



# Rule Change Notice: Allowable Revenue Framework (RC\_2024\_01)

This Rule Change Notice is given under clause 2.5.7 of the Wholesale Electricity Market (WEM) Rules.

**Submitter:** Australian Energy Market Operator (AEMO)

**Date submitted:** 28 August 2024

## The Rule Change Proposal

AEMO proposes that its three-year allowable revenue framework under the WEM Rules be replaced with an annual budget determined through consultation with Market Participants and interested stakeholders, with a requirement for a nil surplus or deficit over the long-term.

AEMO's Rule Change Proposal seeks to remove the requirement for the Economic Regulation Authority (ERA) to determine AEMO's budget. Instead, it is proposed that the new budget and fee design process features the following elements:

- annual priorities, activities, budget and fee setting using established processes with requirements to consult with its stakeholders;
- major project delivery reporting, with the ability for stakeholders to provide input into the scope, sequency and prioritisation of projects;
- transparency around AEMO's performance through annual reporting; and
- review and oversight of the effectiveness of this new framework by the Coordinator of Energy as part of regular WEM effectiveness reporting.

The Rule Change Proposal, which is attached to this notice, gives complete information about:

- the relevant references to the WEM Rules and the proposed amendments to the clauses; and
- AEMO's description of how the proposal will better address the Wholesale Market Objectives.

## Background of the Proposal Development

AEMO submitted two in-period adjustments for its 2022-25 Allowable Revenue to the ERA due to requiring additional expenditure for its operations and capital expenditure.

In its Final Determination of AEMO's second in-period budget adjustment, the ERA highlighted issues with the current regulatory framework and stated it supported replacing it with a more workable arrangement.

AEMO discussed a draft of this Rule Change Proposal at the 25 July 2024 Market Advisory Committee (MAC) meeting. AEMO submitted the Rule Change Proposal to the Coordinator on 28 August 2024.

On 3 September 2024, the Coordinator sought clarification under clause 2.5.5 of the WEM Rules about how AEMO proposes to govern its budget during the planning and delivery phases of its work.

On 13 September 2024, AEMO submitted an updated Rule Change Proposal including the requested clarifications.

## Decision to Progress the Rule Change Proposal

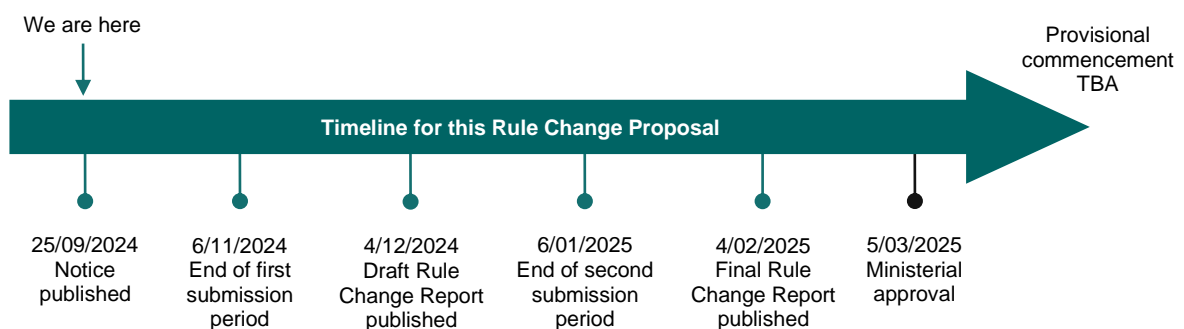
The Coordinator has decided to progress the Rule Change Proposal using the Standard Rule Change Process based on a preliminary assessment that it:

- is not inconsistent with the Wholesale Market Objectives;
- raises a valid issue within the WEM Rules;
- does not create other problems within the WEM Rules; and
- is not part of an upcoming review or reform program.

## Timeline

AEMO’s Rule Change Proposal seeks to include a Protected Provision under regulation 7(3)(c)(i) of the *Electricity Industry (WEM) Regulations 2004* and clause 2.8.13(f) of the WEM Rules. Consequently, if the Coordinator’s final decision is to include a Protected Provision, the Minister is responsible for approving the Final Rule Change Report under clause 2.8.5 of the WEM Rules.

This Rule Change Proposal will be progressed under the Standard Rule Change Process described in section 2.7 of the WEM Rules. The projected timeline for processing this proposal is:



It is noted that under this timeline, Ministerial approval will fall during the Government’s caretaker period. However, the timeline may change if any submission periods or the timelines for the Rule Change Reports are extended. In any case, the Minister has the ability under clause 2.8.6 of the WEM Rules to extend the timeline for approving the Final Rule Change Report.

## Call for Submissions

The Coordinator invites interested stakeholders to make submissions on this Rule Change Proposal.

While the Coordinator is interested in any feedback regarding the proposal, stakeholders are asked in particular to comment on whether they agree with AEMO's and the ERA's assessment of the current allowable revenue framework.

The submission period is 30 Business Days from the Rule Change Notice publication date. Submissions must be delivered to the Coordinator by **5:00 pm (AWST) on 6 November 2024**.

The Coordinator prefers to receive submissions by email, using the submission form available at [Rule Change Process \(www.wa.gov.au\)](http://www.wa.gov.au) sent to [energymarkets@demirs.wa.gov.au](mailto:energymarkets@demirs.wa.gov.au).

Submissions may also be sent to the Coordinator by post, addressed to:

**Energy Policy WA**  
Attn: Director, Wholesale Markets  
Level 1, 66 St Georges Terrace Perth, WA, 6000  
Locked Bag 100  
East Perth WA 6892



## WEM Rule Change Proposal Form

Rule Change Proposal ID: RC\_2024\_01

Date received: 13 September 2024

### Change requested by:

<b>Name:</b>	Kate Ryan
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<b>Organisation:</b>	Australian Energy Market Operator
<b>Address:</b>	GPO Box 7096, Cloisters Square, Perth, WA 6850
<b>Date Submitted:</b>	28 August 2024
<b>Proposed urgency:</b>	High
<b>Rule Change Proposal Title:</b>	New AEMO Budget and Fee Determination Framework
<b>WEM Rule(s) affected:</b>	Table of Contents, 1.XX.X, 1.XX.Y, sections 2.22 and 2.22A, clauses 2.24.2, 2.24.3 and 2.24.7, and the Glossary

### Introduction

Clause 2.5.1 of the Wholesale Electricity Market Rules (**WEM Rules**) provides that any person may make a Rule Change Proposal by completing a Rule Change Proposal form and submitting it to the Coordinator of Energy (**Coordinator**).

This Rule Change Proposal can be sent by:

Email to: [energymarkets@demirs.wa.gov.au](mailto:energymarkets@demirs.wa.gov.au)

Post to: Energy Policy WA  
Attn: Director, Wholesale Markets  
Level 1, 66 St Georges Terrace Perth, WA, 6000  
Locked Bag 100  
East Perth WA 6892

The Coordinator will assess the proposal and will notify you within 5 Business Days of receiving this form whether the Rule Change Proposal will be further progressed.

All of the fields below must be completed for the proposal to be progressed, and the proposal must:

- provide any proposed specific changes to particular WEM Rules; and
- describe how the proposed rule change would allow the WEM Rules to better address the Wholesale Market Objectives.

The Wholesale Market Objectives are:

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

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## Details of the Proposed Rule Change

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### 1. Describe the concern with the existing WEM Rules that is to be addressed by the proposed rule change:

#### 1.1 Background

AEMO recovers the costs for performing its functions under the WEM Rules from Market Participants via market fees. Every three years, AEMO must develop an Allowable Revenue and Forecast Capital Expenditure Proposal to cover its forward-looking costs. The Economic Regulation Authority (ERA) reviews this proposal and determines an amount it considers meets the requirements under section 2.22A of the WEM Rules and the funding proposal guideline developed under clause 2.22A.9<sup>1</sup>.

In addition to this process, the WEM Rules require AEMO to make in-period submissions to the ERA if AEMO forecasts it will overspend the approved Allowable Revenue or Forecast Capital Expenditure by more than the lower of 10% or \$10 million.

The ERA develops and applies stringent guidelines on the quality, accuracy and quantity of information AEMO must provide to substantiate the forecasts as part of that process. This includes both ex-post and ex-ante information.

This current framework is akin to a full, incentive-based regulatory framework typically applied to large, commercial monopoly utility businesses, able to retain a proportion of any profits made in the relevant period. This type of framework is not fit for purpose for a not-for-profit entity such as AEMO in the context of the energy transition, as outlined below.

#### 1.2 The case for change

As highlighted by the ERA in its June 2024 Final Determination on AEMO's second in-period revenue adjustment, the current incentive-based regulatory framework is not suitable for making assessments of AEMO's funding requirements in the current environment.<sup>2</sup>

The application of section 2.22A of the WEM Rules and associated guidelines means the ERA can only approve forecast costs that have a high degree of certainty. However, in the fast-moving energy transition, it is extremely difficult to forecast with the accuracy and specificity required by the current

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<sup>1</sup> Available at: <https://www.erawa.com.au/cproot/22925/2/-AR.6---Final-funding-proposal-guideline.PDF>

<sup>2</sup> See ERA Final Determination, p32: <https://www.erawa.com.au/cproot/24147/2/AR-6-2nd-In-period-CapEx-and-OpEx-submission-Final-determination.PDF>

framework, particularly beyond a 12-month horizon.

Market Participants' needs, energy reform agendas and policies, and project requirements are constantly evolving as WA's energy transition progresses. This introduces considerable year-on-year uncertainty regarding obligations on AEMO and Market Participants, and the associated costs.

This pace of change is expected to prevail throughout the next decade. This means AEMO will continue to be limited in the level of certainty and detailed information it can produce to satisfy the rigid requirements of the current allowable revenue framework.

This, in-turn, hinders the ERA's ability to make an accurate assessment of the prudence and efficiency of those forecasts – the key tests under the current framework. The rigidity of the prudence and efficiency tests under the current rules does not allow the ERA sufficient flexibility to approve a three-year forecast that will be subject to changing priorities, with limited visibility of project scope.

The design of the current allowable revenue framework has led to:

1. AEMO making four revenue and forecast capital expenditure submissions since 2020, due to the uncertainty inherent in the energy transition, and changing implementation needs from critical Government-led reform initiatives.
2. Delays to the implementation of key reform projects required to enable and manage the risks of the energy transition.
3. Uncertainty for Market Participants regarding the delivery of critical projects due to funding uncertainty, leading to an inability to accurately forecast market fees. This ultimately affects the costs passed through to consumers.
4. High costs of administration and associated resourcing to develop the funding proposals. Each submission has costed AEMO an estimated \$1 million, driven by the requirements of the current regime to provide very detailed costing and information, with the ERA and Market Participant also experiencing additional costs from the process.

