019%20WA%20Functions%20Allowable%20Revenue%20Proposal.PDF>

<sup>2</sup> On 5 December 2016, AEMO provided a revised submission for market reform expenditure, noting that legislation to transfer network regulation to the national framework had been delayed and that the timelines for implementation and details of the design were under review.

## Invitation to make submissions

This consultation paper has been prepared to clarify the ERA's assessment process and to assist interested parties to make submissions on AEMO's proposal. Interested parties are invited to make submissions on any aspect of AEMO's proposal by **4:00 pm (WST) Friday, 24 March 2017** via:

Online: [www.erawa.com.au/consultation](http://www.erawa.com.au/consultation)

Email address: [publicsubmissions@erawa.com.au](mailto:publicsubmissions@erawa.com.au)

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### CONFIDENTIALITY

In general, all submissions from interested parties will be treated as being in the public domain and placed on the Authority's website. Where an interested party wishes to make a submission in confidence, it should clearly indicate the parts of the submission for which confidentiality is claimed, and specify in reasonable detail the basis for the claim. Any claim of confidentiality will be considered in accordance with the provisions of section 55 of the *Economic Regulation Authority Act 2003*.

The publication of a submission on the Authority's website shall not be taken as indicating that the Authority has knowledge either actual or constructive of the contents of a particular submission and, in particular, whether the submission in whole or part contains information of a confidential nature and no duty of confidence will arise for the Authority.

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## AEMO Proposal

AEMO's submission notes the proposed adjustment relates to a subset of the market reform work scope requested in its original submission in September 2016 for the AR4 period. AEMO states:<sup>3</sup>

“With the delay of components of the EMR related regulatory packages that underpin the market reforms, and the pending WA State election, there is now a level of uncertainty as to when market reform (and associated regulatory changes) will occur and what this will involve. Given this uncertainty, AEMO has already taken prudent measures to revise the overall program approach, to reduce the resource profile, and to defer significant components of planned IT and market readiness expenditure.

As a result, for the duration of the 2017 calendar year and until such time as greater reform certainty is available, AEMO is seeking approval for a subset of the original WAMRP scope encompassing the following areas of activity:

- WEM Rules Changes: EMR components that are already enacted in the WEM Rules and which AEMO is required to implement to avoid non-compliance issues:
  - Third stage of changes to the Reserve Capacity Mechanism (RCM3)
  - The Reserve Capacity Auction.
- Single Perth Office Data Centre Works: The data centre works and communication links required to support the creation of the single AEMO Perth office.
- Power Systems Operations Core Security Management Systems: Critical system management IT systems (Energy Management Systems, Forecasting and Modelling) design and build work to reduce risk and avoid expenditure on end-of-life Western Power provided systems.
- Market Development: EMR market development activities during 2017:
  - Engagement with the Public Utilities Office on regulatory planning and rule proposal (not rule-making) functions.
  - Engagement with stakeholders to support market preparedness and market design acceptance.
- Market Solution Design: EMR market solution planning, scoping, initial solution, design, change management, IT, and prototyping of market systems to ensure that an integrated reform solution can go live in 2019. Without this work, there will be a high risk that a July 2019 implementation date may not be achieved, potentially pushing reform implementation into 2020 to avoid the summer period.”

A summary of AEMO's proposed adjustment for market reform expenditure is set out in Table 1 overleaf.

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<sup>3</sup> See page 6 of AEMO's application.

**Table 1: AEMO Proposed Adjustments to Allowable Revenue and Forecast Capital Expenditure**

\$'000 (nominal)	<i>Actual to Dec-16</i>	<i>Jan-17 to Jun-17</i>	<i>2016/17</i>	<i>Jul-17 to Dec-17</i>	<i>Jan-18 to Jun-18</i>	<i>2017/18</i>	<i>2018/19</i>	<i>AR4 Total</i>
<b>Allowable Revenue</b>								
<b>Market Operations:</b>								
RCM 3	87	39	126	91	179	270	331	727
Data Centre	3	-	3	82	162	244	327	574
Market Development	479	-	479	-	-	-	-	479
<b>Total Adjustment Market Operations</b>	<b>569</b>	<b>39</b>	<b>608</b>	<b>173</b>	<b>341</b>	<b>514</b>	<b>658</b>	<b>1,781</b>
<b>System Management:</b>								
Power System Operations	486	2	488	10	-	10	-	498
Data Centre	3	-	3	82	162	244	327	575
<b>Total Adjustment System Management</b>	<b>489</b>	<b>2</b>	<b>491</b>	<b>92</b>	<b>162</b>	<b>254</b>	<b>327</b>	<b>1,073</b>
<b>Total Adjustment Allowable Revenue</b>	<b>1,058</b>	<b>41</b>	<b>1,099</b>	<b>265</b>	<b>503</b>	<b>768</b>	<b>985</b>	<b>2,854</b>
<b>Forecast Capital Expenditure</b>								
<b>Market Operations:</b>								
RCM 3	753	1,869	2,622	987	-	-	-	3,609
RC Auction	-	-	-	65	-	-	-	65
Data Centre	96	1,567	1,663	58	-	-	-	1,721
Market Development	543	200	743	221	-	-	-	964
Market Design	-	-	-	671	-	-	-	671
<b>Total Adjustment Market Operations</b>	<b>1,392</b>	<b>3,636</b>	5,028	<b>2,002</b>	-	-	-	<b>7,030</b>
<b>System Management:</b>								
Power System Operations	326	320	646	1,107	-	-	-	
Data Centre	96	1,567	1,663	58	-	-	-	1,753
Market Development	-	200	200	221	-	-	-	1,721
Market Design	-	-	-	671	-	-	-	421
<b>Total Adjustment System Management</b>	<b>422</b>	<b>2,087</b>	2,509	<b>2,057</b>	-	-	-	<b>671</b>
<b>Total Adjustment to Forecast Capital Expenditure</b>	<b>1,814</b>	<b>5,723</b>	<b>7,537</b>	<b>4,059</b>	-	-	-	<b>11,596</b>

A summary of allowable revenue and forecast capital expenditure for AR4, including AEMO's proposed adjustment, is set out in Table 2 and Table 3 below.

