Cost Allocation Methodology

Directlink Joint Venture
2025-2030 Revenue Proposal

Energy Infrastructure Investments

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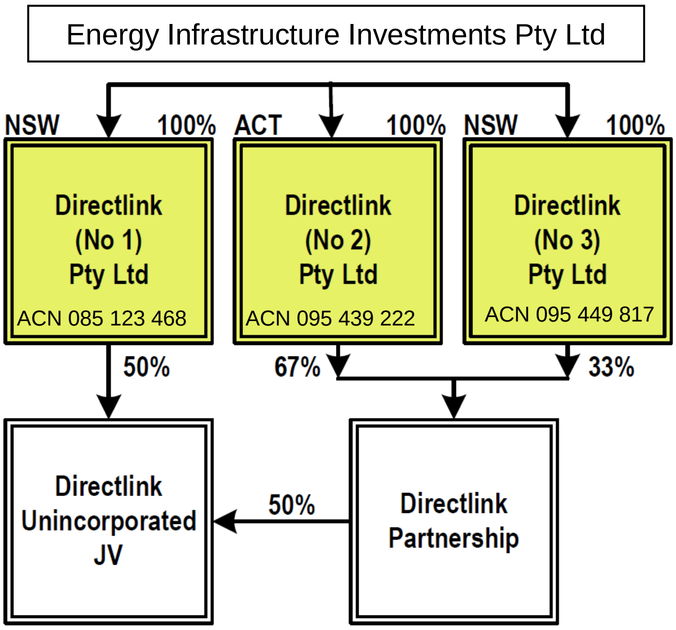
1 Introduction

The Directlink Interconnector is owned by the Directlink Joint Venture. The Directlink Joint Venture is an unincorporated joint venture between three businesses:



Each of these businesses is ultimately 100% owned by Energy Infrastructure Investments Pty Ltd, which in turn is owned by a consortium of investors, as shown below.

EII is an energy infrastructure investment company which owns electricity interconnectors (including Directlink), a coal seam gas processing plant and gas transmission pipelines. The shareholders in EII are Marubeni Group through MM Capital Partners (49.9%), Osaka Gas through Osaka Gas Energy Oceania Pty Ltd (30.2%) and APA Group ("APA") (19.9%).

- Marubeni Group through MM Capital Partners (49.9%) – Marubeni Corporation is one of the largest Japanese trading and investment companies. It is a publicly traded company with 131 branches and offices and 480 consolidated companies. Business sectors include food materials, food products, textiles, materials, pulp and paper, chemicals, energy, metals and mineral resources, transportation machinery, finance & leasing, lifestyle and includes offshore trading. Marubeni's activities also extend to power projects and infrastructure, plants and industrial machinery, finance, logistics and information industry, and real estate development and construction.

  In Australia, Marubeni has operations in power, gas related infrastructure, transportation infrastructure, construction machinery, food, metal, chemical, forest product etc.

Under the specific arrangement between Marubeni, MM Capital Partners and MM Capital Infrastructure Fund I, EII is owned by MM Capital Partners through an investment vehicle, outsourcing the decision making processes of operational and financial policies to Marubeni.

Major investments include an investment in Roy Hill iron ore project with Hancock Group, coal mines with Jellinbah Group and other major players and Gold Coast Light Rail project.

- Osaka Gas through Osaka Gas Energy Oceania Pty Ltd (30.2%) – Osaka Gas was established in 1897 and is headquartered in Osaka, Japan. The company provides gas, electricity, and other energy products and services in Japan and internationally with 154 consolidated subsidiaries. Its main business lines include:

  - Domestic energy, gas: the production, supply and sale of city gas, sale of gas appliances, gas pipe installation, sale of LNG and LPG, LNG transport, sale of industrial gas;
  - Domestic energy, electricity: power generation and sale of electricity;
  - International energy: development of and investment regarding natural gas, energy supply; and
  - Life and business solutions: development and leasing of real estate properties, information-processing services, sale of fine materials and carbon material products.