AEMO considers a 'set and forget' funding arrangement that establishes a multi-year fixed budget via rigid ex-ante scrutiny, is not appropriate where there is uncertainty surrounding policy, regulatory outcomes and project scope.

The ERA raises similar concerns in its June 2024 Final Determination:

*The ERA is concerned that the regulatory framework is not leading to outcomes that are beneficial to the WEM, especially given the resourcing required by AEMO and the ERA to bridge information gaps and undertake the ongoing analysis that is associated with the allowable revenue regulatory regime. On this basis, the ERA strongly supports a replacement of the existing regulatory regime with a more workable arrangement.<sup>3</sup>*

### **1.3 Design principles**

AEMO has identified the following principles for any new budget and fee framework:

1. **Transparency** – Ongoing transparency for Market Participants of AEMO's priorities, operational activities, proposed major investments, and associated costs.

Greater transparency will place a strong incentive for AEMO to demonstrate value and control costs where possible, and provide Market Participants with a mechanism to hold AEMO to account. Transparency can be achieved through providing forward-looking estimates of AEMO's activities, priorities, costs and fees, which would provide Market Participants with the certainty to budget for and determine what costs can reasonably be passed on to consumers.

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<sup>3</sup> Ibid.

2. **Engagement and accountability** – Direct engagement with Market Participants and interested stakeholders.

This would allow those paying market fees to provide input when AEMO plans, priorities, costs and delivers major projects. This could include providing input on the scope, technical solution and timing, and providing advice on what reflects value for money. This also includes reporting on delivery and actual costs.

3. **Certainty** – Certainty that AEMO's cost base is reasonable and sufficient to ensure Market Participants and energy consumers are getting services they value from AEMO.

Certainty of the recovery of AEMO's reasonable costs of providing those services is critical to ensure AEMO has confidence in and access to the funding it needs to deliver projects in an efficient and timely manner, without unnecessary project risk.

4. **Flexibility** – A shorter forecast period and more regular revision of budgets and fees would allow work programs and deliverables to adapt to changing priorities.

This is particularly important as AEMO is implementing reform initiatives and responding to fast-paced change. In this context, a lack of flexibility can lead to higher administration costs, increased risk and greater uncertainty for all parties. This reduces the likelihood of projects being delivered as efficiently and effectively as they otherwise could.

5. **Timeliness** – the rapidly changing energy landscape necessitates the determination of budgets and fees closer to the time that they will apply.

Taking a shorter-term budgeting approach will ensure the costs and project estimates used to determine the forecast revenue and fees are up-to-date and accurate. Greater accuracy provides cost and fee certainty. Shorter-term budgeting must be balanced with longer-term visibility and certainty around upcoming activities. This balance can be provided by regular revisions and earlier stakeholder input into future priorities.

6. **Simplicity** – the budget and fee determination process should be as mechanistic as possible and should use existing business as usual (BAU) processes where practicable.

Assessment of ongoing, recurrent operating costs should be relatively light touch, with greater scrutiny placed on major (large-scale, high-cost or long-timeframe) projects.

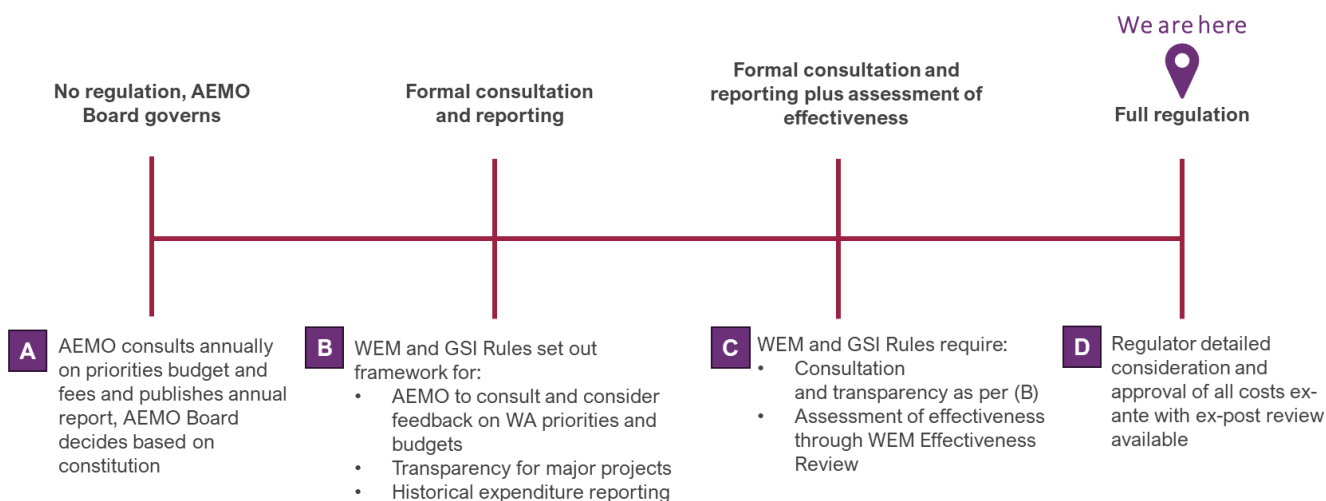
7. **Oversight** – adequate checks and balances are required to ensure an oversight body is able to undertake an independent assessment of AEMO's funding framework.

External oversight should be complementary to, not a replacement for, AEMO's internal governance process. An external oversight body should have the ability to intervene where it considers AEMO's investments are not delivering outcomes for consumers consistent with the Wholesale Market Objectives. This provision is a back-stop and should be considered the exception rather than the rule.

In developing a fit-for-purpose budget and fee framework, AEMO considered the full spectrum of options outlined in

Figure 1. AEMO considers neither of the bookend options are consistent with the goals of the framework, or proposed design principles, and has instead proposed a framework in this Rule Change Proposal that sits somewhere in between.

**Figure 1: Spectrum of options for budget and fee determination**



Any new budget and fee determination framework needs to balance the need for transparency and genuine engagement on AEMO’s priorities, with the need for a more simple, lower cost framework that is better suited to the fast pace of change in the energy transition. AEMO considers this Rule Change Proposal reflects that balance.

AEMO has engaged with stakeholders on an early draft of this rule change proposal, including with Energy Policy WA and the Market Advisory Committee (MAC) and has incorporated amendments to the proposed rules and throughout the body of this proposal to address the feedback received.

#### **1.4 AEMO’s proposed new budget and fee determination process**

AEMO proposes to replace the current revenue and fee determination process outlined in sections 2.22A and 2.23 of the WEM Rules with a new process (proposed to be introduced in the currently blank section 2.22).

The proposed new budget and fee design process features the following key elements<sup>4</sup>:

1. **Annual priorities, activities and budget and fee setting:** established processes for internal and external governance, and a requirement for AEMO to consult with stakeholders on its priorities, activities and resulting budget and fees.
2. **Major Project delivery reporting:** A requirement for AEMO to consult with stakeholders on ‘Major Projects’, both as they are being initiated and during their lifecycle, to enable

<sup>4</sup> As considered in options B and C in the spectrum of options presented in Figure 1.



stakeholders to provide input into the scope, sequence and prioritisation of projects, and to monitor their delivery.

3. **Transparency around AEMO’s performance:** Annual reporting on AEMO’s performance against its budget and other key operational measures.
4. **Review and oversight of AEMO’s budget and fees process:** Monitoring and reporting by the Coordinator of Energy on the effectiveness of this new framework following the first full cycle, as part of the three-yearly review of the effectiveness of the WEM.

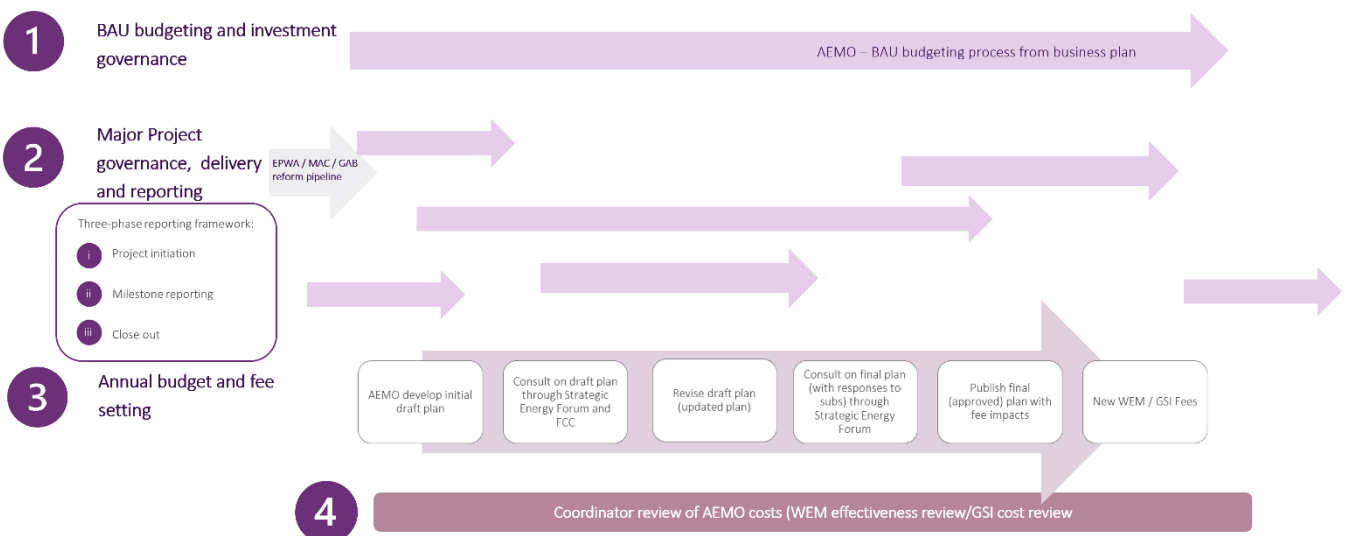
The key change from the existing framework is the change in the external governance body. Under the existing framework, the ERA is the third party responsible for assessing the prudence and efficiency of AEMO’s costs and forecasts. As raised previously, the constraints of the current framework mean the ERA is not often in the best position to do this.

AEMO therefore proposes under the new framework that the external governance role shifts to the organisations who ultimately pay the fees resulting from AEMO’s activities – Market Participants. The new framework substitutes the rigidity of the current arrangements for greater transparency and flexibility in ongoing project delivery. This is achieved by facilitating greater engagement with Market Participants in budget setting and major investments.

