Final decision

United Energy

Revised Cost Allocation Method v2.0

19 December 2014

AUSTRALIAN ENERGY REGULATOR

Inquiries about this decision should be addressed to:
Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001
Tel: (03) 9290 1444
Fax: (03) 9290 1457

Email: AERInquiry@aer.gov.au

AER reference: 45316

Contents

Shortened forms

AER	Australian Energy Regulator
CAM	Cost Allocation Method
Distributor, DNSP	Distribution Network Service Provider
NEL	National Electricity Law
NEM	National Electricity Market
Rules, NER	National Electricity Rules
guidelines	Distribution Cost Allocation Guidelines

1 Introduction

1.1 Summary

On 22 October 2014, United Energy submitted a revision to their Cost Allocation Method (CAM—see Appendix A to this paper. United Energy is a licensed entity providing distribution services in Victoria. A CAM is used to separately account for the costs of providing electricity distribution services, including from other services the Distribution Network Service Provider (distributor) might provide. United Energy submitted their proposed revised CAM in anticipation of a new regulatory control period commencing 1 January 2016.

We have determined that United Energy's proposed CAM:

- accords with the requirements of the National Electricity Law (NEL) and National Electricity Rules (the rules)
- gives effect to and is consistent with our Distribution Cost Allocation Guidelines (guidelines).[1]

Accordingly, we have approved United Energy's proposed CAM under clause 6.15.4(c) of the rules.

1.1.1 Background

We are responsible for regulating revenues of electricity distribution businesses in the National Electricity Market (NEM) in accordance with the NEL and the rules. Chapter 6 of the rules deals with economic regulation of electricity distribution services.

Cost allocation concerns attributing a regulated business's costs, or allocating shared costs, between distribution service categories and non-regulated business sections. The different service categories are defined in the NEL and the rules. The CAM allocates costs between:

- direct control services, comprising:
    - standard control services
    - alternative control services
- negotiated distribution services
- unclassified, or unregulated, services.

In our distribution determinations, we classify distributor services according to the above categories. The prices distributors charge for the different categories of distribution services depend on the costs incurred in providing those services. It is therefore important that cost allocation between service classifications accurately and fairly represents costs incurred in providing those services. We rely upon historical and forecast costs allocated in accordance with approved CAM to determine prices charged, or revenues raised, by distributors such as United Energy.

United Energy's previous CAM was prepared and approved in 2010 under transitional arrangements applicable to Victorian distributors for the 2011–15 regulatory control period.[2] These arrangements related to United Energy's transition from a state-based regulatory framework, administered by the Essential Services Commission Victoria (ESCV), to the national framework which we regulate.

1 AER, *Electricity distribution network service providers - Cost allocation guidelines*, June 2008.

2 NER, clause 11.16.3.

Distribution regulatory proposals, or the regulatory arrangements proposed by distributors to us for a particular regulatory control period, must comply with an approved CAM. United Energy submitted their proposed revised CAM in anticipation of the 2016–20 regulatory control period. The revised CAM will be used by United Energy respectively to develop their individual regulatory proposals, which must be submitted to us by 31 April 2015.

Following our approval, Version 1.0 of United Energy's CAM will remain relevant to their respective statutory accounts, reporting and regulatory proposals until 31 December 2015. Version 2.0 will take effect from 1 January 2016, unless we approve a further CAM variation.

2 The rule requirements & assessment process

2.1 The rule requirements

- Clause 6.15.4(a) of the rules requires a distributor to submit to us for approval a document setting out its proposed CAM.
- Clause 6.15.4(b) requires that a CAM give effect to and be consistent with our guidelines.
- Clause 6.15.4(c) provides for us to approve or refuse to approve a CAM submitted under paragraph (a).

2.2 Assessment process

United Energy (UE) submitted a draft of their proposed CAM on 22 October 2014. We assessed the draft proposed CAM. Resulting from this assessment, UE was provided verbally with feedback that no corrections were required to permit approval of the CAM.

The results of our assessment of UE's revised proposed CAM against the requirements of our guidelines are set out in sections 2 and 3 of this paper.