  Australian mid and downstream assets are all held through Osaka Gas Energy Oceania Pty Ltd

- APA Group (19.9%) - APA is a major owner and operator of energy infrastructure across Australia. APA owns or manages and operates in excess of $22bn of energy assets including:

  - Gas transmission pipelines: over 15,000km in length;
  - Gas distribution: over 29,500 km of gas mains and pipelines (includes 100% of assets operated by APA in Queensland, NSW, Victoria and South Australia);
  - Gas storage: Mondarra Gas Storage and Processing Facility in Western Australia and Dandenong LNG Storage Facility in Victoria;
  - Power generation: 883MW gas-fired power station, 342 MW wind generation, 39 MW BESS, and 311MW solar generation; adn
  - Electricity Transmission: over 800 km of high voltage electricity transmission (including Directlink and Murraylink).

The Directlink asset is operated and maintained by the APA Group under contractual arrangements. The primary contract is the Management, Operations and Maintenance and Commercial Services Agreement (MOMCSA). Under the MOMCSA, APA provides the following services to EII, at a margin on all relevant costs, in respect of its asset portfolio (refer to Appendix B):

- management, operating and maintenance;
- liaison with third parties;
- administration;
- procurement;
- project work; and
- litigation.

APA also provides commercial services (financial management and reporting, legal and regulatory and project management services) which are provided on a fixed fee basis.

EII is an investment vehicle and as such has no employees.

Directlink is a Direct Current transmission link which interconnects the NSW and Queensland AC power grids.

Clause 6A.19.4(a) *National Electricity Rules* (NER) requires the Directlink Transmission Partnership (the *Transmission Network Service Provider*) to submit to the *Australian Energy Regulator* (AER) for its approval a document setting out its proposed cost allocation method to manage the allocation of direct and shared costs to its transmission service.

Directlink's proposed cost allocation methodology has been developed in accordance with the AER's *Electricity Transmission Network Service Providers Cost Allocation Guidelines* (the Guidelines).

1.1 Scope of Methodology

Directlink's proposed cost allocation methodology covers the allocation of direct and shared costs to its transmission service, as required by clause 6A.19.2 of the NER. The electricity transmission service provided by Directlink, the costs associated with this service and the method for allocating the costs is set out in sections 2 and 3 below.

The proposed cost allocation methodology also covers the allocation of management and commercial services charges which are charged to EII by the APA Group in accordance with the MOMCSA Agreement and then allocated to Directlink as one of the EII assets.

The broad structure of EII, the nature of the services provided to Directlink under the MOMCSA Agreement and the basis for allocating the costs associated with those services are outlined in the Appendices B and C.

1.2 Overview of Approach

The proposed approach is the cost allocation methodology which will be used to prepare Directlink's regulatory accounts, which will be submitted annually to the AER on the basis of a regulatory year ending on 30 June. This method essentially involves:

- costs directly associated with the operation and maintenance of Directlink which are directly attributed to the Directlink Transmission Partnership; and
- costs associated with the provision of other commercial services under MOMCSA which are allocated by EII to the Directlink Transmission Partnership using the allocation rules outlined in Appendix C.

Section 3 provides information on the nature of each shared cost item and where and how it is allocated, in sufficient detail to enable the cost allocation to be replicated by the AER or an independent third party.

1.3 Implementation and Accountabilities

The proposed cost allocation methodology will apply once it is approved by the AER. It will be used to prepare Directlink's regulatory accounts each reporting period thereafter, until revisions to this methodology are approved.

All direct and shared costs are allocated in accordance with Directlink's approved cost allocation methodology and recorded in EII's financial systems, which are maintained by APA. This information will be used to prepare Directlink's:

- regulatory accounts;
- forecast operating expenditure;
- forecast capital expenditure;
- the certified annual statement (in accordance with clause 6A.17.1(a) of the NER); and
- actual or estimated capital expenditure for the purposes of increasing the value of its regulatory asset base.

Directlink's cost allocation methodology will be updated (subject to AER approval) and maintained by the Regulatory Manager, APA Group acting on behalf of EII and will be applied by APA Group officers, acting on behalf of EII, who report to the APA Group Chief Financial Officer.

EII, and APA acting on behalf of EII, will allocate costs on a substance over legal form basis, but will not do so in such a way that contravenes any legal requirement.

Internal monitoring and reporting on the application of the cost allocation methodology will be conducted on an ongoing basis by both the Regulatory Manager, APA Group acting on behalf of EII and officers reporting to the APA Group Chief Financial Officer acting on behalf of EII.