The robustness of the information provision requirements under the current allowable revenue process will be retained under the proposed new framework. AEMO will also remain subject to its robust internal governance arrangements, which includes the requirement to produce businesses cases and analysis to support its capital projects, as well as an annual corporate planning and budget cycle which already includes public consultation. The key change under the new process is that AEMO intends to provide more of this information publicly, earlier in the planning cycle, to facilitate more meaningful engagement with stakeholders.

Figure 2 shows that the proposed new Annual Budget and Fees process leverages AEMO’s internal budgeting process, taking two snapshots of the work program and associated costs each year to form the basis of the draft and final Annual Budget and Fees documents.

**Figure 2: Alignment of budget and fee setting and reporting**



Further detail on the key elements of the proposed budget and fee setting process is provided in the following sections.

### 1.4.1 Annual priorities, activities and budget and fee setting

#### 1.4.1.1 Internal governance arrangements

AEMO’s current robust internal governance arrangements will continue to apply to the new budget and fee setting process. AEMO is a not-for-profit public company limited by guarantee incorporated under the *Corporations Act 2001 (Cth)*. AEMO operates on a cost-recovery basis, whereby it only recovers the actual costs of providing market and power system services in line with its functions. AEMO is committed to transparent and accountable financial and risk management.

### AEMO’s Board

AEMO’s Board is responsible for overall governance of the organisation, including overseeing its activities to ensure it meets its responsibilities under relevant laws and regulations as well as approving AEMO’s annual budget and expenditures (including the extent and use of management delegations for expenditure below approved thresholds). The Board also monitors the performance and cost-effectiveness of, and risks associated with, AEMO’s operations and systems.

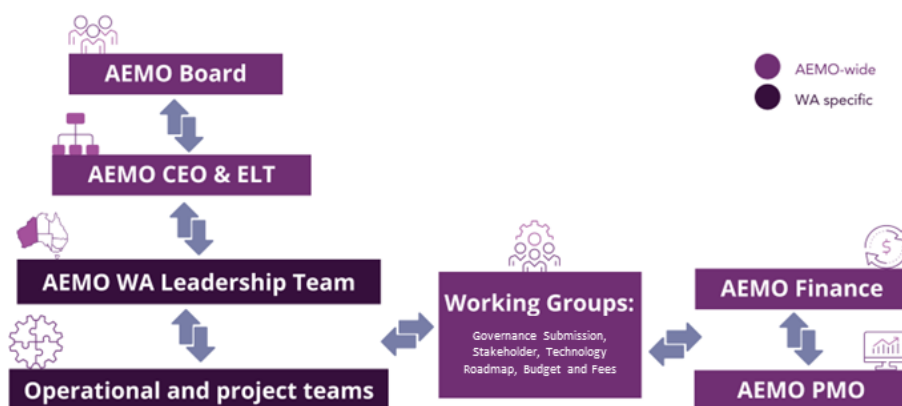
Collectively the Board possesses the core skills and experience prescribed in the AEMO Constitution and Board charter<sup>5</sup> and comprises an independent Chair, a Managing Director (who is also the Chief Executive Officer (CEO)), and eight non-Executive Directors. The Board is ultimately accountable to AEMO’s members (60 % Australian Governments and 40% industry and market participants).

### Executive Management Team

The Board delegates the day-to-day management of AEMO to the Managing Director & CEO, assisted by AEMO’s executive leadership team (ELT). The ELT has authority over all AEMO jurisdictions and has a permanent and active presence in WA. Executive committees are established around key programs of work and functions. They are responsible for overseeing the implementation of strategic initiatives and key programs of work to achieve AEMO’s vision and purpose.

Key members of the ELT also sit on WA investment committees, which provide scrutiny and challenge on budget and fee estimates. The ELT provides ongoing financial stewardship and is responsible for ensuring the WA projects and services are delivered at the lowest practicably sustainable cost. Figure 3 below shows how AEMO’s financial governance hierarchy works in practice.

**Figure 3: AEMO’s financial governance hierarchy**



### Financial Governance

AEMO has a Finance and Governance team which is responsible for establishing, maintaining and improving AEMO’s financial, risk and governance policies, procedures and systems. AEMO’s finances are managed in line with AEMO’s financial principles and budget.

An important feature of AEMO’s broader financial governance processes is the development and approval of investment requests. The review and approval of investment requests, as well as project

<sup>5</sup> More information can be found here: <https://aemo.com.au/about/corporate-governance/governance-processes-and-policies>.

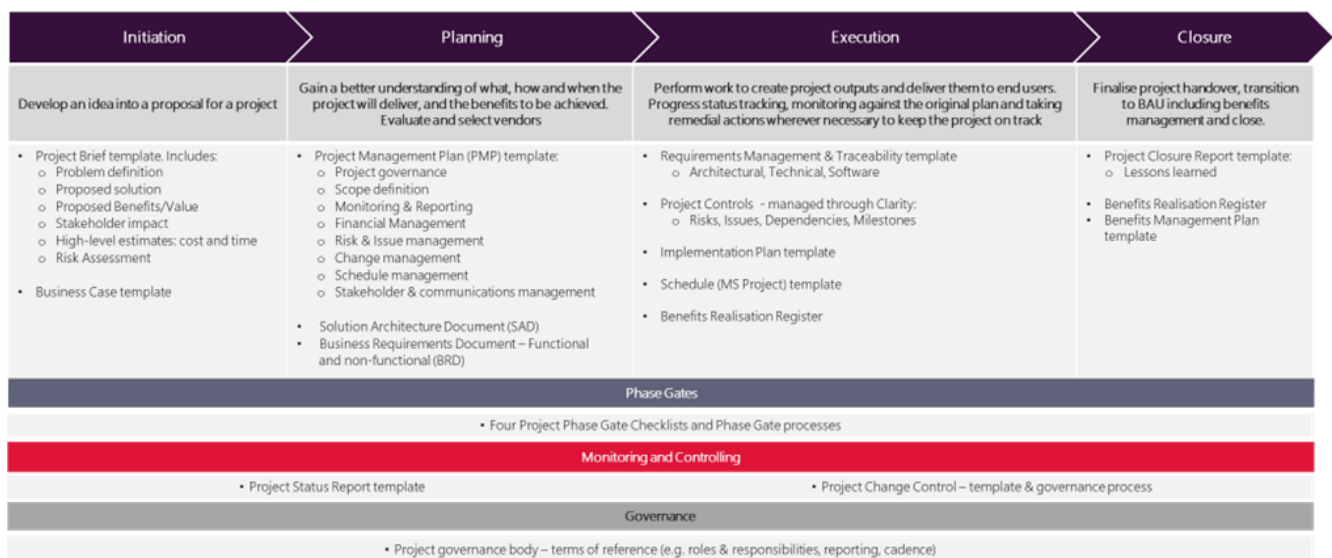
delivery, is governed by AEMO’s Project Management Framework. Capital projects are subject to a detailed investment request, which outlines the following considerations:

- Problem/opportunity
- Strategic driver
- Investment rationale
- Value/benefit
- Proposed solutions
- Cost estimates
- Options considered
- Change impacts/interdependencies
- Risks and contingency

These investment requests are subject to scrutiny and challenge from the ELT and AEMO’s Board. Project investment approval is subject to a stage gate process, and ongoing reporting to the ELT and Board is required for major programs of work. The Board is responsible for approving budget and fee estimates.

Figure 4 summarises AEMO’s investment approval cycle. This detailed top-down governance approach is well established within AEMO and will continue for all investments made under the new budget and fees framework.

**Figure 4: AEMO’s investment approval cycle**



Under the new framework outlined in this proposal, AEMO also intends to make investment briefs available for consideration during the relevant stakeholder consultation processes (noting that some information may need to be redacted due to confidentiality requirements). This approach is consistent with the current allowable revenue framework, whereby business cases and written evidence and analysis is shared with the ERA and made publicly available if confidentiality restrictions allow. Stakeholder feedback will then inform further consideration and any decisions by the AEMO Board and Management.

AEMO’s internal governance processes help establish a clear rationale for expenditure at the outset of the budget cycle and before commencing investment in Major Projects. Cost estimates are based on the best information available at the time, and there is continued monitoring throughout execution, with a formal change management process for when project assumptions invariably change.

#### 1.4.1.2 External governance – stakeholder consultation

AEMO proposes to amend the WEM Rules to include a requirement for AEMO to:

1. consult with stakeholders on its priorities, activities and resulting budget and fees, and to respond to any stakeholder feedback received; and
2. publish its plan and final budget and fees prior to the start of a financial year.

Stakeholder consultation on AEMO’s priorities, activities and the associated budget and fees will occur in advance of AEMO Board approval to provide visibility of AEMO’s activities and likely costs, and provide a genuine opportunity for stakeholders to be engaged. This will include a forward estimate of AEMO’s budget over at least a three-year period, to provide stakeholders with ongoing visibility on the likely trajectory of costs and fees.

In practice, AEMO proposes:

- Early engagement, including via AEMO’s Finance Consultation Committee (FCC)<sup>6</sup> and WA Strategic Energy Forum, late in each calendar year, on AEMO’s priorities, activities, and estimated budget and fees for the upcoming Financial Year.
- Publication of a draft annual budget and fees outlining AEMO’s priorities, activities and resulting budget and fees as influenced through early engagement activities by April ahead of the start of the upcoming Financial Year. This will be out for consultation over a period of at least 20 Business Days.
- Publication of the final annual budget and fees and responses to feedback by 30 June for the forthcoming Financial Year. The budget for the upcoming Financial Year would then be fixed. Estimates for the outer Financial Years will be included for context and fee smoothing, and will be revised on a rolling annual basis.

The intent of this process (proposed to be included in amended clause 2.22.3) is to complement AEMO’s existing governance framework and provide greater opportunities for stakeholder input and direct engagement than the current Allowable Revenue process.

Table 1 below compares the engagement approach under the current Allowable Revenue with that under the proposed Annual Budget and Fees process.

