



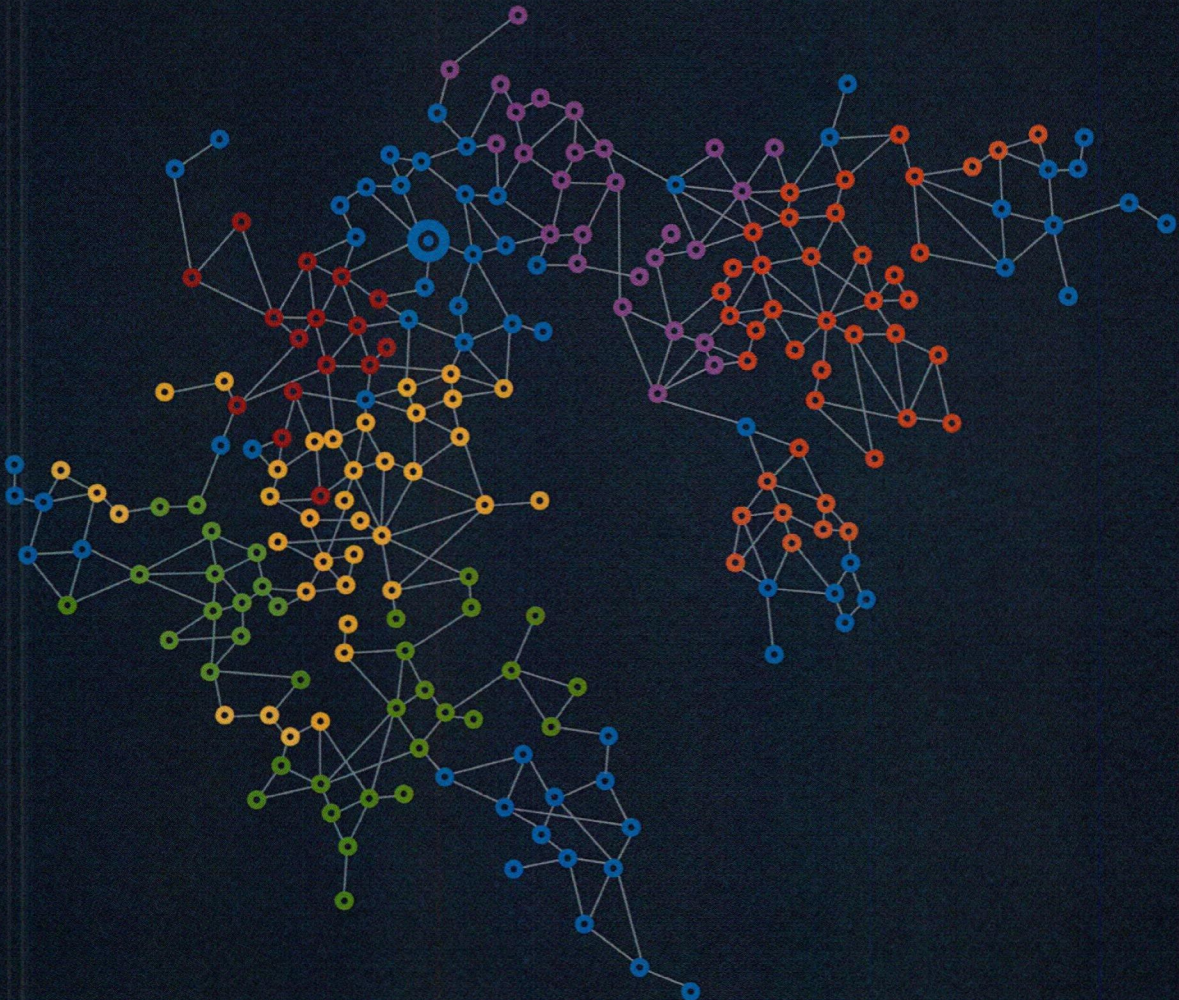
INDEPENDENT  
MARKET  
OPERATOR

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# ERA Submission Proposal for GSI Allowable Revenue and Forecast Capital Expenditure 1 July 2013 to 30 June 2016

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June 2013



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## Executive Summary

The Independent Market Operator (IMO) has been appointed to establish and operate a Gas Bulletin Board (GBB) and prepare and publish a Gas Statement of Opportunities (GSOO) for the Western Australian natural gas sector.

