

# Allowable Revenue Framework Review – Scope of Work

## 1. Introduction

- The Coordinator of Energy (Coordinator) is conducting a review of the Australian Energy Market Operator's (AEMO) Allowable Revenue Framework (ARF) under the Electricity System and Market Rules (ESMR)<sup>1</sup> and the Gas Services Information (GSI) Rules, to identify and implement changes necessary to improve the frameworks.
- This review has been initiated following a rule change proposal by AEMO, which sought to replace the current revenue and fee determination process outlined in sections 2.22A and 2.23 of the ESMR and Part 7, Division 1 and 2 of the GSI Rules with new processes<sup>2</sup>.
- The Final Rule Change Reports<sup>3</sup> signal the Coordinator's intent to undertake a fulsome review of the ARFs to:
  - identify any issues and inefficiencies regarding the current AEMO Allowable Revenue and Forecast Capital Expenditure processes; and
  - undertake a jurisdictional scan of similar revenue setting mechanisms and performance reviews; and
  - develop a new fit-for-purpose replacement framework for the determination of AEMO's Allowable Revenue and Forecast Capital Expenditure under the ESMR and GSI Rules.

## 2. Background

### 2.1 The role and functions of AEMO

- AEMO is a member-based, not-for-profit organisation with its functions in respect of the WEM outlined in the *Electricity Industry (Electricity System and Market) Regulations 2004* and the ESMR. Its functions in relation to WA's gas information services are outlined in the *Gas Services Information Regulations 2012* and the GSI Rules.
- As the independent energy market and system operator and system planner for the WEM, AEMO is assigned the functions of ensuring secure and reliable operation of the South West Interconnected System (SWIS).

The ESM Regulations also provide for the ESMR to confer additional functions on AEMO, including operating and setting the Reserve Capacity Mechanism, the Short-Term Energy Market and the Real-Time Market, planning and forecasting, and supporting the Economic Regulation Authority (ERA) in monitoring compliance with the ESMR (clause 2.1A.2 of the ESMR).

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<sup>1</sup> The *Electricity Industry Regulations Amendment (Distributed Energy Resources) Regulations 2025* commenced in February 2025. These regulations renamed the Wholesale Electricity Market (WEM) Regulations to *Electricity Industry (Electricity System and Market) Regulations 2004* and the WEM Rules to the Electricity System and Market Rules.

<sup>2</sup> [Rule Change Notice: Allowable Revenue Framework \(RC 2024\\_01\)](#) and [Rule Change Notice: Allowable Revenue Framework \(GRC 2024\\_01\)](#)

<sup>3</sup> [Final Rule Change Report – AEMO's Allowable Revenue Framework \(RC 2024\\_01\)](#) and [Final Rule Change Report – AEMO's Allowable Revenue Framework \(GRC 2024\\_01\)](#)

- In relation to the provision of information regarding the WA's gas supply and services, AEMO is responsible for the operation and development of the Gas Bulletin Board (GBB), the preparation and publication of the Gas Statement of Opportunities (GSOO) and supporting the ERA in monitoring compliance with the GSI Rules.

## 2.2 The current ARF

- As a not-for-profit organisation, AEMO can only charge, through market fees, for the costs it incurs to perform its functions under the ESMR and GSI Rules (collectively the Rules). These costs are eventually passed through to consumers.
- AEMO's ability to raise funds through market fees is governed by the Allowable Revenue regime in the Rules.
- Every three years, AEMO must develop an Allowable Revenue and Forecast Capital Expenditure proposal to cover the forward-looking costs of performing its functions.
- The ERA is responsible for determining the level of funding required for AEMO to execute its functions under the Rules.
- The Rules outline the factors that the ERA must consider in determining AEMO's funding proposal.
  - Principally, these include that costs must only consist of those that would be incurred by a prudent service provider, acting efficiently, and seeking to achieve the lowest practically sustainable cost of delivering its functions, while promoting the State Electricity Objective (SEO) in the WEM<sup>4</sup>.
  - In addition to the matters prescribed in the Rules, the ERA may give consideration to any other relevant matter in its determination of AEMO's Allowable Revenue.
- The ERA determines a single figure it considers meets the requirements under the Rules for each of the Allowable Revenue and the Forecast Capital Expenditure for each 3-year Review Period. Recurring expenditure are to be recovered in the year of expenditure, while capital expenditure is recovered over time through depreciation and amortisation of assets.
- In addition to this process, the 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 in relation to the WEM or the lower of 10% or \$0.5 million in relation to AEMO's GSI functions.
- Under the current regulatory frameworks, AEMO must provide all information needed to satisfy the ERA that requested funding is prudent and efficient, and sufficient to cover AEMO's forward looking costs, with the onus on AEMO to develop convincing and thorough submissions.
- To assist AEMO in providing information to demonstrate that its funding request meets the required standard to satisfy the ERA's assessment criteria, the ERA has published a proposal guideline that outlines a two-pronged approach to assessing the prudence and efficiency of AEMO's costs<sup>5</sup>.