**Table 1: Comparison of AEMO’s stakeholder engagement approach under existing and proposed frameworks**

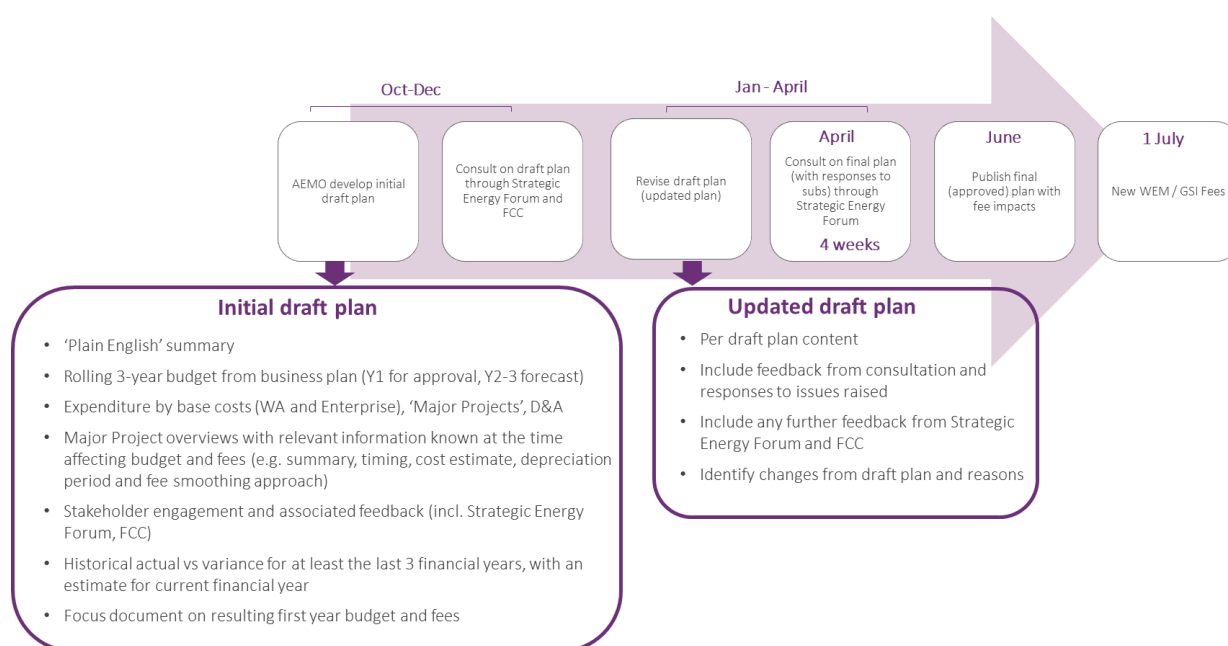
Engagement type	Existing Allowable Revenue process	Proposed Annual Budget and Fees process
<b>Initial engagement – strategy and priority setting</b>	Preparation for initial Allowable Revenue submission through various AEMO forums	Early consultation on proposed activities and priorities in preparation for draft Annual Budget and Fees through various AEMO forums
<b>First round of feedback</b>	Publication of AEMO’s initial Allowable Revenue submission  ERA issues paper raising key issues/questions and request for stakeholder submissions  ERA-led forum	Publication of draft Annual Budget and Fees with call for submissions (see section 1.4.1.2 for content)  AEMO-led forums

<sup>6</sup> More information on the FCC is available at: <https://aemo.com.au/consultations/industry-forums-and-working-groups/list-of-industry-forums-and-working-groups/financial-consultation-committee>

Engagement type	Existing Allowable Revenue process	Proposed Annual Budget and Fees process
Stakeholder feedback	Publication of submissions	Publication of submissions
Response to feedback	ERA draft decision summarising AEMO's initial submission, stakeholder feedback and ERA's initial views	Publication of revised Annual Budget and Fees with summary of, and responses to, feedback

The proposed points for external engagement throughout the year are shown in Figure 5.

Figure 5: External engagement on Budget and Fees



This external governance of AEMO's annual budget setting process will be complemented with direct stakeholder engagement on investment in Major Projects, which is based on AEMO's National Electricity Market (NEM) Reform Delivery Committee process. The Major Projects process is described in section 1.4.2.

### 1.4.1.3 Content of Annual Budget and Fees

AEMO proposes to establish a minimum level of information to be published as part of the Annual Budget and Fees in the WEM Rules. The minimum level of information and the processes for consultation are outlined in the proposed new section 2.22 of the WEM Rules, and include:

- AEMO's priorities, enterprise-wide and for the WA functions, incorporating feedback for early engagement where relevant.
- Estimated expenditure for the current Financial Year and commentary on any material variances.
- The proposed budget for the next Financial Year showing the breakdown of capital and operating expenditure by expense type, and separating 'base' operating expenditure from Major Projects.
- Information on Major Projects relevant to budgets and fees as available depending on which stage of the project lifecycle it is in.

- Forecasts for the following two years to show expenditure trajectories and provide context for any budget and fee smoothing.
- The unadjusted revenue path, estimated Market Participant Market Fees and the impact of each expense type on those estimates.
- Information on revenue or fee smoothing options considered and the approach used in developing the Annual Budget and Fees with reasons.
- Details of stakeholder engagement already undertaken, and proposed for the future, with any material feedback and AEMO's response.

As the proposed new process is embedded, AEMO intends to work with stakeholders to ascertain the type and granularity of information stakeholders find valuable. AEMO expects the process will continue to evolve as stakeholders' needs change.

The intent of the proposed new framework is to provide better information to Market Participants, and engage on our priorities and activities directly, rather than through a third party (in this case the ERA). The type of information and granularity of the information underpinning our budget and fee setting will not change from the current Allowable Revenue process, however more of it will be available to all stakeholders and can be adapted over time to suit stakeholder needs.

The following Table 2 shows the information provided to stakeholders under the current Allowable Revenue compared with the proposed new Budget and Fees framework.

**Table 1: Comparison of content published under existing and proposed frameworks**

Key content	Existing Allowable Revenue process	Proposed Annual Budget and Fees process
Governance and procurement arrangements, including evidence of competitive procurement and market testing	✓	✓
Expenditure forecasting methods	✓	✓
Industry trends and emerging issues	x	✓
AEMO strategic priorities	✓	✓
WA priorities and alignment of work program and costs to WA functions and industry priorities	x	✓
Expenditure performance in last 3 years	✓	✓
Performance against KPIs	x	✓
Performance in project delivery	x	✓
Unsmoothed revenue forecast by category for next 3 years	✓	✓
Fee smoothing options, analysis and approach	x	✓
Smoothed revenue by category for next 3 years	x	✓
Capital expenditure by category for next 3 years	✓	✓

Key content	Existing Allowable Revenue process	Proposed Annual Budget and Fees process
Major Project information / business cases based on lifecycle stage with cost benefit analysis, options analysis and assessment criteria	x	✓
Impact of Major Projects on fees	x	✓
Operating expenditure forecast by category for next 3 years	✓	✓
Evidence of the deliverability of the proposed work program	x	✓
Opex projects	✓	✓
Stakeholder engagement activities undertaken and planned	x	✓
Stakeholder feedback and responses	✓	✓
Risk assessments	✓	✓
Benchmarking (overall and project)	✓	✓
Estimated WEM fees including trajectory	✓	✓
Annual financial reporting for prior year	✓	✓

#### 1.4.1.4 Revenue and fee smoothing

As noted above, the current revenue and fee determination framework requires AEMO to adjust fees for the most recent full year actuals to ‘true-up’ the amount of revenue recovered, accounting for the variance between the forecast revenue and the actual revenue requirement.

This results in potentially significant fluctuations between years (both increases and decreases) where there is a material variance between forecast revenue and the actual revenue requirement. This happens most often in periods of uncertainty such as currently experienced through the energy transition. This volatility in fees from one year to the next is inconsistent with Market Participants’ desire for fee certainty and stability.

AEMO proposes to amend clause 2.24.5A of the WEM Rules to allow it to either recover a shortfall or retain any excess revenue related to its costs<sup>7</sup> between years. This will allow AEMO to smooth revenue and fees over the short term. The proposed revenue smoothing ability would be underpinned by a requirement for AEMO to seek to trend the revenue differential towards zero over time.

<sup>7</sup> AEMO’s proposal only relates to smoothing for AEMO’s Market Participant Market Fees. AEMO does not propose to provide for smoothing of the Regulator and Coordinator fees because they are set by Government through a separate process, the timing of which often would provide insufficient time for AEMO to consult with industry or apply any smoothing. Clauses 2.24.6 and 2.24.6A of the WEM Rules only require the ERA and the Coordinator to provide AEMO with the relevant budget information five business days prior to 30 June each year. The Regulator and Coordinator Fees are relatively small compared to AEMO’s Market Participant Market Fees, meaning that smoothing of these will provide little impact.

AEMO proposes to consult with stakeholders on smoothing options as part of its annual determination of its budget and fees.

#### **1.4.2 Major Project governance, delivery and reporting**

AEMO undertakes projects to implement energy reforms, maintain and upgrade its systems, and to deliver its functions. AEMO acknowledges that the costs of major projects need to be considered earlier than has been the case in recent years, and that stakeholders need an opportunity to provide input into the timing, prioritisation and in some cases scope of these projects – many of which also have implementation costs for Market Participants. Early consultation on this rule change proposal has reinforced this as a key stakeholder requirement.

To enable this, AEMO proposes establishing the concept of a ‘Major Project’ and an associated requirement for stakeholder consultation throughout the initiation and delivery of Major Projects. As such, AEMO proposes to introduce the requirement on AEMO to consult with the Market Advisory Committee (MAC) to determine whether a project is a Major Project. AEMO will also be required to provide additional information throughout the lifecycle of the project or program. More detail around the governance and reporting processes that will be implemented for Major Projects is outlined below.

A new requirement for AEMO to determine whether a project is a Major Project, and the criteria AEMO must consider when determining whether a project is a Major Project, is proposed to be included in proposed new clauses 2.22.5 to 2.22.7 of the WEM Rules. In response to consultation on a draft of this Rule Change Proposal, AEMO proposes this to include consideration of the impact on AEMO, Market Participants, and the operation of the WEM. The additional reporting obligation is captured in the proposed new clause 2.22.8 of the WEM Rules.

AEMO considers Major Projects could include any of the following programs or projects:

- a major Government-led reform or market development project or program of work;
- a major change to a function, responsibility, obligation or power of AEMO under these rules; and
- a major change to any of the systems (hardware or software) AEMO uses in the performance of its functions, responsibilities, obligations or powers under the WEM Rules.