The GBB and GSOO are established by the *Gas Services Information Act 2012*, and are governed by this Act, the *Gas Services Information Regulations 2012* and the Gas Services Information Rules (GSI Rules).

The GBB is expected to commence operation on 1 August 2013, with the first GSOO to be published in mid 2013.

In accordance with the GSI Rules, the IMO seeks approval from the Economic Regulation Authority (ERA) for the IMO's initial Allowable Revenue and Forecast Capital Expenditure for the initial Review Period commencing 1 July 2013.

This constitutes the IMO's first Gas Services Information (GSI) Allowable Revenue and Forecast Capital Expenditure submission.

The IMO is seeking Allowable Revenue across the three-year Review Period of \$6.919 million. This includes the recovery of costs associated with the implementation of the GBB and GSOO by the IMO, which will be fully recovered over the first five years of operation of these two new gas information services.

In addition, the IMO has also made allowance for the resources to undertake its role in the Wholesale Electricity Market (WEM). While not directly impacting this submission, the majority of the IMO's management costs and overhead is allocated to this activity. The Economic Regulation Authority approved the IMO's Allowable Revenue and Forecast Capital Expenditure submission for its WEM activities on 2 April 2013.

In summary, the IMO is seeking approval of its Allowable Revenue and Forecast Capital Expenditure across the three-year initial Review Period as set out below:

	2013/14	2014/15	2015/16
Allowable Revenue (\$'000)	2,250	2,360	2,309
Forecast Capital Expenditure (\$'000)	88	157	216

## 1. Introduction

In accordance with rule 108, and rule 14 of Schedule 3, of the Gas Services Information (GSI) Rules, the Independent Market Operator (IMO) must seek approval of its initial Allowable Revenue and Forecast Capital Expenditure from the Economic Regulation Authority (ERA) for the initial Review Period, for each of the GSI Services listed in rule 107.

The GSI Services are:

- to establish, operate and maintain the Gas Bulletin Board (GBB);
- to register or deregister Registered Participants and Registered Facilities and to grant Exemptions;
- to prepare and publish the Gas Statement of Opportunities (GSOO);
- to make Amending Rules and Procedures, including the initial Rules made by the Minister under regulation 6 of the GSI Regulations;
- to facilitate the processes of the Gas Advisory Board;
- to monitor compliance and investigate breaches or possible breaches of the Rules or the Procedures;
- to take enforcement action under the GSI Regulations;
- to manage information gathering and disclosure functions under the GSI Regulations and the Rules; and
- services deriving from the exercise of any other functions conferred on the IMO under the GSI Act, the GSI Regulations or the Rules.

The IMO budget is based on the costs that would be incurred by a prudent provider of the defined services, acting efficiently, while effectively promoting the GSI Objectives.

The purpose of this submission is to provide relevant information to the ERA for it to assess and approve the IMO's initial Allowable Revenue and Forecast Capital Expenditure for the initial Review Period 1 July 2013 to 30 June 2016.

Under the GSI Rules, the IMO is required to submit the initial Allowable Revenue and Forecast Capital Expenditure submission to the ERA by the later of 30 April 2013, or the first business day after the day on which the GSI Rules commence<sup>1</sup>. In accordance with rule 14 of Schedule 3, the ERA is required to determine the IMO's initial Allowable Revenue and Forecast Capital Expenditure within four months of the date it is submitted by the IMO.

### 1.1 Legislative Framework

In 2011, the Western Australian Government appointed the IMO to be the operator of a new GBB and

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<sup>1</sup> The GSI Rules commenced on 29 June 2013, therefore this submission is due on Monday, 1 July 2013.

GSOO. The IMO is a body corporate that was established on 1 December 2004 to administer and operate the Wholesale Electricity Market (WEM) of Western Australia.

The key roles and functions of the IMO in relation to the GBB and GSOO are set out in the following instruments:

- Gas Services Information Rules; and
- *Gas Services Information Regulations 2012*.

