

**MINUTES OF THE RULES CHANGE PANEL
20th PANEL MEETING
HELD ON MONDAY, 27 JUNE 2005 AT 10.15AM
AT ENERGY MARKET CO. PTE LTD
9 RAFFLES PLACE #22-01
REPUBLIC PLAZA, SINGAPORE 048619**

Present:	Allan Dawson (Chairman) Yip Pak Ling Robin Langdale T P Manohar	Eu Pui Sun Low Boon Tong Kok Shook Kwong
Absent with	Ben Lau Francis J. Gomez	Dr. Daniel Cheng Tan Boon Leng
In Attendance:	Tan Zing Yuen, CFO (EMC) Gan Bock Yeng, VP (EMC) Luke Peacocke, Corporate Analyst	

1.0 Notice of Meeting

The Chairman called the meeting to order at 10.15am. The Notice and Agenda of the meeting were taken as read.

2.0 Justification of Efficiency Gains Achieved by EMC in FY 2004/05
(Paper No. EMC/RCP/20/2005/02)

On 1 October 2004, the EMA imposed a revenue-cap price regulation regime on EMC with a performance based regulation (PBR) regime to ensure that performance standards are not compromised. The structure of the revenue-cap is outlined in EMA's Economic Regulation Framework for EMC (the "framework") (refer to accompanying EMA letter of 17 June 2005).

The purpose of the regime is to provide incentives for EMC to make cost efficiencies while maintaining service quality. The regime comprises two key components:

- A *revenue cap* that puts a limit on the amount EMC can recover from the market. Over time the revenue cap is adjusted taking into account an efficiency factor (0.6 percent per year) and the prevailing inflation rate.
- A *performance based regulation system* (known as PIMS) that rewards EMC with a revenue bonus if it exceeds performance standards agreed with the industry.

Under the revenue cap regime EMC is able to retain savings (i.e. as a result of expenditure below the revenue cap level) if these savings are the result of efficiency gains. Revenue caps in future years are then adjusted downward to reflect the efficiencies achieved in previous years.

The objective of the revenue cap regime is to incentivise EMC for being efficient with the result being downward pressure on EMC's costs and fees in the long-term.

For FY2004/05 EMA set EMC's revenue cap at \$29.587m. This was based on EMC's budget plus a post-tax Return On Assets (ROA) of 9.9 percent.

The economic regulation framework states that "EMC would be allowed to keep any surplus due to efficiency gains while operating at or below the allowed revenue cap... the efficiency gain will then be taken into account in the setting of the revenue cap for the subsequent regulatory periods." Non-efficiency gains are to be refunded to market participants.

The EMA had asked EMC for a written justification of claims for efficiency gains in FY2004/05. The EMA had also requested that the Rules Change Panel comment on EMC's efficiency gain justifications. This request is contained in EMA's letter to EMC on 17 June 2005.

In reply to Mr. Robin Langdale's question on the \$28.6m shown on the Revenue Cap Model, Mr. Tan Zing Yuen explained that in developing the EMC budget of \$28.6m for 2005/06, efficiency gains identified then have been included.

Mr. Robin Langdale commented that the concept of the efficiency gains is not a precise calculation and as the revenue cap regime is designed to incentivise EMC to be cost-efficient, the system must ensure that it motivates Management in the right direction and rewards the Company for doing so. He noted that the underlying principle seems to be that EMC would achieve the same reward for efficiency gains irrespective of whether the efficiency gains are short-term or long-term. However, EMC should be further rewarded if the efficiency gain would be beneficial to the market in the longer term.

Mr Langdale noted three types of efficiency gains:

1. on-going gains where the benefits will be realized each year for the foreseeable future;
2. gains which will be realized over more than one year; and
3. one-off gains which have been realized only once.

The present system of rewarding EMC for the actual gain realized during the financial year it is introduced does not match the benefit achieved for the Market. To achieve a greater degree of equity between the reward for EMC and the benefit to the Market, it is suggested that the basis of computing the reward for EMC should be reviewed on the following basis:

On type 1. gains, EMC could receive an efficiency gain bonus of more than one year's gain

On type 2. gains, a bonus of one year's gain may be appropriate, but perhaps the bonus should vary according to how many years the market is expected to benefit from the gain

On type 3. gains, EMC should receive a bonus related to the full amount of the gain regardless of whether it is all achieved in the year it is implemented but it seems inequitable for the market if the whole amount of such a gain is paid as a bonus to EMC.

Under Point 10.0 Depreciation – Mr. Low Boon Tong was concerned that if IT projects are being deferred then the deferred depreciation charge should be considered as a non-efficiency gain. Mr. Tan Zing Yuen informed the Panel that if EMC did not carry the project because of EMC policy change or EMC Management's decision without any adverse effects on EMC's stated objectives or service deliveries, then this would be considered as an efficiency gain under EMA's definition.