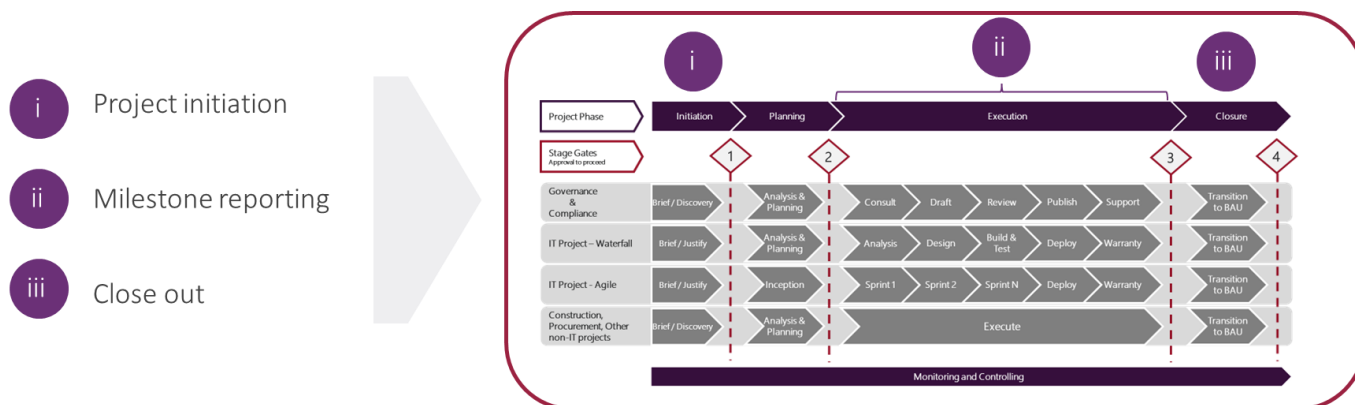
If AEMO (in consultation with the MAC) determines a project is a Major Project, it will become subject to additional engagement with relevant stakeholders and the MAC (or working group, should these functions be delegated by the MAC). The MAC may be requested to provide advice on these projects to AEMO and/or the Coordinator. AEMO considers the MAC may wish to establish a working group to undertake this function. This function is proposed to be included as new clause 2.22.9 of the WEM Rules.

Major Projects will then form a component of AEMO’s Annual Budget and Fees, as detailed above.

Similar to the annual budget process, the process for identifying, initiating and undertaking Major Projects aligns with our investment planning and governance frameworks, as outlined in Figure 6.



**Figure 6: Mapping the Major Project reporting framework to AEMO’s internal governance processes**



AEMO proposes the three stages of Major Project reporting as follows:

### 1. Project initiation

- AEMO to document high level implementation plan through development of a project brief, to include AEMO’s early understanding of the following:
  - description of driver of project including link to objectives;
  - technical solution;
  - timing;
  - options for consideration, variations in scope, timing, phasing;
  - AEMO’s cost estimate and fee impact;
  - any known information on Market Participant impacts including cost and change management;
  - key assumptions; and
  - risks with any proposed controls.
- MAC to provide feedback on the project brief, including on whether the project should be a Major Project.
- MAC and AEMO to agree an indicative milestone reporting plan.

### 2. Milestone reporting

- Provide visibility of the delivery progress of a Major Project, including material variances (+/-) and reason for variances related to:
  - technical solution;
  - timeframes;
  - AEMO’s cost estimate and fee impact;
  - key assumptions;
  - any known information on impacts to Market Participant including cost and change management; and
  - risks and/or controls.
- MAC to provide feedback as required to inform project delivery, including where required recommendations for AEMO’s consideration.
- Documentation of key changes to be published to provide transparency.

### 3. Close out

- Provide visibility of what was achieved as part of each Major Project, including:

- project objectives mapped to achievements/expected outcomes;
  - final technical solution, including any changes to scope;
  - overall cost, including any key drivers of higher/lower costs for both AEMO and Market Participants (if known);
  - project timelines, including any challenges or opportunities;
  - key risks and success of mitigation measures;
  - lessons learnt and overall project commentary; and
  - any feedback received from Market Participants (as applicable).
- Documentation of project outcomes to be published to provide transparency and inform the delivery of future projects.

While AEMO does not propose to include this level of detail in the WEM Rules, this information has been provided to outline how it would engage with stakeholders in practice (as additional context for consideration of the proposed Amending Rules).

Separately to this Rule Change Proposal, AEMO has, and will continue to, engage with the MAC<sup>8</sup> to establish a MAC Working Group to consider and engage with AEMO on these Major Projects. AEMO proposes to refer to engagement with MAC despite the MAC potentially choosing to delegate this responsibility to a Working Group, as the Working Group has no formal standing under the WEM Rules.

AEMO intends this MAC Working Group would operate in a similar manner to the NEM Reform Delivery Committee<sup>9</sup>. This group has been established as an industry-wide body tasked with providing advice on a reform implementation roadmap for the NEM that appropriately sequences and seeks to achieve least whole of system cost for implementation of reforms, and supports the overall delivery of the reform portfolio.

AEMO expects the first priority of the new MAC Working Group would be to collaborate with AEMO and Energy Policy WA to develop a 'WEM reform roadmap', similar to that produced for the NEM<sup>10</sup>, after which it will be the group providing input into, and receiving program implementation documentation. Similarly, AEMO would seek to produce materials similar to the initiative briefs and business cases produced for the NEM.<sup>11</sup>

### **1.4.3 Visibility of AEMO's performance**

#### **1.4.3.1 Annual financial reporting**

AEMO considers visibility of its annual financial reporting is critical to stakeholders' understanding of AEMO's finances and financial performance.

Clause 2.22A.8 of the WEM Rules requires AEMO to publish its actual financial performance against the Annual Budget and Fees for the previous financial year.<sup>12</sup> Under the new budget and fees framework, AEMO will continue to publish its financial reports following the end of the financial year (by 31 October).

<sup>8</sup> More information on the establishment of the Working Group is included as Agenda Item 7 of the 25 July 2024 MAC Meeting Papers, available at: [https://www.wa.gov.au/system/files/2024-07/mac\\_2024\\_07\\_25\\_meeting\\_papers.pdf](https://www.wa.gov.au/system/files/2024-07/mac_2024_07_25_meeting_papers.pdf)

<sup>9</sup> More information on the scope and operation of the NEM Reform Delivery Committee are available at: <https://aemo.com.au/en/consultations/industry-forums-and-working-groups/list-of-industry-forums-and-working-groups/reform-delivery-committee>

<sup>10</sup> The NEM Reform Implementation Roadmap is available at: <https://aemo.com.au/initiatives/major-programs/nem-reform-implementation-roadmap>

<sup>11</sup> Ibid.

<sup>12</sup> AEMO's financial reports are available at: <https://aemo.com.au/en/energy-systems/electricity/wholesale-electricity-market-wem/wa-allowable-revenue/western-australian-financials>

#### 1.4.3.2 Annual performance reporting

Under the new framework, AEMO will provide visibility of its performance on non-financial matters. This is consistent with stakeholder feedback during engagement on an early draft of this Rule Change Proposal.

AEMO's priorities and performance measures form part of its annual strategic corporate plan. AEMO proposes a new obligation to report on its performance against these priorities and measures. The performance report would provide a summary of AEMO's achievements and performance against the measures, identify actions to address any areas of underperformance, and highlight any changes to measures proposed in the forthcoming reporting period.

#### 1.4.4 **Review and oversight of AEMO's budget and fees process**

One of the benefits of the current Allowable Revenue framework is that it provides for third-party oversight of AEMO's costs – noting that while AEMO is a not-for-profit entity, it is also not subject to competitive pressures.

AEMO therefore considers it important to maintain the ability for an independent party to review the way it determines its budget and fees, to ensure the framework is delivering benefits for Market Participants and energy consumers consistent with the Wholesale Market Objectives and the new State Electricity Objective.

The current drafting of clauses 2.16.13A and 2.16.13B of the WEM Rules (the 'WEM effectiveness review') requires the Coordinator to monitor market design problems and the effectiveness of AEMO in carrying out its functions under the WEM Rules. The Coordinator will therefore be able to assess the effectiveness of AEMO in carrying out its functions under new section 2.22, including whether AEMO has sought to recover its costs in accordance with the principles proposed under new clause 2.22 (including prudence and efficiency).

In accordance with clause 2.16.13D of the WEM Rules, the next WEM Effectiveness Review report is due to be published by 1 July 2025. AEMO has therefore proposed a transitional rule to exclude assessment of AEMO's performance under section 2.22 from the next WEM effectiveness review. The new framework would not have completed a full cycle and it would not be possible for the Coordinator to make an adequate assessment.

AEMO has also proposed a transitional rule requiring the Coordinator to specifically assess the effectiveness of the new budget and fees process under section 2.22 as well AEMO's effectiveness in fulfilling its new obligations. This is proposed to occur as part of the second WEM effectiveness review, scheduled to be completed by 1 July 2028. AEMO considers it necessary to ensure there is a thorough review of the effectiveness, benefits, and suitability of the new framework based on two-to-three years of operation (which will likely include the delivery of several Major Projects). This is intended to give confidence to key stakeholders that the process is fit-for-purpose.

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## 2. **Explain the reason for the degree of urgency:**

Western Australia's energy transition is ongoing. Further market reforms and significant investments to support the move towards a decarbonised power system are scheduled over the next decade (for example Distributed Energy Resources integration, amendments to the Reserve Capacity Mechanism, meter data handling investments, changes to WEM settlement timeframes), with other initiatives likely to emerge.

AEMO is a facilitator of the energy transition and must be able to respond quickly to the changing needs of the power system and market. Both AEMO and Market Participants will benefit from an environment in which AEMO can secure funding on an annual basis, and provide certainty and visibility around its key priorities and investments. AEMO therefore considers the rule changes outlined in this proposal to be essential to the efficient management of the energy transition.

