



Guideline to inform AEMO funding submissions under the WEM Rules and GSI Rules

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1. Introduction

The Economic Regulation Authority is responsible for determining funding for the Australian Energy Market Operator (AEMO) in the Western Australian energy markets.

The ERA determines funding for AEMO to execute its functions under the Wholesale Electricity Market Rules and the Gas Services Information Rules (the Rules). AEMO recovers its costs from market participants through market fees.

The ERA has prepared this guideline in accordance with new transitional provisions to the Rules gazetted on Friday 29 October 2021.¹

The guideline is based on proposed changes to the Rules that cover:

- The timing of the AR6 and future allowable revenue and forecast capital expenditure determinations, in section 2.
- The funding determination criteria, in section 3.

The guideline is intended to assist AEMO to make its funding proposal for the upcoming allowable revenue period, which will commence on 1 July 2022, known as AR6. Section 3.4 lists the type of information and level of detail the ERA requires to assess AEMO's proposed funding and provides additional information on how the ERA will conduct its review and determination.

¹ Western Australian Government Gazette, 29 October 2021, No. 183, pp 3-4 ([online](#))

2. Timing

The timing of AEMO's funding proposal and the ERA's determination are different for the AR6 determination, compared to future funding review and determination processes.

2.1 Timing for AR6

The transitional provisions in the Rules gazetted on 29 October 2021 establish the timeline for AR6.

First, the ERA must publish a proposal guideline to assist AEMO to prepare its funding proposal (this document) by 31 October 2021.

AEMO must submit its proposal to the ERA by 31 December 2021.

Following a review of AEMO's proposal, the ERA must publish a draft determination by 31 March 2022 and a final determination by 31 May 2022.

Once the ERA has made its determination for AR6, the transitional Rules will be deleted. The funding submission and review process going forward will revert to the timing outlined in section 2.2.

2.2 Timing for future allowable revenue periods

The ERA understands that Energy Policy WA (EPWA) intends to consult on and introduce a range of amendments to the existing WEM Rule 2.22A and corresponding amendments to the equivalent GSI Rules by mid-December 2021. It is the ERA's expectation that these amended Rules will apply to AEMO's AR6 proposal. Further changes to the Rules may occur by December 2021. If this happens the ERA will amend this guideline accordingly.

The timing of AEMO's proposal, the ERA's determination and the high-level process for allowable revenue periods beyond AR6, is governed by proposed WEM Rule 2.22A.2A and any equivalent proposed GSI Rule.

AEMO must submit its proposal by the end of October before the start of the next allowable revenue period (which begins on 1 July) and the ERA must make its final determination by the end of April.

2.3 Process

The due dates for AEMO to submit its proposal and for the ERA to make its determination for both AR6 and beyond have been changed to allow the ERA more time to undertake its review.

The ERA must now publish and consult on a draft determination. Historically, the ERA has undertaken a consultation process as part of its review but this approach is now mandated. This addition provides interested parties an opportunity to comment on the draft determination and the ERA will take this feedback into account in making the final determination.

3. Proposed changes to the Rules

As a not-for-profit entity, AEMO can only charge, through market fees, the costs it incurs to perform its functions under the Rules.

The proposed changes to the Rules provide additional accountability on AEMO in respect of the costs it forecasts and then incurs in fulfilling its functions. The proposed changes require AEMO to provide information to a sufficient level of detail to enable the ERA to make a determination on whether AEMO's forecast costs are consistent with the funding determination requirements in the proposed Rules.

Following determination, transparency is increased by requiring AEMO undertake additional regulatory reporting to identify how its expenditure is progressing against the ERA's determination.

3.1 Funding determination criteria

Under the proposed Rules, the ERA's criteria for determining AEMO's funding will be strengthened to enable the ERA to confirm that only expenditure consistent with AEMO as a prudent provider, acting efficiently to achieve the "lowest practicably sustainable costs" in performing its functions, is collected through market fees.

There have been three main changes to the funding determination criteria, as captured in proposed:

- WEM Rule 2.22A.3: Funding proposed and approval is tied, where practicable, to individual projects, or where not practicable, to specific functions, in AEMO's proposal.
- WEM Rule 2.22A.5: The funding approval criteria has been strengthened to align with the WEM objective "to minimise the long-term costs of electricity supplied to consumers from the South West Interconnected System."
- WEM Rule 2.22A.6: The ERA can expressly approve part-funding for an identified project or function.