2.3 United Energy's CAM revisions and structure

UE sought AER approval of the attached amended Cost Allocation Methods (CAM) under clause 6.15.4(f) of the National Electricity Rules. They state that the CAM was amended primarily to reflect changes to UE's service classifications in the 2016—2020 regulatory control period to reflect the AER's Framework and Approach decision, dated 24 October 2014.[3]

UE has also revised the description of its corporate governance and ownership structures respectively, to bring them up to date with changes in personnel and ownership.. Version 1.0 of the UE CAM relied on a table in section 8 to detail how costs associated with executives which are not directly attributable were allocated to specific services. In version 2.0 this has been replaced with a flow diagram in section 7 and a breakdown of the functional allocation of positions that are not directly attributable in section 8. UE state that this is the same process as that described in version 1.0 of the CAM. Their reason for adopting this approach is that it allows for changes in executive responsibilities as may arise through internal restructuring to be attributed without needing to also amend the CAM.

A further difference is that the Advanced Metering Infrastructure (AMI) Order in Council will expire at the end of 2015. However, AMI metering costs will continue to be incurred in 2016 and potentially, beyond. The amended CAM describes how AMI costs will be attributed in the next regulatory control period. This is to be a continuation of the current approach to AMI costs and so, does not affect the basis of allocation of any other services.

Although the changes in governance structures described by UE do not directly affect the delivery of services, we consider it important that regulatory documents accurately describe the ownership and corporate governance circumstances of the business. This is because these factors will affect the quantum of overhead costs incurred by the business. These costs will ultimately be passed on to customers in the ordinary course of business, unless disallowed by us in a regulatory determination because they are found not to be efficient costs. We accept these changes are material.

[3] AER, *Final Framework and Approach for the Victorian Electricity Distributors, Regulatory Control Period commencing 1 January 2016*, 24 October 2014

We accept that UE has not changed the basis of allocation of costs to services.

3 Consistency with our cost allocation guidelines

This section sets out our assessment of United Energy's proposed CAM against the requirements of our guidelines.

3.1 United Energy's CAM Assessment

The format and content of CAM are regulated by clause 3.2(a) of our guidelines. Table 1 compares United Energy's proposed CAM against the requirements of clause 3.2(a).

Table 1: comparison of proposed CAM with clause 3.2(a) of our Cost Allocation Guidelines

Clause 3.2(a)	Findings & CAM references
(1) A version history and date of issue for the document	Compliant. See page 2.
(2) A statement of the nature, scope and purpose of the document and the way in which it is to be used by the distributor.	Compliant. See section 3.
(3) Details of the accountabilities within the distributor for the document in order to set out clearly: A. the distributor's commitment to implementing the CAM; and B. responsibilities within the distributor for updating, maintaining and applying the CAM and for internally monitoring and reporting on its application.	Compliant. See section 4.
(4) A description of the distributor's corporate and operational structure to enable the AER to understand how the distributor is organised to provide its distribution services.	Compliant. See section 5.
(5) A specification of the categories of distribution services that the distributor provides to which costs are to be attributed or allocated and the types of persons to whom those services are provided.	Compliant. See section 6.
(6) The distributor's detailed principles and policies to be used for attributing costs directly to, or allocating costs between, categories of distribution services that meet the requirements of clause 2.2 of the Guidelines. For the avoidance of doubt, this includes the attribution or allocation of costs relating to any related party transactions.	Compliant. See sections 7-8.
(7) A description of how the distributor will maintain records of the attribution or allocation of costs to, or between, categories of distribution services to enable any such attribution or allocation to be: A. demonstrated to the AER, in accordance with clause 5.2 of these Guidelines; and B. audited or otherwise verified by a third party, including the AER, as required.	Compliant. See section 10.
(8) A description of how the distributor will monitor its compliance with the CAM and the Guidelines.	Compliant. See section 9.
(9) Details of the proposed date on which the CAM will commence, having regard for clause 4.1(d) of these Guidelines.	Compliant. See section 11.

4 Decision

We consider the CAM proposed by United Energy gives effect to and is consistent with our guidelines and the rules. We therefore approve, under clause 6.15.4(c) of the rules, United Energy's proposed CAM.

Appendix A: United Energy's CAM

United Energy's CAM is attached as a separate document. Digital copies are available at www.aer.gov.au.