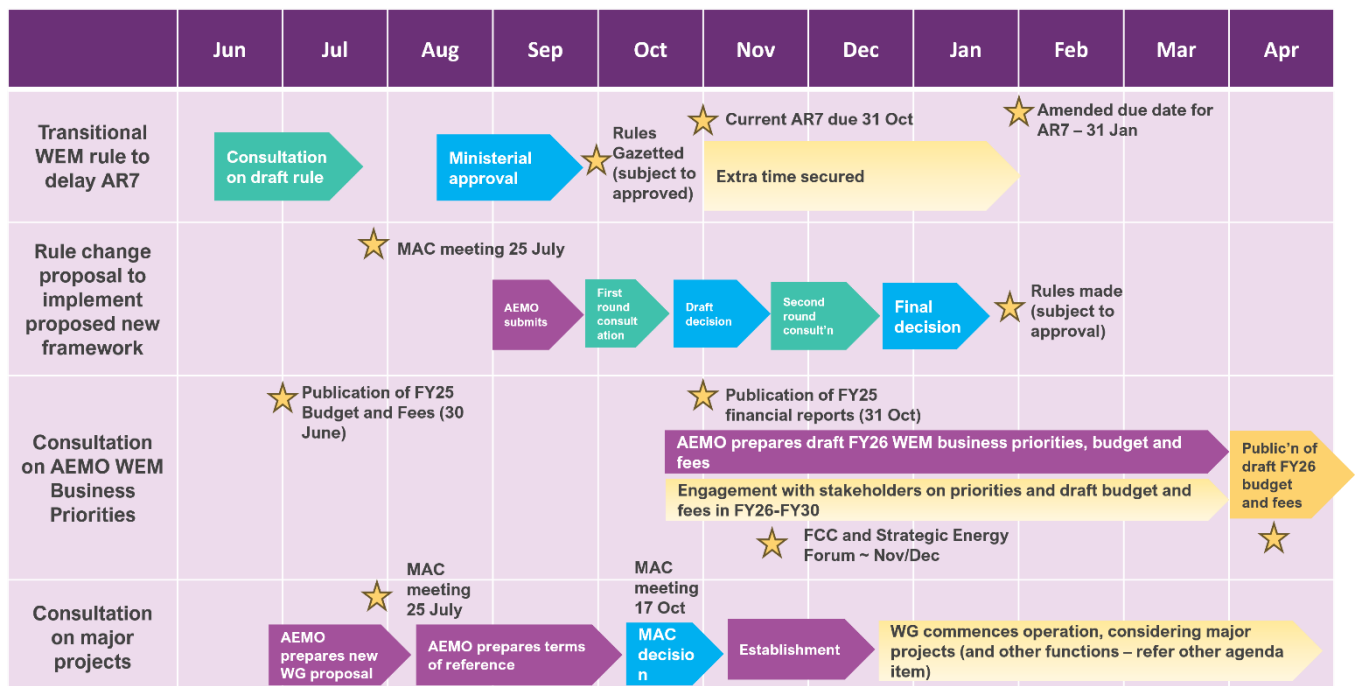
AEMO’s next allowable revenue period (AR7) extends from 1 July 2025 to 30 June 2028. Under the current framework, AEMO is required to submit its AR7 proposal to the ERA by 31 October 2024. Energy Policy WA has consulted on, transitional WEM Rules provisions to defer this date until 31 January 2025. This is to allow adequate time to consider an alternative framework under the progression of this Rule Change Proposal.<sup>13</sup>

AEMO therefore proposes that the necessary amendments to introduce a new fit-for-purpose budget and fees framework are progressed as a matter of urgency. This will ensure the new framework can be implemented in time for the 2025-26 Financial Year and provide those immediate benefits around forward-looking Market Participant Market Fees, Major Projects and AEMO’s funding requirements.

Any delay to the progression of this rule change proposal may result in AEMO being required to submit a proposal under the existing allowable revenue process, with full oversight by the ERA. The risks and costs associated with this process have been outlined in the first section of this rule change proposal.

The timeline set out in Figure 8 summarises the Allowable Revenue rule change proposals and consultation on Major Projects, strategy, priorities and the resulting budget and fees over coming months.

**Figure 8: Timeline for proposed rule changes and consultation**



<sup>13</sup> See Energy Policy WA, Miscellaneous 3 WEM Rule Amendments available at <https://www.wa.gov.au/government/publications/exposure-draft-of-the-miscellaneous-amendments-no3-wem-amending-rules>.

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

For ease of review and reference AEMO proposes to remove section 2.22A, and insert a new section that replaces the current blank section 2.22 of the WEM Rules.

Mark-ups are based on the WEM Rules in force as at 11 July 2024 (8 June 2024 version). AEMO acknowledges EPWA is in the process of progressing Amending Rules that affect a number of clauses in sections 2.22A and 2.24. AEMO will incorporate these changes to the extent relevant once those rules have been gazetted.

AEMO proposes the following amendments to the WEM Rules.

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2.22A. AEMO’s annual financial and performance reporting

~~2.22A. Determination of AEMO’s budget~~

...

#### Explanatory Note

New transitional clause 1.XX.X is proposed to ensure the next WEM effectiveness review, required to be published before 1 July 2025, does not capture the new Annual Budget and Fees framework. This is because the first process will only be completed a short time ahead of the due date for the report, which would provide insufficient time for the assessment of the process.

New transitional clause 1.XX.XX is proposed to require the Coordinator (as part of its WEM effectiveness monitoring and reporting) to specifically assess whether the new Annual Budget and Fees framework is fit for purpose and delivers on the intended objectives, and whether AEMO has been effective in fulfilling/performing its new obligations under section 2.22.

These new clauses are proposed as transitional provisions as the Coordinator will already have scope to consider these matters on an ongoing basis under existing clauses 2.16.13A and 2.16.13B.

More information is provided in section 1.4.4 of this Rule Change Proposal.

1.XX.X. The Coordinator is not required to monitor, or report on the effectiveness of the operation of section 2.22 of the WEM Rules under clause 2.16.13A and 2.16.13B(b) until after 1 July 2025.

1.XX.Y. For the second report issued under 2.16.13D, the Coordinator must specifically assess and report on:

(a) the effectiveness of AEMO in carrying out its obligations under section 2.22 of the WEM Rules; and

(b) the effectiveness of the process for determining AEMO's Annual Budget and Fees under section 2.22 of the WEM Rules.

...

#### **Explanatory Note**

Proposed new section 2.22 is intended to replace the existing framework for AEMO's Allowable Revenue and Forecast Capital Expenditure under section 2.22A with the new Annual Budget and Fees framework.

More information is provided in section 1.4 of this Rule Change Proposal.

...

## **2.22. ~~[Blank]~~Determination of AEMO's Annual Budget and Fees**

2.22.1. AEMO may recover its costs for performing its functions under the WEM Regulations and the WEM Rules, subject to the processes outlined in this section 2.22 of the WEM Rules.

#### **Explanatory Note**

Proposed new clause 2.22.2 outlines the principles AEMO must apply in seeking to recover its costs. The key difference from existing provisions under the WEM Rules is the ability 'smooth' fees over the short to medium term to reduce annual volatility in fees.

More information on revenue and fee smoothing is provided in section 1.4.1.3 of this Rule Change Proposal.

2.22.2. AEMO must seek to recover its costs for performing its functions in accordance with the following principles:

(a) recurring expenditure requirements and payments are recovered in the year of the expenditure, subject to clauses 2.22.2(e) to 2.22.2(g);

(b) capital expenditure is to be recovered through the depreciation and amortisation of the assets acquired by the capital expenditures in a manner that is consistent with generally accepted accounting principles;

(c) if 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 the respective functions;

(d) costs incurred by AEMO are only those that would be incurred by a prudent provider acting efficiently;

- (e) if AEMO recovers an excess of revenue over expenditure in a Financial Year, it may roll over the excess to a later Financial Year (or later Financial Years) so as to reduce revenue requirements in the later Financial Year or Financial Years;
- (f) AEMO may recover a shortfall of revenue as against expenditure for the provision of a particular service/function in a later financial year or later financial years; and
- (g) AEMO may take any other action it considers desirable to smooth the impact of actual or anticipated cost variations on Market Participants.

**Explanatory Note**

Proposed new clause 2.22.3 outlines the process and timing requirements for AEMO's Annual Budget and Fees, with subclause 2.22.3(a) providing a mechanism for AEMO to undertake early consultation on its business activities and priorities in addition to an annual formal consultation process outlined in subclauses 2.22.3(b) and (c).

More information is provided in section 1.4.1.1 of this Rule Change Proposal.

2.22.3. AEMO must adhere to the following requirements in developing its Annual Budget and Fees:

- (a) undertake initial consultation on its proposed activities and priorities, and indicative budget and Market Participant Market Fees, prior to the publication of its draft Annual Budget and Fees under clause 2.22.3(b);
- (b) by 30 April each year, publish on the WEM Website a draft Annual Budget and Fees for public consultation for no fewer than 20 Business Days; and
- (c) by 30 June each year, publish on the WEM Website the final Annual Budget and Fees, including the level of Market Participant Market Fees that will apply for the coming Financial Year, alongside:
  - i. AEMO's response to the issues raised in submissions on the draft Annual Budget and Fees; and
  - ii. an explanation of any material changes from the draft Annual Budget and Fees published under clause 2.22.3(b).

**Explanatory Note**

Proposed new clause 2.22.4 is proposed to be introduced to give AEMO the flexibility to engage more broadly on its priorities and activities throughout the year, in a fit-for-purpose manner.

2.22.4. AEMO may undertake any further consultation on its proposed activities, priorities, budget and estimated level of Market Participant Market Fees as it considers necessary throughout the Financial Year.

**Explanatory Note**

Proposed new clause 2.224 is designed to outline the minimum requirements that must be included in AEMO's draft and final Annual Budget and Fees documents. AEMO acknowledges there must be sufficient information available to enable Market Participants and interested stakeholders to make a considered submission on AEMO's draft Annual Budget and Fees under clause 2.22.3(b).

The proposed drafting of clause 2.22.5 covers the material information AEMO considers relevant to this assessment, but allows discretion to include more information where relevant. In practice AEMO will work with stakeholders to ensure there is an appropriate balance of information such that stakeholders are informed but not overwhelmed with the amount of information provided.

2.22.5. AEMO must include the following information, as a minimum, in its Annual Budget and Fees published under clauses 2.22.3(b) and 2.22.3(c):

- (a) relevant information regarding AEMO's activities and priorities for the coming Financial Year;
- (b) an estimate of the expenditure expected to be incurred in the current Financial Year, incorporating year-to-date actual expenditure and reasons for any material variances to the relevant year final Annual Budget and Fees;
- (c) the budget for the coming Financial Year identifying forecast expenditure, which must be classified as:
  - i. forecast base operating expenditure;
  - ii. financing costs;
  - iii. depreciation and amortisation;
  - iv. forecast base capital expenditure; or
  - v. forecast expenditure associated with Major Projects as defined under clause 2.22.5, identified as either capital or operating expenditure;
- (d) the level of Market Participant Market Fees for the coming Financial Year, including the impact of each expenditure category under clause 2.22.4(c) on Market Participant Market Fees;
- (e) information on each Major Project determined under clause 2.22.6, as relevant to the Annual Budget and Fees;
- (f) forecast expenditure for a minimum of two Financial Years following the coming Financial Year, classified to the extent possible, by the same categories as the proposed budget;
- (g) the unadjusted revenue path and Market Participant Market Fees resulting from the Annual Budget and Fees;



- (h) information on the revenue or fee smoothing options considered by AEMO in developing its Annual Budget and Fees, with reasons for the smoothing approach used, if any; and
- (i) details of any additional stakeholder engagement activities undertaken under clause 2.22.3(a) or 2.22.4, and any feedback received.

#### **Explanatory Note**

Proposed new clauses 2.22.6 to 2.22.9 outline the new framework for Major Projects as discussed in section 1.4.2 of this Rule Change Proposal. The Major Projects framework is designed to identify projects that stakeholders should have an opportunity to understand in greater detail and require AEMO to provide the appropriate information on the progress of these projects on a regular basis.