The changes are intended to encourage AEMO to provide forecast cost information in its proposal in sufficient detail for the ERA to better understand the estimated costs of AEMO's different functions under the Rules. This will enable the ERA to better assess AEMO's costs, including benchmarking of AEMO's costs against the costs of market and system operators in other jurisdictions.

There is a new clause in the proposed Rules that expressly requires AEMO to forecast operating and capital expenditure at the project level. This will allow the ERA to consider, in more detail, how AEMO is planning and forecasting its projects. The detailed information requirements listed in section 4 will better enable the ERA to apply the proposed central test for determining AEMO's funding:

The Allowable Revenue and Forecast Capital Expenditure must include only costs which would be incurred by a prudent provider of the services provided by AEMO in performing its functions, acting efficiently, to achieve the lowest practicably sustainable cost of delivering AEMO's functions, while effectively promoting the Wholesale Market Objectives.

The ERA expects AEMO to demonstrate how its proposed costs will achieve the lowest practicably sustainable costs of delivering AEMO's functions.

3.2 Regulatory reporting

The introduction of regulatory reporting requirements is intended to increase the transparency of AEMO's determined funding and actual expenditure. This is consistent with the regulatory reporting requirements of market and system operators in other jurisdictions. Regulatory reporting provides clarity to market participants on the expenditure, delivery and timing for individual projects and functions that is being recovered through market fees.

Requiring AEMO to report how its actual expenditure is tracking against approved forecast expenditure should improve accountability in how AEMO expends funds and recovers expenditure through market fees.

3.3 Reassessment

The Rules recognise that funding approved for a three-year allowable revenue period may not be sufficient to cover the efficient costs of AEMO's obligations.

There are several reasons why AEMO's funding may change. AEMO may obtain new functions or obligations within the Rules that were not known or legislated at the time its allowable revenue and forecast capital expenditure were approved, or it may incur costs to implement a rule change.

AEMO can request the ERA to reassess its allowable revenue and capital expenditure during the review period. Currently, the Rules enable AEMO to expend up to 15 per cent above its approved allowable revenue and/or 10 per cent above its forecast capital expenditure before it needs to request a reassessment.

The proposed Rule changes reduce the thresholds to 10 per cent or \$10 million (whichever is lower) above either AEMO's approved allowable revenue and/or its approved forecast capital expenditure, before AEMO needs to request a reassessment.

The proposed Rule also changes the timings by which AEMO must apply to the ERA for a reassessment and when the ERA must make a determination. AEMO is required to submit its Allowable Revenue reassessment proposal by 31 March to the ERA.

The following sections outline how the ERA will approach its review and determination of AEMO's allowable revenue and forecast capital expenditure, including the type of information required from AEMO.

3.4 The funding proposal

This section of the guideline is intended to assist AEMO by indicating the type and level of detail of information the ERA expects will be included in a funding proposal and/or reassessment proposal.

Changes in AEMO's functions

Periodically, AEMO's functions will change as electricity and gas markets evolve. In its funding proposal, AEMO should explain what functions it had in the previous allowable revenue period that have been removed or are expected to be removed in the upcoming period. The explanation should include how a reduction in functions has influenced the funding proposal. For example, have staff that were performing the function been made redundant or re-employed in other vacant positions, or were consultant costs avoided as functions have been lost?

Similarly, AEMO should explain what new functions it has gained or will gain in this allowable revenue period and how these new functions will affect staff numbers and associated costs.

AEMO's internal governance

The funding proposal submitted to the ERA should include a full description and evidence in support of the process that the proposal has been through within AEMO to ensure it is accurate, tested and approved by AEMO's leadership.

Cost categorisation by functions

Data should be grouped such that the ERA is able to understand the proposed costs for each of AEMO's functions under the Rules. The cost data should distinguish between AEMO's proposed costs for business-as-usual functions and any market reform functions.

Business cases

Any information or data provided as part of AEMO's funding should include information about historically incurred costs and forecast future costs, including any business cases used to inform these forecasts.

Format

Any spreadsheets provided as part of the funding submission should include calculations where possible and sufficient explanation identifying the data included in the sheet, field descriptions and if there are any limits to, or omissions in, the information provided.

Market fee estimates

AEMO should provide information on how it has calculated forecast market fees for the allowable revenue period, including provision of market fee calculations and forecast denominators.

To be able to assess AEMO's proposal against the approval criteria, the ERA provides guidance on the appropriate level of granularity for information and data in the following sections.