## 1.2 GSI Objectives and Primary Purpose

The *Gas Services Information Act 2012* sets out the objectives and primary purpose of the GBB and GSOO.

Primary purpose of the GBB:

“The gas bulletin board is a website the primary purpose of which is to include information relating to short and near term natural gas supply and demand and natural gas transmission and storage capacity in the State.”

Primary purpose of the GSOO:

“The gas statement of opportunities is a periodic statement the primary purpose of which is to include information and assessments relating to medium and long term natural gas supply and demand and natural gas transmission and storage capacity in the State.” (section 5(1) of the *Gas Services Information Act 2012*)

Objectives of the GBB and GSOO:

“The objectives of the GBB and GSOO are to promote the long term interests of consumers of natural gas in relation to —

- a) the security, reliability and availability of the supply of natural gas in the State;
  - b) the efficient operation and use of natural gas services in the State;
  - c) the efficient investment in natural gas services in the State;
  - d) the facilitation of competition in the use of natural gas services in the State.”
- (section 6 of the *Gas Services Information Act 2012*)

## 1.3 Allowable Revenue and Forecast Capital Expenditure Approval Mechanism

After the Allowable Revenue and Forecast Capital Expenditure for the Review Period is determined by the ERA, the IMO is required to prepare budgets annually that are consistent with the ERA determination. The annual budgets are submitted to the Minister for Energy for approval and provide the basis for the calculation of GSI Fees.

However, for the first year of operation of the GBB and GSOO in 2013/14, the IMO is required to submit its initial GSI Budget Proposal to the Minister for Energy at the same time it submits this Allowable Revenue and Forecast Capital Expenditure submission to the ERA.

Accordingly, the initial GSI Budget Proposal must be consistent with this Allowable Revenue and Forecast Capital Expenditure submission. In the event that the ERA approves a different amount of Allowable Revenue and Forecast Capital Expenditure for 2013/14, the IMO must include any adjustment as part of its 2014/15 Budget Proposal to the Minister for Energy (subrule 15(6) of Schedule 3 of the GSI Rules).

If an IMO budget proposal is likely to result in revenue recovery (over the Review Period) of more than 15% of the ERA determination, the IMO is required to apply to the ERA for a reassessment of its Allowable Revenue. On the basis of the amounts included in this submission, the 15% threshold equates to \$1.038 million.

Similarly, if an IMO Budget Proposal is likely to result in capital expenditure (over the Review Period) being 10% greater than the capital expenditure approved by the ERA, the IMO is required to apply to the ERA to approve the adjusted Forecast Capital Expenditure. On the basis of the amounts included in this submission, the 10% threshold equates to \$0.046 million.

These reassessment mechanisms exclude Declared GSI Projects that involve major changes to the IMO's functions or a major change to IT systems used by the IMO to deliver the GSI Services. For the next Review Period, the threshold that would apply for a Declared GSI Project is \$0.738 million.

Before commencing any Declared GSI Project, the IMO must obtain ERA approval for any increase in the Allowable Revenue in relation to the project.

#### 1.4 Basis for this Submission

The IMO makes this submission on the basis that it covers the first three years of "business as usual" operation of the GBB and GSOO, and the IMO has had to estimate the resources required to deliver these new services. A key component of the Allowable Revenue for this initial Review Period is the recovery (via depreciation) of the costs of implementing the GBB and GSOO.

The IMO's activities to implement the GBB and GSOO were funded by borrowings from the Western Australian Treasury Corporation (WATC) of \$2.965 million. At the time of preparing this submission, the full expenditure required from these loan funds is not known and this submission has been developed on the basis that the full amount of loan funding is expended during the implementation phase.

If this full amount of loan funding is not expended in the implementation of the GBB and GSOO, any adjustment to reflect this will be made in the Budget Proposal for 2014/15.

In addition, the business requirements of Gas Market Participants and other stakeholders have an influence on the IMO's workload and subsequent expenditure.

The GSI Rules place an obligation on the IMO to progress and administer proposed Rule Changes

submitted within a prescriptive set of timeframes and while there is a degree of flexibility with regard to implementation timeframes, under normal circumstances the IMO is not in a position to delay the implementation of a Rule Change until the next Allowable Revenue period.