Clauses 2.22.6 and 2.22.7 provide the criteria for Major Projects, and 2.22.8 provides an overview of the additional obligations that the determination of a project as a Major Project will trigger.

2.22.6. AEMO may determine any of the following types of projects and programs to be a Major Project:

- (a) a major Government-led reform or market development project or program of work;
- (b) a major change to a function, responsibility, obligation or power of AEMO under the WEM Rules;
- (c) a major change to any of the systems (hardware or software) AEMO uses in the performance of its functions, responsibilities, obligations or powers under the WEM Rules; or
- (d) any other program or project raised by a Market Participant, the Market Advisory Committee or other relevant stakeholder for consideration by AEMO as a Major Project.

2.22.7. For the purposes of making a determination under clause 2.22.6, AEMO must:

- (a) consider the potential impact of the project or program on AEMO, Rule Participants and the operation of the Wholesale Electricity Market, having regard to the:
  - i. scope of change;
  - ii. cost; and
  - iii. timing (including AEMO's delivery timeframe); and
- (b) consult with the Market Advisory Committee and other relevant stakeholders.

2.22.8. If AEMO determines a project or program to be a Major Project under clause 2.22.6, AEMO must:

- (a) publish detailed information on the Major Project;
- (b) engage with Market Participants and other relevant stakeholders as required; and

(c) report to the Market Advisory Committee on the plan for, and progress of, the delivery of the Major Project.

2.22.9. The Market Advisory Committee may provide advice on Major Projects, as requested or required by AEMO or the Coordinator.

**Explanatory Note**

Clause 2.22.10 is an optional clause for inclusion. AEMO would welcome feedback from interested stakeholders, and consideration by the Coordinator, as to whether the option of providing further guidance (in the form of a WEM Guideline or WEM Procedure) on these processes would be beneficial.

2.22.10. AEMO may develop and publish guidelines on the WEM Website regarding its Annual Budget and Fees process or the requirements associated with Major Projects under this section 2.22.

**Explanatory Note**

Proposed clause 2.22A.1(a) is consistent with the drafting in existing clause 2.22A.8 of the WEM Rules and retains the requirement for publication of the annual financial report. New clause 2.22A.1(b) is a new requirement for AEMO to report on its actual performance against its key priorities and performance measures.

These reporting requirements are intended to provide additional transparency and accountability with respect to AEMO's financial and non-financial performance. See section 1.4.3 of this rule change proposal for further detail about the type of information AEMO will include in this report.

**2.22A. AEMO's annual financial and performance reporting**

2.22A.1. By 31 October each year, AEMO must publish on the WEM Website:

- (a) a financial report showing AEMO's actual financial performance against its final Annual Budget and Fees published under clause 2.22.3(c) for the previous Financial Year (including, without limitation, the actual amount paid to a Delegate compared to the budgeted amount); and
- (b) a performance report providing a summary of AEMO's performance against its key performance measures for the previous Financial Year.

**~~2.22A. Determination of AEMO's budget~~**

~~2.22A.1. Subject to the requirements of this section 2.22A, AEMO may recover its costs for performing its functions under the WEM Regulations and the WEM Rules.~~

~~2.22A.2. For the Review Period, AEMO must seek the determination of its Allowable Revenue and Forecast Capital Expenditure from the Economic Regulation Authority for its functions, in accordance with the proposal guideline referred to in clause 2.22A.9.~~

~~2.22A.2A. A submission by AEMO under clause 2.22A.2 must be made and processed in accordance with the following timelines:~~

- ~~(a) — by 31 October of the year prior to the start of the Review Period, AEMO must submit a proposal for its Allowable Revenue and Forecast Capital Expenditure over the Review Period to the Economic Regulation Authority;~~
- ~~(b) — by 31 March of the year in which the Review Period commences, the Economic Regulation Authority must publish on its website a draft determination of AEMO's Allowable Revenue and Forecast Capital Expenditure for the Review Period for public consultation;~~
- ~~(c) — by 30 April of the year in which the Review Period commences, the Economic Regulation Authority must prepare and publish on its website its final determination of AEMO's Allowable Revenue and Forecast Capital Expenditure for the Review Period together with any submission received in response to the draft determination published in accordance with clause 2.22A.2A(b); and~~
- ~~(d) — where the Economic Regulation Authority does not make a determination by the date in clause 2.22A.2A(c) or clause 2.22A.2B(c), the Market Participant Market Fee rate determined in accordance with section 2.24 for the current Financial Year will continue to apply until the Economic Regulation Authority makes a determination.~~

~~2.22A.2B. Notwithstanding clause 2.22A.2A, for the Review Period from 1 July 2022 to 1 July 2025 the following applies:~~

- ~~(a) — the Economic Regulation Authority must publish a proposal guideline by 31 October 2021;~~
- ~~(b) — AEMO must submit a proposal for its Allowable Revenue and Forecast Capital Expenditure to the Economic Regulation Authority for the Review Period by 31 December 2021;~~
- ~~(c) — the Economic Regulation Authority must publish on its website a draft determination of AEMO's Allowable Revenue and Forecast Capital Expenditure for the Review Period for public consultation by 31 March 2022; and~~
- ~~(d) — the Economic Regulation Authority must prepare and publish on its website its final determination of AEMO's Allowable Revenue and Forecast Capital Expenditure for the Review Period by 31 May 2022.~~

~~2.22A.3. AEMO's proposal under clauses 2.22A.2A(a) or 2.22A.2B(b) or AEMO's application for reassessment under clauses 2.22A.12 or 2.22A.13 must, to the extent practicable, identify proposed costs that are associated with a specific project or where that is not practicable, one or more specific functions.~~

~~2.22A.4. If AEMO appoints a Delegate, then its proposal for, or application for reassessment of, its Allowable Revenue and Forecast Capital Expenditure must separately itemise the amount payable to the Delegate.~~

~~2.22A.5. The Economic Regulation Authority must take the following into account when determining AEMO's Allowable Revenue and Forecast Capital Expenditure or an application for reassessment to the Allowable Revenue or Forecast Capital Expenditure:~~

- ~~(a) — the Allowable Revenue must be sufficient to cover the forward looking costs of performing AEMO's functions in accordance with the following principles:
 
  - ~~i. — recurring expenditure requirements and payments are recovered in the year of the expenditure; and~~
  - ~~ii. — capital expenditure is to be recovered through the depreciation and amortisation of the assets acquired by the capital expenditures in a manner that is consistent with generally accepted accounting principles;~~~~
- ~~(b) — 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 performing AEMO's functions, 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 functions and/or projects in other jurisdictions;~~
- ~~(d) — 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:
 
  - ~~i. — costs recoverable as part of AEMO's Allowable Revenue and Forecast Capital Expenditure; and~~
  - ~~ii. — other costs not to be recovered under the WEM Rules; and~~~~
- ~~(e) — any other matters the Economic Regulation Authority considers relevant to its determination.~~

~~2.22A.6. The Economic Regulation Authority may do any or all of the following in respect to AEMO's proposal under clauses 2.22A.2A(a) or 2.22A.2B(b):~~

- ~~(a) — approve the costs of any project;~~
- ~~(b) — approve the costs of AEMO performing its functions;~~
- ~~(c) — if the Economic Regulation Authority considers that some costs do not meet the requirements of clause 2.22A.5, reject the costs fully or partially, or substitute those costs with costs the Economic Regulation Authority considers meets the requirements of clause 2.22A.5; and~~
- ~~(d) — recommend to AEMO that some of the costs be considered in a subsequent Review Period or in accordance with clause 2.22A.14.~~

~~2.22A.7. By 30 June each year, AEMO must publish on the WEM Website a budget for the costs AEMO will incur in performing its functions for the coming Financial Year (including, without limitation, the amount to be paid to a Delegate). AEMO must ensure that its budget is:~~

- ~~(a) — consistent with the Allowable Revenue and Forecast Capital Expenditure determined by the Economic Regulation Authority for the relevant Review Period and any reassessment; and~~

~~(b) — reported in accordance with the Regulatory Reporting Guidelines issued by the Economic Regulation Authority from time to time in accordance with clause 2.22A.9.~~

~~2.22A.8. By 31 October each year, AEMO must publish on the WEM Website a financial report showing AEMO's actual financial performance against its budget for the previous Financial Year (including, without limitation, the actual amount paid to a Delegate compared to the budgeted amount). The report must be in accordance with the Regulatory Reporting Guidelines issued by the Economic Regulation Authority from time to time in accordance with clause 2.22A.9.~~

~~2.22A.9. The Economic Regulation Authority must issue guidelines, following public consultation, in relation to this section 2.22A, including:~~

~~(a) — proposal guidelines, which must consider how future projects that carry a risk of not proceeding or for which the associated costs are not able to be quantified may be dealt with, and provide clarity and guidance to AEMO and Market Participants regarding the level of detail about projects, functions and costs expected in AEMO's proposal; and~~

~~(b) — regulatory reporting guidelines, which:~~

~~i. — must contain annual reporting obligations and provide clarity and guidance to AEMO and Market Participants about the scope of reporting and how AEMO should annually report to the Economic Regulation Authority and Market Participants; and~~

~~ii. — are aimed at providing transparency and accountability in relation to AEMO's functions and Allowable Revenue and Forecast Capital Expenditure.~~

~~2.22A.10. The Economic Regulation Authority may amend guidelines issued under clause 2.22A.9 at any time, following public consultation which allows a reasonable opportunity for relevant stakeholders to present their views.~~

~~2.22A.11. Where the revenue earned for the functions performed by AEMO via Market Fees in the previous Financial Year, is greater than or less than AEMO's expenditure for that Financial Year, AEMO's current year's budget must take into account any difference between AEMO's Market Fees revenue and AEMO's expenditure in the previous Financial Year by:~~

~~(a) — decreasing the budgeted revenue by the amount of any revenue surplus; or~~

~~(b) — increasing the budgeted revenue by the amount of any revenue shortfall.~~

~~2.22A.12. Where, taking into account any adjustment under clause 2.22A.11, AEMO's budget is likely to result in revenue recovery, over the relevant Review Period, being at least the lower of 10% of the Allowable Revenue or \$10 million, greater than the Allowable Revenue determined by the Economic Regulation Authority, AEMO must apply to the Economic Regulation Authority to reassess the Allowable Revenue.~~

~~2.22A.13. AEMO must apply to the Economic Regulation Authority to determine the adjusted Forecast Capital Expenditure for the current Review Period if the capital expenditure, over the relevant Review Period, is likely to be at least the lower of 10% of the Forecast Capital Expenditure or~~

~~\$10 million, greater than the Forecast Capital Expenditure determined by the Economic Regulation Authority.~~