<sup>4</sup> On 6 February 2025, the Electricity Industry Act 2004 was amended and the Wholesale Market Objectives were replaced by the State Electricity Objective. While the WEM Rules have not yet been updated to reflect this change, the Electricity Industry Act takes precedence over the ESMR (WEM Rules) as provided by clause 1.5.2.

<sup>5</sup> [ERA Guideline to inform the Australian Energy Market Operator's funding proposal 2022](#)

## 2.3 Case for change

### 2.3.1 AEMO's Rule Change Proposals

- On 28 August 2024, AEMO submitted two Rule Change Proposals titled “AEMO’s Allowable Revenue Framework” (RC\_2024\_01) and (GRC\_2024\_01) to address challenges with the ARFs.
- These Rule Change Proposals sought to remove the requirement for the ERA to determine AEMO’s budget and proposed specific elements for the new budget and fee design process, including:
  - annual priorities, activities, budget and fee setting using AEMO 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 as part of its WEM effectiveness reporting.
- AEMO considered that its current frameworks are not fit-for-purpose because:
  - The current framework allows the ERA only to approve forecast costs that have a high degree of certainty. In the current environment of fast-paced energy transition and reforms, costs are difficult to forecast with certainty.
  - Energy market participants’ needs, energy reform agendas and policies, and project requirements are constantly evolving as WA’s energy transition progresses. This introduces considerable uncertainty year-on-year regarding what AEMO and market participants may be required to do, and the associated costs.
  - The rigidity of the current frameworks 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.
- AEMO considered that the current framework has caused the following problems:
  - requiring AEMO to make four Allowable Revenue submissions to the ERA since 2020 because of the uncertainty inherent in the energy transition;
  - delays to the implementation of key reform projects required for the energy transition;
  - uncertainty for market participants regarding the delivery of critical projects due to funding uncertainty, leading to an inability to accurately forecast Market Fees; and
  - the high costs of administration and associated resourcing to develop the allowable revenue submissions under the Rules has cost AEMO an estimated \$1 million.
- AEMO considered a ‘set and forget’ funding arrangement, that establishes a multi-year fixed budget via rigid ex-ante scrutiny, is not appropriate if there is uncertainty surrounding policy, regulatory outcomes and project scope.

- All submissions received from stakeholders during the first consultation period and subsequent independent consultant report published by the Australian Energy Council<sup>6</sup> strongly objected to the proposed removal of the independent regulatory oversight by the ERA from AEMO's budget process.
  - A key reason cited for this was the concern that market participants and other stakeholders did not have the resources or expertise to consider the prudence and efficiency of AEMO's proposed expenditure.
- Stakeholders acknowledged that it is difficult for a market operator to forecast expenditure during time of significant change but raised concerns that the proposed changes did not adequately address the core issues with the current frameworks rather, that it may reduce AEMO's accountability and transparency, and increase costs to market participants.
- The Coordinator's Final Rule Change Reports rejected the Rule Change Proposals and instead made Amending Rules to suspend AEMO's current Allowable Revenue Framework and set interim fees until fees can be set under a replacement framework<sup>7</sup>.

### 2.3.2 ERA concerns with the current framework

- The ERA's Final Determination of AEMO's second in-period budget adjustment for AR6 highlighted issues with the current regulatory frameworks and indicated support for the development of a replacement framework with more workable arrangements<sup>8</sup>.
- The ERA specified the following concerns with the current ARF:
  - The current framework is reflective of others, such as for electricity networks, where past costs are a good indicator of forward-looking costs; this assumption does not hold true in an environment where reform-related activities must be prioritised and AEMO's functions are rapidly expanding;
  - 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;
  - AEMO has spent most of its funding and needs to reclaim it from additional funding demonstrates that the incentive-based regulatory framework is not suitable for making assessments of AEMO's funding requirements; and
  - Due to the timelines imposed by the ESMR, AEMO could not have asked for an operating expenditure adjustment when it made its first in-period submission.
- The ERA also noted that it had experienced considerable challenges receiving a clear explanation from AEMO regarding increases to operational labour costs between the original AR6 and the second in-period submission. The ERA noted that supplementary information provided after the draft determination demonstrated gaps in AEMO's processes and systems, often making justifications incomplete and difficult for the ERA to reach a clear understanding of AEMO's position and need for additional funds.