Consequently, while the Allowable Revenue and Forecast Capital Expenditure submission makes allowance for the operating and capital expenditure to support business as usual activity, it is possible that during the Review Period Gas Market Participants will request the IMO to undertake activity that was not budgeted in this submission.

Where this has occurred in the past in relation to its WEM functions, the IMO has separately identified and justified the activity as a special project and incorporated this into the IMO's annual Operational Plans for the Minister's consideration. Examples of where this has occurred are the Renewal Energy Working Group, the Market Evolution Program, and the Reserve Capacity Mechanism Working Group.

Once the costs of any such projects can be determined they will be incorporated into the annual IMO budget approval process and the Market Fees.

### 1.5 Allocation of costs across the IMO's electricity and gas functions

With the appointment of the IMO to operate the new GBB and publish the GSOO, the IMO now has two key areas of function:

- the functions set out in the WEM Rules; and
- the functions set out in the GSI Rules.

In implementing the GBB and GSOO, the IMO is integrating its new functions under the GSI Rules into its existing teams. This integration allows the IMO to achieve operational efficiencies, which would not be achieved if the functions were operated separately.

While some costs are directly attributable to the IMO's functions under the GSI Rules (e.g. the cost of consultants preparing forecasts for the GSOO), many of the IMO's resources will be shared across both functions (e.g. staff, administrative support, office accommodation, and other corporate and management support).

The IMO has developed a detailed cost allocation methodology to allocate these shared costs across its functions under the WEM and GSI Rules. This allocation methodology was included in the IMO's Allowable Revenue and Forecast Capital Expenditure submission for its WEM activities, which was approved by the ERA on 2 April 2013.

## 2. Gas Information Services Project

The IMO established the Gas Information Services Project (GISP) in 2011, to implement the GBB and GSOO. As part of the GISP, the IMO has been responsible for the following aspects of the

implementation of the GBB and GSOO:

- development of the initial GSI Rules, for approval by the Minister;
- development of a GBB system and website, to collect and publish GBB information;
- development of an Emergency Management Facility (EMF), as part of the GBB system; and
- preparation and publication of the GSOO.

Throughout the GISP, the IMO has also been establishing internal processes and procedures for the transition to operation of the gas information services in 2013/14.

In October 2011, the (then) Office of Energy agreed to provide the IMO with seed funding of \$350,000 to enable the GISP to get underway. The seed funding did not need to be repaid, and funded the implementation activities of the IMO up to the end of June 2012.

In July 2013, following the commencement of the *Gas Services Information Regulations 2012* which formally appointed the IMO as the operator of the GBB and GSOO, the IMO was provided with WATC loan funding of \$2.965 million to enable it to complete the implementation of the GBB and GSOO. This loan funding will be capitalised at the end of the GISP and will be recovered from Gas Market Participants over the first five years of operation of the GBB and GSOO in accordance with the IMO's depreciation policy.

In March 2012, the Hon. Peter Collier MP, then Minister for Energy, announced that the GBB would commence operation by 1 July 2013 and the first GSOO will be published by mid 2013. However, due to delays in the development of the GSI Regulations, the commencement of the GBB has been delayed to 1 August 2013.

### 3. Recurrent Budget 2013/14 – 2015/16

#### 3.1 Budget Categories

Budgeted expenditure in this submission has been broken into the cost categories required by the Auditor General for the IMO's Financial Statements.

These cost categories are:

- *Employee Benefits Expense* – salaries, superannuation, payroll tax, fringe benefits tax and other staffing costs.
- *Supplies and Services* – includes IT expenditure, accounting, auditing, human resources, administrative costs, insurance, travel and training. In addition, consultant expenditure in support of service delivery.
- *Accommodation* – Portion of office rental, cleaning, electricity, maintenance and car parking.
- *Depreciation* – depreciation of fixed assets, including capital costs associated with the GISP.



- *Borrowing* – interest expense.