~~2.22A.13A. If AEMO underspends on the Allowable Revenue and/or Forecast Capital Expenditure determined by the Economic Regulation Authority in a Review Period, then, for the next Review Period, the \$10 million threshold in clause 2.22A.13 is to be increased to the amount equal to 30 percent of the underspend plus \$10 million.~~

~~2.22A.14. AEMO may apply to the Economic Regulation Authority, at any time during a Review Period, for additional costs to be considered by the Economic Regulation Authority as part of the Allowable Revenue and Forecast Capital Expenditure for that Review Period:~~

~~(a) — for the Allowable Revenue:~~

- ~~i. — costs previously rejected by the Economic Regulation Authority pursuant to clause 2.22A.6;~~
- ~~ii. — new costs for new projects or new functions conferred on AEMO since AEMO's proposal for its Allowable Revenue for the current Review Period was submitted; and~~
- ~~iii. — costs which were not able to be estimated with reasonable confidence at the time the Allowable Revenue for the current Review Period was submitted; and~~

~~(b) — for the Forecast Capital Expenditure:~~

- ~~i. — costs previously rejected by the Economic Regulation Authority pursuant to clause 2.22A.5;~~
- ~~ii. — new costs for new projects or new functions conferred on AEMO since AEMO's proposal for its Forecast Capital Expenditure for the current Review Period was submitted; and~~
- ~~iii. — costs which were not able to be estimated with reasonable confidence at the time of the Forecast Capital Expenditure for the current Review Period was submitted.~~

~~2.22A.15. The Economic Regulation Authority may request information from AEMO in relation to the performance of its functions under this section 2.22A. AEMO must provide the information to the Economic Regulation Authority by the time specified in a request, which must be reasonable.~~

~~2.22A.16. AEMO must make an application under clauses 2.22A.12 or 2.22A.14(a) by 31 March for the Economic Regulation Authority to make a determination before the commencement of the Financial Year to which it relates.~~

~~2.22A.17. The Economic Regulation Authority may amend a determination under clauses 2.22A.2A(c) or 2.22A.2B(d) if AEMO makes a reassessment application under clauses 2.22A.12, 2.22A.13 or 2.22A.14 and the Economic Regulation Authority:~~

~~(a) — must take the matters referred to in clause 2.22A.5 into account in determining any reassessment;~~

- ~~(b) — may consider as part of its amended determination any earlier determined costs where the Economic Regulation Authority reasonably considers it necessary to review those earlier determined costs as part of the reassessment;~~
- ~~(c) — is not required to reassess earlier determined costs in making its redetermination of the Allowable Revenue or Forecast Capital Expenditure; and~~
- ~~(d) — must complete such public consultation as the Economic Regulation Authority considers appropriate in the circumstances.~~

...

2.24.2. Before 30 June each year, AEMO must determine and publish the level of:

...

to apply over the year starting 1 July in accordance with:

- (f) AEMO's final Annual Budget and Fees published under clause 2.22.3(c); ~~budget published under clause 2.22A.7;~~

...

2.24.3. At the same time as AEMO publishes a level of revised Market Participant Market Fee rate, Market Participant Coordinator Fee rate or Market Participant Regulator Fee rate (as applicable), AEMO must also publish an estimate of the total amount of revenue to be earned from:

- (a) Market Participant Market Fees as published in the final Annual Budget and Fees under clause 2.22.3(c); ~~collected for AEMO's:~~
  - i. ~~market operation services;~~
  - ii. ~~system planning services;~~
  - iii. ~~market administration services; and~~
  - iv. ~~system management services;~~

~~where the amounts to be earned for each service is equal to the relevant costs in AEMO's budget published in accordance with clause 2.22A.7 or as adjusted under clause 2.24.2A;~~

...

2.24.7. The level of each Application Fee:

...

- (b) ~~must be consistent with the Allowable Revenue approved by the Economic Regulation Authority~~ final Annual Budget and Fees published under clause 2.22.3(c); and

...

...

### Explanatory Note

The glossary is proposed to be amended to reflect the new Annual Budget and Fees framework.

## 11. Glossary

...

~~**Allowable Revenue:** Means the allowable revenue for AEMO in performing its functions set out in clause 2.1A.2 as determined by the Economic Regulation Authority in accordance with section 2.22A.~~

...

**Annual Budget and Fees:** means the document AEMO is required to publish under clause 2.22.3, which includes the budget and level of Market Participant Market Fees required for AEMO to perform its functions set out in clause 2.1A.2.

...

~~**Forecast Capital Expenditure:** With respect to AEMO, the predicted sum of capital expenditure required for a Review Period as determined by the Economic Regulation Authority in accordance with section 2.22A.~~

...

**Major Project:** means a project determined by AEMO under clause 2.22.6.

...

~~**Review Period:** In the case of the first Review Period, the 3 year period commencing on 1 July in the calendar year following the calendar year in which Energy Market Commencement occurs. For each subsequent Review Period, the 3 year period commencing on the third anniversary of the commencement of the previous Review Period.~~

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

This Rule Change Proposal provides for a regulatory framework that replaces the rigidity and high threshold for forecasting accuracy of the current framework, with greater visibility of forecast costs, greater certainty of funding, and more flexibility to respond to change. The revised framework achieves this primarily by substituting the need for perceived accuracy with transparency.

It is almost impossible to get an expenditure forecast right, especially in a fast-moving reform environment. However, it is important to highlight that Market Participants only pay for what AEMO actually spends and fees are trued-up accordingly. This means the accuracy of the forecast is less



important than the reasonableness of the estimate and the delivery of the projects proposed within it. The new framework therefore places greater emphasis on engagement, visibility of actual expenditure, and ongoing dialogue to test that AEMO's rolling budgets are reasonable.

AEMO understands Market Participants want visibility of forward-looking expenditure and fees, and the opportunity to provide input into the timing, priorities and scope of AEMO's major investments. A three to five-year forecast would provide this. Under the proposed framework, AEMO is required to develop a budget and fee estimate over the short-to-medium term based on the best information available to it at the time. Once established, the Annual Budget and Fees would be refreshed annually, with Market Participant Market Fees and forecasts updated accordingly.

While the Annual Budget and Fees covers between three and five years, it is accepted that the accuracy of the estimates will diminish for the outer years of the period. However, only the first year will be subject to annual approval and is required to be reasonably accurate. The forecasts for the outer years are designed to provide Market Participants and consumers a price signal and used for smoothing fees going forward.

The Annual Budget and Fees will be informed by historical actuals and will present the past three years of rolling actual expenditure to provide visibility of how AEMO is performing against targets and trends over time. Most importantly, the Annual Budget and Fees will be annually reviewed and scrutinised by Market Participants and other stakeholders and they will have multiple opportunities to provide input throughout its development.

A key principle of the new regulatory framework is more direct, earlier engagement with stakeholders. By its own admission, the ERA's ability to assess AEMO's prudence and efficiency is limited by the quality of information provided to it. The pace of change means any uplift in the quality or accuracy of information is difficult. To address this, rather than the ERA having to surmise what participants are prepared to support, AEMO will engage with Market Participants directly. Under the new framework Market Participants play a vital role, providing oversight and a formal and direct way of influencing AEMO's priorities and work program.

This will be achieved through publication of an annual proposal, which will be subject to ongoing consultation via the FCC, Strategic Energy Forum and a public consultation period. AEMO should be required to demonstrate that forecasts have been developed on a reasonable basis, consider stakeholder feedback, and respond accordingly.

Another important change will be the separate engagement on Major Projects. A large portion of AEMO's costs is fixed and recurrent. The now-established new market and AEMO's recent operating model changes means AEMO's BAU costs (e.g. labour, accommodation, licences) should be relatively stable over the coming years, in the absence of any additional significant change. Once AEMO has established this cost base, it will be straightforward to publish a reasonably accurate annual budget, and an estimate over the following three-to-five years, adjusted for economic and other escalators. BAU should be considered separately from Major Projects, and oversight and intervention should be relatively light touch.

As Major Projects are those that have a material impact on costs, systems and/or participants, there should be greater levels of information available to be scrutinised by Market Participants, including for prudence and efficiency. Examples would be the recent WEM Reform program, any significant changes to market settlement processes, and replacement of the metering system.

Under the proposed new framework, Major Projects must be tested with the MAC and cost estimates developed using the best information available at the time. This gives Market Participants the ability to provide input into aspects of the scope, timing and prioritisation of the proposal, the appropriateness of the technical solution, and also provide information on the implementation costs for Market Participants.

Major Projects can be tested with the MAC on an ongoing basis, with relevant activities and costs then included in the relevant annual budget and fee proposal(s). This provides sufficient flexibility for AEMO to be able to respond to in-period energy transition needs, as well as providing a degree of visibility for Market Participants and opportunities for input.

By enabling greater involvement and oversight from Market Participants, the form of heavy-handed and inflexible regulation placed on AEMO's investment in the WEM by incentive-based regulation, is replaced with a framework whereby AEMO's ongoing costs and major investments will be scrutinised by the parties in the best position to assess whether they are of value to the market and ultimately energy consumers.

Finally, the proposed new budget and fee determination framework will have a lower ongoing administrative burden than full regulation. The process of annual refresh and ongoing engagement will be significantly easier than producing a three-year bottom-up build of forecast costs (as per current practice). An important principle of the proposed new framework is to leverage channels and processes that already exist rather than create new ones.

For the reasons above, AEMO submits that the WEM Rules as proposed to be amended better meet the requirements of the Wholesale Market Objectives. Specifically:

*(a) to promote the economically efficient, safe and reliable production and supply of electricity and electricity related services in the South West interconnected system;*

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

The proposed changes enable the efficient investment in the WEM via delivery of the necessary market and power system investments to facilitate the energy transition. In turn, delivering the energy transition will reduce the long-term costs of electricity in the SWIS, enabling lower-cost generation to enter the market.

The proposed new framework will also help ensure that the cost, timing and priority of Major Projects are considered prior to delivery, therefore promoting economically efficient investment and more sustainable change.

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

The proposed new budget and fee determination framework will:

- reduce the costs associated with full incentive-based regulation – AEMO's costs alone are at least \$1 million for the development an allowable revenue submission, with the ERA and Market Participant review costs on top;
- streamline the budget and fee determination process to leverage existing investment governance and internal budgeting processes and information, thereby reducing internal effort required to repurpose forecast cost and project information;
- allow timely investments in market and system operations to be undertaken by AEMO thereby improve overall market outcomes for the benefit of consumers; and
- improve engagement outcomes by providing a direct and continuing channel for Market Participants to review, scrutinise and provide input into the delivery of Major Projects.