3.5 Workforce planning and costing

Labour costs form a large proportion of AEMO's cost base. To be able to approve resource forecasts and costs, the ERA needs to understand why the labour resources are required, how they enable AEMO to fulfil its obligations, what drives the cost, and how the resources proposed meet the funding approval requirements.

When providing information on and justification for the number, cost and use of labour resources, the following detail is required:

- Details of all current positions and their associated costs at the date of submission.
- Position numbers and position titles for all forecast positions, both as a list and within an organisation chart.
- A clear explanation of any labour classifications used in the submission, for example staff, internal contractors, external contractors, consultants, along with:
 - Identification of whether the position is occupied or vacant.

- The legal status of each position and any associated costs (for example, associated recruitment and/or labour hire).
 - Provision, for contract positions, of the contract end date, with details on whether the position will be re-contracted or abolished beyond the allowable revenue period, as appropriate.
 - Information on AEMO's policy on backfilling if permanent staff are seconded to project-based roles.
- Budgeted costs for labour based on actual historical costs for each position and any new position to be included in the submission.
 - For each position, base salary plus superannuation, long service leave, bonuses, workers' compensation, annual leave and annual leave loading.
 - Monthly allocation of individual positions to capital projects over the allowable revenue period.
 - Allocation of labour costs between AEMO's WEM activities, AEMO's National Electricity Market (NEM) activities and any other activities AEMO engages in, and an explanation of the basis for cost allocations.
 - Evidence in support of any proposed new position costs. This should use actual market data wherever possible: for example, the cost of recent hires, estimated ranges of costs from labour hire agencies, and benchmarking.
 - Evidence in support of new consultant costs. This should use actual market data wherever possible: for example, a range of quotes from different consultancies for named positions.

The use of management accounting costing for employees is to be avoided in compiling forecast costing for the submission, wherever possible.

3.6 Capital projects

The ERA uses the prudence test in proposed clause 2.22A.5 of the proposed WEM Rules to clarify how a proposed project or expenditure relates to AEMO's functions under the WEM Rules. AEMO's descriptions of its capital projects need to include the reason or driver for the capital project and how it directly or indirectly supports AEMO to execute its functions. This could include information on what stage the capital project has reached through the project development framework. For example, is the project underway, being scoped or yet to be defined? The stage of project development will indicate the degree of uncertainty surrounding the project. Uncertainty, in turn, influences the information available for the project and how robust the project costings will be.

AEMO must also anticipate and capture internal efficiencies resulting from the implementation of capital projects. For example, if an internal manual process is automated or an Information Technology (IT) system is enhanced or replaced, what are the efficiencies associated with this expenditure? These efficiencies could include a reduction in staffing levels or reduced unit or activity cost following automation or enhancement.

AEMO should provide specific project information in sufficient detail and with supporting evidence for the ERA to be able to assess the proposed expenditure against the approval criteria. This could include, but is not limited to:

- Information on how a project was scoped. This includes if or how the project scope was expanded or narrowed before the proposed scope was approved, to demonstrate why the proposed scope is prudent and just sufficient to ensure AEMO can deliver its obligation, function or service.
- Capital costs allocated by category, for example labour (including type, position title, and whether contracted or redeployed, time contribution profiled monthly), IT software, IT hardware, travel, property, financing, project contingency stated by project.
- Where resources are used for capital projects, the skillsets required for the project.
- Where projects use NEM resources, the detailed rationale and basis for capital cost allocation between NEM and WEM and any other AEMO activities, and electricity and gas (as appropriate).
- Information in support of the procurement process used and how this procurement process will deliver costs consistent with the determination approval criteria.
- For Australia-wide capital projects – the total project cost, plus the rationale and basis for allocating costs to Western Australia and the benefit to Western Australia of being part of a national project, compared to the costs of other alternatives.
- The basis for calculating project contingencies, how actual project contingencies were incurred in other similar/comparable projects, and how feedback from actual project contingencies incurred is used to inform future project contingency estimation.
- Identification of dependencies between capital projects and linked capital costs. If the ERA makes a determination to not approve or part approve proposed funding its needs to understand the implications for other projects.
- Depreciation and amortisation schedules and calculations.

AEMO should include information on any overspend of previously approved funding in the current allowable revenue period.

3.7 Operating costs and allowable revenue

Historically, operating costs have constituted the largest portion of AEMO's expenditure. The information presented needs to include:

- Operating cost and allowable revenue data presented by detailed cost category.
- For the previous allowable revenue period, comparison of approved expenditure to budget and to actuals, where possible.
- Identification and explanation of variances year-on-year, and actuals to budget.