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<sup>6</sup> [Australian Energy Council – 10 December 2024 – AEMO's budget framework- analysis and options for change](#)

<sup>7</sup> [Final Rule Change Report – AEMO's Allowable Revenue Framework \(RC 2024\\_01\)](#) and [Final Rule Change Report – AEMO's Allowable Revenue Framework \(GRC 2024\\_01\)](#)

<sup>8</sup> [ERA's Australian Energy Market Operator's AR6 second in-period allowable revenue and forecast capital expenditure proposal Final Determination](#)

### 2.3.3 The need for review

- As Australia's energy transition has evolved, so have AEMO's role and responsibilities.
- When AEMO was established, power system conditions were more predictable, characterised by central large-scale synchronous generation and passive demand, with a network designed for one-way flow to end consumers.
- With further market reforms and significant investments to support the move towards a decarbonised power system scheduled over the next decade, AEMO's role and responsibilities are expected to continue to evolve and expand as planning and operating the WEM and power system become more complex.
- In the last few years, the ARF process has not adequately provided market participants with accurate guidance of AEMO's market fees. In the same period, AEMO's costs have increased substantially.
  - Most recently, AEMO has estimated that its AR6 second in period submission will increase the 2024-25 market fee by \$1.04 per MWh (a 68 per cent increase) to \$2.57 per MWh for 2024-25<sup>9</sup>, up from \$1.53 per MWh in 2023-24.
- As previously outlined, AEMO, the ERA and stakeholders have raised concerns that the current ARF is not fit-for-purpose and that improvements are necessary.
- The Coordinator acknowledges the various concerns raised with the ARF and agrees that the current framework under the Rules likely require a wholistic review to develop an improved, fit-for-purpose framework.

## 3. Project Scope

### 3.1 Objective

The objective of this review is to:

- identify any issues and inefficiencies regarding the current AEMO Allowable Revenue and Forecast Capital Expenditure process against the criteria described below;
- undertake a jurisdictional scan of similar revenue setting mechanisms and performance reviews; and
- develop a new fit-for-purpose replacement framework for the determination of AEMO's Allowable Revenue and Forecast Capital Expenditure under the ESMR and GSI Rules (replacement frameworks), that balances the views of AEMO, the ERA and stakeholders.

These objectives should be achieved while balancing the three limbs of the SEO:

The SEO is to promote efficient investment in, and efficient operation and use of, electricity services for the long-term interests of consumers of electricity in relation to —

- (a) the quality, safety, security and reliability of supply of electricity;
- (b) the price of electricity; and
- (c) the environment, including reducing greenhouse gas emissions.

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<sup>9</sup> See above link.

The ARF under the ESMR is very similar to the ARF for the GSI Rules and, historically, AEMO has combined both of its WEM and GSI Allowable Revenue submissions to the ERA.

Therefore, the Coordinator plans to include a review of AEMO's ARF under the GSI Rules in the scope of the ARF Review for the WEM.

## 3.2 Project Stages

The review is planned to proceed in three stages:

### Stage One: Assess existing frameworks

The first step is to undertake a comprehensive assessment of AEMO's current Allowable Revenue and Forecast Capital Expenditure process under the Rules, identifying any issues and inefficiencies (existing and future), consistent with the criteria outlined below. The analysis will cover the following elements with the current frameworks:

- the process for setting the Allowable Revenue (including the quality of information exchange);
- the process for reviewing and adjusting the Allowable Revenue in-period;
- the evidentiary standard applied;
- governance oversight;
- extent and method of stakeholder input and how this input is treated under a framework;
- regulatory guidance provided to stakeholders and the regulated party; and
- performance review (including the impact on incentives/disincentives).

This stage will also include a jurisdictional scan of similar revenue setting mechanisms and performance reviews for non-for-profit monopoly service providers (not limited to electricity system and/or market operators).

This should include the new National Energy System Operator in the UK, and at least two other jurisdictions identified or agreed by Energy Policy WA. The interjurisdictional analysis should identify specific initiatives to address issues and inefficiencies identified in the current framework to inform the detailed analysis required in Stage Two.

### Stage Two: Options development and assessment, proposals development

A replacement framework under the ESMR and GSI Rules will need to be developed. The aim of the revised frameworks should be to provide an efficient and effective allowable revenue framework that is fit-for-purpose, and reflects consideration of stakeholder views and concerns.

#### Assessment criteria

To guide the review, criteria have been developed to inform the development and assessment of suitable reform options.