### 3.2 Cost Comparisons

The budgeted expenditure for the Review Period is set out in the categories below:

	2013/14 (\$'000)	2014/15 (\$'000)	2015/16 (\$'000)	Total (\$'000)
Employee Benefits Expense	798	761	793	2,352
Accommodation	103	99	103	304
Supplies and Services	629	727	628	1,985
Borrowing Costs	150	127	103	379
Depreciation	571	646	683	1,899
<b>Total Expenditure</b>	<b>2,250</b>	<b>2,360</b>	<b>2,309</b>	<b>6,919</b>
Interest Revenue	-	-	-	-
<b>ALLOWABLE REVENUE</b>	<b>2,250</b>	<b>2,360</b>	<b>2,309</b>	<b>6,919</b>

### 3.3 Annual Indexation

This submission incorporates annual indexation costs, which has been based on Department of Treasury advice of 1.75% across the Review Period.

Excluded from this indexation are costs that are covered by fixed priced contracts, where the IMO has received specific advice for a cost category on market price movement (e.g. annual remuneration increases) and borrowing costs.

### 3.4 Employee Benefits

#### 3.4.1 *Approved positions*

The IMO currently has 39 approved positions, corresponding to 38.5 FTE's after adjusting for part-time positions.

Five temporary positions (corresponding to 4.5 FTE) were approved for 2012/13 for the GISP, with three of these positions planned to transition into permanent positions from 2013/14.

It is important to note that there are no dedicated "gas" positions proposed for 2013/14 onwards – as the IMO functions under the GSI Regulations and Rules will be integrated into the IMO's existing

operations and will be delivered by IMO staff that has both electricity and gas responsibilities. This has the advantage of strengthening the operational capability of the IMO and our delivery for both the WEM and gas information services. This structure should also reduce the risk of the IMO facing key man dependency going forward (for example in the Legal and Compliance team).

The IMO has determined that an additional two positions (2 FTE's) are required to meet business needs in the Review Period. These are:

- Junior Lawyer. The IMO has taken on increased market compliance monitoring activities (as a result of MEP changes), additional rule drafting and commercial legal responsibilities. This additional resource will address these needs as well as reduce the key person dependency that currently exists. A portion (17%) of the costs for the Junior Lawyer and the Manager of Legal and Compliance have been allocated to the GSI Budget.
- Additional Graduate. The IMO has strategically acknowledged that it is difficult to recruit suitably qualified and experienced analysts and market operators in Western Australia. The IMO graduate program has now been operational for four years. In the first three years, the IMO has appointed one graduate each year. All three graduates secured permanent roles at the IMO. With staff turnover averaging 2 -3 staff each year, it is beneficial and cost-effective to take on an additional graduate enabling a suitably trained resource to be appointed when a vacancy arises. As a result, in 2013 the IMO increased its graduate intake to two graduates each year. A portion of Graduate costs (12.5%) has been allocated to the GSI Budget.

A detailed schedule showing the FTE split of all IMO staff between electricity and gas is available as part of the detailed working papers which supports this submission.

The detailed FTE split between gas and electricity is informed by a comprehensive costing methodology which allocates overheads between gas and electricity. This is also available as part of the detailed working papers.

The combined effect of the three positions transitions from the GISP implementation and the two new positions result in the IMO having 44 positions from 2013/14, corresponding to 43 FTE after adjusting for part-time positions.

#### *3.4.2 Market salary levels*

Employee Benefit Expenses is the IMO's biggest expenditure category, accounting for 32% of total budgeted expenditure across the Review Period.

The quality of the IMO service delivery is heavily dependent on the quality of staff and the retention of institutional knowledge.

The IMO operates in the competitive Western Australian job market which presents challenges for both

recruiting and retaining quality staff. This is particularly true of the buoyant Western Australian energy sector.

In September 2012, the IMO engaged an independent remuneration consultant, Mercers, to conduct a detailed remuneration review on 18 selected positions, with a focus on those positions that have a specialised aspect to them e.g. Market Operators.

The remuneration review recommended a base salary range for each position. This recommendation was based on remuneration comparisons with:

- organisations of similar size;
- organisations from a similar industry sector; and
- Comparative organisations that compete with the IMO for staff in the same job market (e.g. electricity Market Operators and Western Australian energy market participants).