If, in the current allowable revenue period, operating expenditure exceeded the level previously approved by the ERA, AEMO should provide information on why this overspend occurred. This is helpful to the ERA in understanding how AEMO is managing its expenditure.

3.8 Determination

Section 3 identified the approval criteria that the ERA applies to AEMO's funding proposal to make its determination. Practically, this translates to a combination of any or all the following activities:

- A combination of top-down and bottom-up analyses on information provided.
- The use of analytical tools to assess particular issues or costs of importance to each project.
- Comparison of forecasts to target out-turn costs (actual total costs) in the prior period.
- Using technical consultants to assess aspects of proposals, where necessary.
- Where possible, benchmarking AEMO's proposed costs against:
 - Comparable AEMO projects in the WEM and NEM.
 - Costs incurred by system and market operators in international jurisdictions.
- Using sound regulatory principles, aligning with the market objectives.
- Meeting regularly with AEMO to seek clarity on any issues arising or to discuss any concerns that the ERA may have about the review and/or information provided by AEMO.

The ERA will make its determination within the statutory time period.

The ERA has a strict approach to sensitive business and commercial-in-confidence information and is bound by its obligations relating to confidential information in the *Public Sector Management Act 1994* and the *Economic Regulation Authority Act 2003*.

AEMO can submit commercial-in-confidence information as part of its funding proposal with confidence that the ERA will treat the information consistent with its legal obligations. The ERA will endeavour to also provide AEMO with an embargoed copy of the ERA's publications in advance, so that AEMO is able to review the document to identify whether any confidential or commercial-in-confidence information may have inadvertently been included.

3.8.1 Proposed WEM Rule 2.22A.5

To implement the threshold for the determination of AEMO's forecast costs, the ERA considers that proposed WEM Rule 2.22A.5 is a two-stage test of estimates for prudence and then efficiency.

First, for the ERA to be able to determine if the costs requested would only be costs which would be incurred by a prudent provider of the services provided, AEMO is requested to provide evidence that the project is necessary, that there is a clear connection between the forecast costs and AEMO's function(s) and that the scope of the project provides the functions as described in the Rules and no more. That is, a prudent provider, in a similar position to AEMO, in performing that function or functions, would expect to incur those forecast costs.

Second, the ERA considers whether the prudent project or function, as described and costed, is efficient.

Application of the test in proposed WEM Rule 2.22A.5 (and its corresponding GSI Rule) includes analysing evidence that AEMO has submitted to the ERA costs consistent with this approval requirement. Ideally, this evidence should:

- Demonstrate a consistent project cost estimation model and/or approach, including any efforts to continuously improve the method or approach.
- Demonstrate that the outputs from the project cost estimation model have undergone a thorough governance and challenge process.

- Compare estimated costs against the costs of similar projects.
- Show a competitive procurement process for products and services, where appropriate.
- Demonstrate how resources will be optimised across the project program.
- Demonstrate that proposed costs are consistent with current market costs for comparable labour resources, services and products.²
- Provide information that different options for resolving the issue or delivering the project or function have been considered, along with details on the option assessment criteria in support of selection of the preferred option.
- Show how the option meets the requirement to be the “lowest practicably sustainable cost,” where initially a solution may not represent the lowest cost option. For example, this may be where a higher capital cost option may be offset by lower operating costs in the future, even if this efficiency is achieved outside the allowable revenue period for which the funding is sought.

The ERA will also consider as part of the above-mentioned test how the proposed costs will effectively promote the market objectives and any other matters that the ERA considers relevant to its determination.

3.8.2 *Dealing with uncertainty*

Proposed WEM Rule 2.22A.6 clarifies that the ERA has the express power to determine part-funding for aspects of AEMO’s proposal.

Some proposed funding may be highly uncertain and contingent on external events (such as the market reform program). There is an expectation that forecast funding for the function or project will be resubmitted, as an in-period funding application, once the level of uncertainty has reduced and a forecast that does meet the funding approval criteria can then be determined.

If some costs are rejected by the ERA, for example, because they are not yet fully scoped or insufficient evidence has been provided by the AEMO to the ERA, then the AEMO may re-apply for those costs at a later date, either in the next allowable revenue period or by way of reassessment.

To make its determination, the ERA will weigh all the relevant evidence (including technical advice) and determine a lesser amount of funding where AEMO’s forecasts are not well supported or are considered unacceptable, and an adjustment can be justified.

² Subject to AEMO’s legal obligations.