- **Alignment with the new State Electricity Objective:** The framework should be developed with a clear focus on meeting and promoting the new SEO;

- **Transparency and stakeholder visibility:** The framework should ensure high levels of transparency in all aspects, particularly in the revenue-setting mechanisms and cost drivers. The framework should provide market participants and other stakeholders with high level visibility of AEMO's cost drivers to ensure that they have confidence in the mechanism;
- **Cost-certainty and predictability:** The framework should achieve cost certainty for AEMO and predictability of market fees for market participants and other stakeholders to support planning and investment, with consideration to be given to mechanisms that smooth costs and reduce the need for additional revisions within a regulatory control period (whatever form this may take);
- **Regulatory burden and efficiency:** The framework should strike a balance between the costs of operating the framework and the need to provide adequate scrutiny and incentives for AEMO's efficient and prudent operation, supporting the achievement of the SEO, minimising inefficient administrative burdens on the regulator, AEMO, and stakeholders;
- **Performance and accountability:** The framework should incentivise AEMO to operate efficiently and fulfill its commitments and deliver on promised outputs. There should be robust mechanisms for monitoring AEMO's performance and ensuring accountability. The framework must provide clear performance indicators and metrics to effectively assess AEMO's prudence and efficiency in delivering on its obligations under the Rules. It should also facilitate adequate level of scrutiny to provide confidence that costs are set at a level that effectively meets all limbs of the SEO.
- **Addressing the energy transition and market reforms:** The framework should consider the scale, pace, and dynamic nature of the energy transition, as well as the evolving market reforms. It should provide the necessary tools and flexibility to accommodate changes, including integrating and responding to evolving policy requirements and provide sufficient funding to AEMO to continue operating the WEM and its functions in relation to WA's gas information services efficiently and deliver key reform activities required to support the energy transition.

Stakeholder suggestions to enhance the ARF, made during the Rule Change Process, as well as issues raised in the ERA's previous determinations and earlier AEMO funding submission processes, will be considered as part of this stage.

Stage Two will also include consultation with AEMO and the ERA, with EPWA finalising the proposed policy position adopted for Stage Three.

### **Stage Three: Proposed policy position and implementation**

The final step will be to draft and consult on the proposed policy position, detailed design and the rules to give effect to these. Transitional arrangements (if any) need to be considered.

Changes will also be required to relevant subsidiary instruments, which have their own change management process.

Energy Policy WA intends to consult with key stakeholders, including members of the Market Advisory Committee (MAC) and Gas Advisory Board (GAB) on the policy proposal and detail design. A stakeholder workshop (forum) at the start of Stage Three will serve as the primary forum for briefing and receiving feedback from stakeholders, prior to the release of a Consultation Paper.

A formal Consultation Paper will be released at the end of Stage Three. This will be followed by an Information Paper together with an Exposure Draft on the relevant amending the ESMR with the final design proposals and responses to submissions. For the amending GSI Rules, this stage will be undertaken through a Coordinator initiated standard rule change process under the GSI Rules.

## 4. Stakeholder engagement and consultation

Given the roles and responsibilities of AEMO and the ERA in relation to the ARF, close consultation with AEMO and the ERA will be required throughout the project to ensure that the replacement framework that is developed is fit-for-purpose.

Energy Policy WA intends to consult with all key stakeholders, including members of the MAC and GAB on the policy proposal and detail design.

A stakeholder workshop (forum) at the start of Stage Three will serve as the primary forum for briefing and receiving feedback from industry stakeholders prior to the release of a Consultation Paper.

## 5. Project Schedule

The following is a high-level project schedule for the ARF Review.

Tasks/Milestones	Timing (by When)
<b>Stage 1 - Assess current ARF</b>	
Undertake review and analysis of the current ARFs under the ESMR and GSI Rules	February 2025
Jurisdictional comparison of similar revenue setting mechanism and performance review for non-for-profit monopoly service providers (not limited to electricity system and/or market operators) to inform assessment of the framework and the development of suitable options	February 2025
<b>Stage 2 – Options development and assessment, proposals development</b>	
Develop and assess options for a replacement ARF. Develop design proposals for a preferred replacement ARF. Assess whether any transitional measures are needed, and if so, develop the transitional measures	March 2025
Consultation with AEMO and the ERA	March 2025
Develop draft Consultation Paper with proposed outputs from the Review	April 2025

### Stage 3 – Proposed policy position and implementation

Stakeholder workshop	Mid-April 2025
Publish Consultation Paper for four weeks consultation	Mid-May – Mid-June 2025
Review and consolidate submissions received on the Consultation Paper, propose responses and changes to address comments, and undertake any further assessment required	End-June 2025
Develop and publish an Information Paper outlining the final review outcomes with a summary of stakeholder consultation.  Publish the Information paper together with an Exposure Draft of the Amending ESMR to give effect to the outcomes of the Review for stakeholder consultation.	End-June – End-July 2025
<b>Amending Rules</b>	
Submit amending ESMR for consideration and approval by the Coordinator and the Minister for Energy	August 2025
Commencement of ESMR changes	TBD
Coordinator initiated rule change process for the GSI Rules <sup>10</sup> (standard rule change process).	TBD
Submit amending GSI Rules for approval by the Minister for Energy	TBD
Commencement of GSI Rules changes	TBD

<sup>10</sup> The Minister's rule-making power extends only to the ESMR, and the process for amending the GSI Rules must go through a Coordinator-initiated rule change process.