The IMO Board considered the recommendations of the Mercer review, as well as the history of recent salary increases, in determining the appropriate salary levels for IMO staff. The budgeted salary levels included in this submission are based on this consideration.

The IMO reviews staff performance and recommends salary increases commensurate with performance with effect from 1 April of each year.

### 3.5 Supplies and Services

The IMO is a small, professionally-staffed organisation which is strongly reliant on the outsourcing of specialist services to ensure highest quality input at an efficient cost.

	2013/14 (\$'000)	2014/15 (\$'000)	2015/16 (\$'000)
IT Support	210	213	222
Corporate Support	159	148	155
Legal & Compliance	90	116	97
Market Operations	0	0	0
Market Administration	50	151	52
System Planning (GSOO)	120	100	102
<b>Total</b>	<b>629</b>	<b>727</b>	<b>628</b>

IT Support incorporates the following costs:

- GBB system maintenance and support;
- datacentre hosting by specialist service providers;
- high speed fibre links between head office, production and backup datacentres;

- specialist database support;
- IT desktop and infrastructure support; and
- telecommunications and internet access costs.

The biggest component of expenditure is GBB Maintenance and Development Support (around \$95,000 p.a.).

Corporate Support costs include the contribution to the IMO's accommodation, financial, human resources and other administration costs. The largest component of Corporate Support costs are those relating to accommodation (around \$90,000 per annum).

Legal and Compliance costs include the costs associated with the Annual Compliance Audit required by the GSI Rules, compliance investigations and dispute resolution.

Market Administration costs include the external costs of supporting Rule Changes determined by the Gas Advisory Board and in 2014/15 includes the cost of undertaking a post-implementation review of the costs and benefits of the GBB and GSOO requested by Gas Market Participants (\$100,000). In future Review Periods, this will also need to include costs associated with cyclical reviews required under the GSI Rules (e.g. review of Zones and GSOO information).

System Planning costs is the cost of specialist forecasting services for the annual GSOO. These are expected to be highest in 2013/14 as the IMO prepares its first complete GSOO under the GSI Rules, which will require forecasting processes and information gathering mechanisms to be established.

### 3.7 Depreciation

Depreciation accounts for 27% of total budgeted expenditure across the initial Review Period.

Depreciation is determined by the expected written down value of assets as at the conclusion of the GISP (31 July 2013), together with depreciation that flows from assets purchased over the Review Period.

Section 4 deals with the IMO's Forecast Capital Expenditure over the Review Period, which is predicated on the IMO's "IT Roadmap" for the period 2013 -2016.

A copy of the IT Roadmap, which encompasses the budgeted depreciation arrangements for the Review Period, is provided in the materials supporting this proposal.

### 3.8 Borrowing Costs

All capital requirements over the Review Period are funded by way of loan funding provided by the WATC. Projected borrowing costs across the Review Period have been calculated on existing

funding facilities and projected capital expenditure and are based on funding rates provided by the WATC.

#### 4. Forecast Capital Expenditure 2013/14 – 2015/16

Forecast Capital Expenditure is the predicted sum of capital expenditure required for a Review Period.

From July to November 2012, the IMO developed its key strategic IT planning document, culminating in the production of an IT Roadmap for the period 2013 – 2016.

The IT Roadmap is the primary strategic planning tool used to ensure that the planning, delivery, management and use of the IMO's IT systems optimally support the IMO's business.

This document was submitted to the Minister for Energy for endorsement on 26 October 2012, for consideration as part of the State Capital budget for 2013/14 onwards.

This IT Roadmap represents the third time the IMO has developed a technology roadmap and the first to include the new GBB. It has been developed to support the IMO's Allowable Revenue and Forecast Capital Expenditure submission for the Review Period.

This submission seeks Forecast Capital Expenditure across the next Review Period as set out below:

	2013/14	2014/15	2015/16
Forecast Capital Expenditure (\$'000)	88	157	216

A copy of the IT Roadmap, which encompasses the budgeted depreciation arrangements for the Review Period, is provided in the materials supporting this proposal.