**Table 2: Allowable Revenue including AEMO proposed adjustment**

\$'000 (nominal)	2016/17	2017/18	2018/19	Total
<b>Market Operations</b>				
Approved	15,616	13,312	13,555	42,483
Proposed Adjustment	608	514	658	1,781
<b>After proposed adjustment</b>	<b>16,224</b>	<b>13,826</b>	<b>14,213</b>	<b>44,264</b>
<b>System Management</b>				
Approved	16,665	17,090	14,558	48,313
Proposed Adjustment	491	254	327	1,073
<b>After proposed adjustment</b>	<b>17,156</b>	<b>17,344</b>	<b>14,885</b>	<b>49,386</b>
<b>Total</b>				
Approved	32,281	30,402	28,113	90,796
Proposed Adjustment	1,099	768	985	2,854
<b>After proposed adjustment</b>	<b>33,380</b>	<b>31,170</b>	<b>29,098</b>	<b>93,650</b>
<b>% of approved allowable revenue</b>	<b>3.4%</b>	<b>2.5%</b>	<b>3.5%</b>	<b>3.1%</b>

**Table 3: Forecast Capital Expenditure including AEMO proposed adjustment**

\$'000 (nominal)	2016/17	2017/18	2018/19	Total
<b>Market Operations</b>				
Approved	1,779	2,830	1,678	6,287
Proposed Adjustment	5,028	2,002	-	7,030
<b>After Adjustment</b>	<b>6,807</b>	<b>4,832</b>	<b>1,678</b>	<b>13,317</b>
<b>System Management</b>				
Approved	4,828	2,769	120	7,717
Proposed Adjustment	2,509	2,057	-	4,566
<b>After Adjustment</b>	<b>7,337</b>	<b>4,826</b>	<b>120</b>	<b>12,283</b>
<b>Total</b>				
Approved	6,607	5,599	1,798	14,004
Proposed Adjustment	7,537	4,059	-	11,596
<b>After Adjustment</b>	<b>14,144</b>	<b>9,658</b>	<b>1,798</b>	<b>25,600</b>
<b>% of forecast capital expenditure</b>	<b>114%</b>	<b>72%</b>	<b>-%</b>	<b>83%</b>

The market rules allow AEMO to spend up to 15 per cent more<sup>4</sup> than the approved allowable revenue and 10 per cent more than the approved forecast capital expenditure. As can be seen in Table 2 above, the total proposed adjustment is approximately 3 per cent of the total approved allowable revenue for AR4. Table 3 shows the proposed forecast capital expenditure is 83 per cent more than the approved forecast expenditure.

<sup>4</sup> Over the three year period.

## Rules governing the ERA's review

The ERA is responsible for determining the allowable revenue and capital expenditure AEMO can recover for the services it provides. These include:<sup>5</sup>

- operating the WEM market and system management functions as set out in the WEM rules; and
- preparing for and facilitating the implementation of wholesale electricity market reform.<sup>6</sup>

The ERA's determination forms the basis for AEMO's annual budgets. Market fees, which are charged based on the volume of energy generated or consumed by market participants, are adjusted each year to reflect the annual budget. Annual adjustments arising from differences between forecast and actual expenditure are also made to account for surpluses or deficits in revenues from market fees and system operation fees.

AEMO must apply to the ERA to reassess its allowable revenue if its budget proposal is likely to result in revenue over the three-year allowable revenue period being more than 15 per cent greater than the amount determined by the ERA. Capital expenditure can vary by up to 10 per cent over the three-year period before AEMO is required to apply for a reassessment.

The factors the ERA must take into account in approving allowable revenue and forecast capital expenditure are as follows:

- the allowable revenue must be sufficient to cover the forward looking costs of providing the relevant services in accordance with the following principles:
  - recurring expenditure requirements and payments are recovered in the year of expenditure;
  - capital expenditure is to be recovered through the depreciation and amortisation of the assets acquired by the capital expenditure in a manner that is consistent with good accounting principles;
- the allowable revenue and forecast capital expenditure must include only those costs that would be incurred by a prudent provider of the services, acting efficiently, seeking to achieve the lowest practically sustainable cost of delivering the services in accordance with the WEM, while effectively promoting the wholesale market objectives;
- where possible, the ERA should benchmark the allowable revenue and forecast capital expenditure against the costs of providing similar services in other jurisdictions;
- where costs incurred by AEMO relate to both the performance of functions in connection with the WEM Rules and the performance of AEMO's other functions, the costs must be allocated on a fair and reasonable basis between:

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<sup>5</sup> Clauses 2.1A and 2.2 of the WEM Rules provide a detailed list of AEMO's functions and services.

<sup>6</sup> This rule applies until 1 July 2020. Wholesale electricity market reform is defined as any proposed changes to the operation of the WEM or the legislative regime applying to the WEM (including the Electricity Industry Act, the WEM Regulations and WEM Rules) that have been endorsed by the Minister, whether or not legislation has been made to implement it. This includes the entire reform package set out in the report published by the Public Utilities Office of the Department of Finance entitled "Final Report: Design Recommendations for Wholesale Energy and Ancillary Service Market Reforms" published in July 2016.

- costs recoverable as part of AEMO's allowable revenue and forecast capital expenditure; and
- other costs not to be recovered under the WEM Rules.