The Panel was informed that, in EMC's view, the definition of efficiency gain is a broad term and it would be useful to seek EMA's clear definition and guidelines on the treatment of the various types of efficiency gains described above.

Mr. Kok Shook Kwong requested clarification, under Paragraph 6.5 Cost Savings relating to the deferral of the maintenance costs associated with the deferred database split project. In his opinion, new IT projects should have equipment warranties, at least, in the first year of implementation. Mr. Tan Zing Yuen informed Mr. Kok that the maintenance costs saved were for software maintenance and the hardware is under warranty.

Mr. Kok also requested clarification, under Paragraph 8.4, Internet Liability whether EMC would cover its liability under the Internet Liability policy. Mr. Tan informed the Panel that it is not cost-efficient having considered the insurance cover available and the premium payable. EMC's Audit Committee has requested that EMC self-insures this risk. EMC would continue to look for better insurance coverage.

The Panel was informed that EMC is required to submit a report of the Panel's comments to the EMA. EMC would prepare this report on behalf of the Panel and the draft report would be circulated to the Panel for approval, prior to submission to the EMA.

The Panel recommends that EMA notes the Panel's comments on EMC's claims and justifications for efficiency gains for FY 2004/2005.

3.0 EMC's Performance Incentive Measurements and Bonus for FY 2004/05 (Paper No. EMC/RCP/20/2005/03)

EMA in its Economic Regulation Framework for EMC imposed a revenue-cap price regulation regime with a performance based regulation regime to ensure that there are incentives on EMC to improve its service performance standards.

The purpose of the framework is to provide incentives for EMC to make cost efficiencies while maintaining service quality. The regime comprises two key components:

- A revenue cap that puts a limit on the amount EMC can recover from the market. Over time the revenue cap is adjusted taking into account an efficiency factor and the prevailing inflation rate.

The objective of the revenue cap is to incentivise EMC for being efficient with the result being downward pressure on EMC's costs and fees in the long-term.

- A performance based regulation regime, known as Performance Incentive Management System ("PIMS") that rewards EMC with a bonus if it exceeds performance standards agreed with the industry.

Performance based regulation system

EMC developed the performance based regulation system, PIMS, in accordance with its Market Licence requirement.

EMC's PIMS is intended to encourage EMC to identify and provide the key services that are of most value to its customers and to provide it with financial incentives to deliver such services to levels that exceed pre-agreed targets.

The PIMS comprises a set of targets and measures designed to assess the quality of EMC's performance across its key services under the Market Rules.

EMC assesses its performance in delivering the services listed below:-

a) Quantitative measures:

- Systems availability
- Pricing and information accuracy
- Settlement accuracy

b) Qualitative measures:

- Satisfaction with Market Assessment and Dispute Resolution services
- Satisfaction with Rule change process
- Customer responsiveness.

Performance for FY 2004/2005

The performance of the quantitative measures are recorded throughout the year and reported to the EMC Board at each Board meeting.

The performance of the three qualitative service measures was assessed after the end of the financial year by means of a customer survey. The survey was conducted by EMC's external auditors, Ernst & Young in May 2005.

The proper recording of the performance indicator of the three quantitative measures, the compilation of the results of the customer survey for the three qualitative measures and the computation of the PIMS bonus were also audited by Ernst & Young.

The auditors report was tabled for discussion at this meeting.

Under the approved methodology, should EMC be awarded a bonus under its PIMS, EMC will recover the bonus via an adjustment of its fees for the remainder of the subsequent financial year following its determination.

It was proposed that the bonus for FY 2004/2005 be collected from the market via an adjustment in the EMC fee over the six-month period October 2005 to March 2006. The impact on EMC's overall fees for the six-month period is approximately \$0.0132 per MWh¹.

¹ Based on the estimated energy traded per month of 6.13 million MWh.

Mr. Eu Pui Sun then informed EMC that the Panel had earlier requested EMC to look into the impact of PIMS and the impact of efficiency gains to be spread over 12 months. EMC would take this into account in its report to the EMA.

The Panel noted the contents of the paper and requested EMC to make some minor typographical errors.

The Panel accepts the Management recommendation for the PIMS bonus of \$485,814 for FY 2004/2005. The Panel recommends that the EMA notes the Panel comments and acceptance of the PIMS bonus proposal for FY 2004/2005.

There being no other matters, the meeting ended at 10.45am with a vote of thanks to the Chair.

ALLAN DAWSON
Chairman

Minutes taken by:
Eunice Koh
Market Panel Administrator