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Hon Peter Collier MLC
Minister for Energy
10th Floor Dumas House
2 Havelock Street
WEST PERTH WA 6005

Dear Minister,

**THE IMO'S FOLLOW-UP ON THE MINISTER'S REQUEST FOR FURTHER MARKET CONSULTATION ON
RULE CHANGE PROPOSAL: REASSESSMENT OF ALLOWABLE REVENUE DURING A REVIEW PERIOD**

ISSUE

On 3 July 2012, in accordance with clause 2.8.5, the Minister for Energy approved the Rule Change Proposal regarding the Reassessment of Allowable Revenue during a Review Period. However, the Minister considered that some elements of the proposal would benefit from further market consultation. In particular, the Minister observed that the Independent Market Operator made a late change to maintain the existing threshold level for reassessment of Allowable Revenue. He also noted inconsistencies in the tests for reassessment of Declared Market Projects and budget proposals.

THE IMO'S RESPONSE

The IMO tabled the Minister's response and concerns at the Market Advisory Committee (MAC) meeting, held on 11 July 2012. In the Draft Rule Change Report, the IMO Board sought the views of Market Participants on their concerns around specific elements of the changes relating to the proposed thresholds. Members noted that in this second submission round of formal consultation there were no submissions received in relation to the IMO Board's specific request.

The Chair requested the advice of the MAC to consider any further amendments in relation to these provisions in order to fulfil the request of the Minister. It was noted that as the Rule Change had already been approved by the Minister, any further amendments to the provisions would require a new Rule Change Proposal since the Market Rules do not contemplate the ability to undertake further consultation on a Rule Change that has already been approved.

There was general acknowledgment from the MAC that the Rule Change had significantly improved governance. No further issues were raised at MAC that required amendments to these provisions.

The Economic Regulation Authority (ERA) representative on the MAC did express concerns with regard to the threshold levels. The Chair acknowledged the concerns raised by the ERA and offered the opportunity for the ERA and Secretariat to meet with the IMO Management and IMO Board to discuss the issue. The IMO Board has since invited the ERA to attend a luncheon to discuss the matter informally.

BACKGROUND

About the Proposed Rule Change: Reassessment of Allowable Revenue during a Review Period

In its proposal, the Economic Regulation Authority (ERA) seeks to address three concerns over the operation of clauses 2.22.8, 2.22.13 and 2.23.8 of the Market Rules, which provide for a reassessment of Allowable Revenue for the IMO and System Management during a Review Period where an amount of un-forecast expenditure is proposed to be incurred.

Firstly, in their current form, the way in which clauses 2.22.8, 2.22.13 and 2.23.8 of the Market Rules apply to proposed Capital Expenditures of the IMO and System Management can result in inconsistencies, depending on the timing of the expenditure and the period over which the cost is to be depreciated or amortised, in:

- whether a project of a given total cost meets the criteria for a Declared Market Project (clause 2.22.13); and
- whether a reassessment of approved Allowable Revenue by the ERA is triggered.

As a result of these inconsistencies, Capital Expenditures made by the IMO and System Management that involve material increases in the Market Fees charged to Market Participants may or may not be subject to review by the ERA. The proposed amendments are drafted to ensure that it is the Capital Expenditure that is taken into account in the threshold test, rather than the resulting depreciation or amortisation expenses. This eliminates any influence of the timing of the Capital Expenditure within a Review Period or the time over which that expenditure is depreciated or amortised.

Secondly, the ERA considers that the existing threshold value of incremental revenue that acts as a trigger for the declaration of a Declared Market Project (under 2.22.13) and the reassessment of approved Allowable Revenue (under 2.22.8 and 2.23.8) are too high. The ERA proposes to reduce the threshold level from 15 percent to 10 percent of approved Allowable Revenue.

Thirdly, the Market Rules do not allow for the IMO or System Management to request that the ERA review a budget proposal that does not automatically trigger such a review under clauses 2.22.8, 2.22.13 and 2.23.8. As a result no mechanism is currently available to resolve uncertainty over whether the budget proposal satisfies the criteria in clause 2.22.12(b) or 2.23.12(b), and there is a risk that the ERA may not approve the associated Allowable Revenue for the next Review Period. The proposed amendments allow the IMO and System Management to request the ERA to review a budget proposal under these circumstances.

Rule Change Process

The Rule Change Notice for this proposed change was sent to the Minister for information on 14 March 2011.

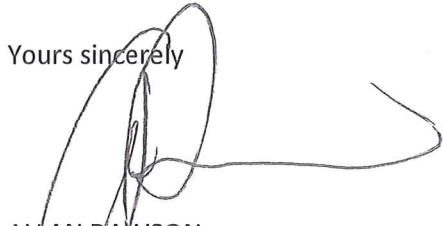
Prior to the IMO's publication of the Final Rule Change Report, there were two formal public consultation periods, during which interested parties have provided their input on the proposed amendments.

During the first submission period the IMO received a number of submissions which supported the intent of the Rule Change Proposal.

In the Draft Rule Change Report, the IMO Board sought the views of Market Participants on their concerns around specific elements of the changes relating to the proposed thresholds. No submissions were received in the second round of formal consultation in relation to the IMO Board's specific request.

Further details of the issues raised in submissions and the IMO's response are available in the Draft Rule Change Report and the Final Rule Change Report (available on the Market Web Site).

Yours sincerely

A handwritten signature in black ink, appearing to be 'Allan Dawson', written over the text 'Yours sincerely'.

ALLAN DAWSON
CHIEF EXECUTIVE OFFICER

09 August 2012