Independent verification (audit), on the application of and compliance with the cost allocation methodology, will be conducted on an annual basis, or as otherwise required, as part of Directlink's Regulatory Financial Report. The verification process will include an assessment of the:

- maintenance of financial records on the allocation of direct and shared costs;
- allocation of direct and shared costs in accordance with Directlink's approved cost allocation methodology;
- arithmetic accuracy; and
- reconciliation to statutory financial statements.

This report is prepared in accordance with the AER's *Electricity Transmission Network Service Providers: Information Guidelines*.

2 Directlink's Transmission Services and Costs

2.1 Transmission Services

Directlink provides one Prescribed Transmission Service which is made available (exclusively) to AEMO for the purposes of dispatch, to ensure the efficient and secure flow of energy.

Directlink does not provide any services that are classified as negotiated services.

The transfer of the Directlink Transmission Partnership to EII was completed on 12 December 2008.

The cost allocation guidelines therefore provide an explanation of how costs are allocated to Directlink's Prescribed Transmission Service. Furthermore, regardless of the entity in which costs are incurred they are to be allocated in accordance with the cost allocation methodology. This requirement extends to the MOMCSA Agreement, where APA must comply with the approved cost allocation methodology when performing financial management and reporting on behalf of EII.

In the event that, in the future, Directlink does provide negotiated or non-regulated services any associated costs will be allocated in accordance with the AER's *Cost Allocation Guidelines* and the National Electricity Rules' Cost Allocation Principles.

2.2 Transmission Costs

Directlink's electricity transmission costs comprise the following components:

- direct network operations, including operating expenses, communications, energy costs and connection costs;
- direct maintenance costs;
- direct other costs, including insurance, contracted services, taxes, travel costs, utilities expenses, accounting fees and legal fees, and other direct expenses which can be attributed to the asset;
- an allocation of the costs incurred by EII for all commercial services under the MOMCSA; and
- additional costs incurred by APA outside of the MOMCSA which may then incur an additional charge on EII. These costs may either be directly attributed to Directlink or may be attributed to EII and then partly or wholly allocated to Directlink.

Each of the direct costs identified above are incurred by Directlink and attributed to the prescribed transmission service.

3 Allocation of Costs to Directlink

EII's corporate structure and asset portfolio is represented in Appendix B. The revenue stream earned from each of these assets represents a mix of regulated and negotiated (commercial) returns.

Section 2.2.6 of the Guidelines requires the cost allocation methodology to be consistent with the Transmission Network Ring-fencing Guidelines. As shown in Appendix A, EII no longer owns/performs a related business (as defined in the ring-fencing guidelines).

In accordance with clause 7.4 of the Ring-fencing Guidelines, shared costs between ring-fenced services will be allocated in accordance with Directlink's approved cost allocation methodology.

Section 3.1 below explains the basis of the allocation of shared costs, notably the MOMCSA cost, between Directlink and other EII related businesses. This allocation approach is used consistently across all assets owned by EII.

3.1 EII Shared Costs

The shared corporate services provided by the APA Group to EII under the MOMCSA include the following functions:

- Accounting, Treasury and Taxation;
- Operations Management;
- Commercial Management;
- Engineering Management;
- Strategic Planning;
- Legal and Regulatory; and
- Company Secretariat.

A monthly cost allocation is undertaken for all shared costs, the bulk of which are incurred under the MOMCSA. These costs are allocated to an individual asset as a percentage (%) of the revenue the asset contributes to EII's total revenue. This should result in the fees only being allocated once, that is the fees are not over – recovered.

EII has no intention to allocate costs more than once. In accordance with clause 2.2.5 of the AER cost allocation guidelines Directlink will not allocate any costs more than once.

Based on historical performance, Directlink believes revenue is an appropriate driver for allocating shared corporate costs as the services provided by means of the shared cost are necessary for the generation of revenue. That is, a causal relationship exists between revenue generation and corporate overheads. The ACCC and AER have previously accepted revenue as an appropriate allocator for shared corporate costs in relation to the Directlink asset.

It should be noted that in instances where a service can be directly attributed to the asset, such as a legal cost relating solely to the asset, then this is attributed as a direct other cost as outlined in section 2.2.

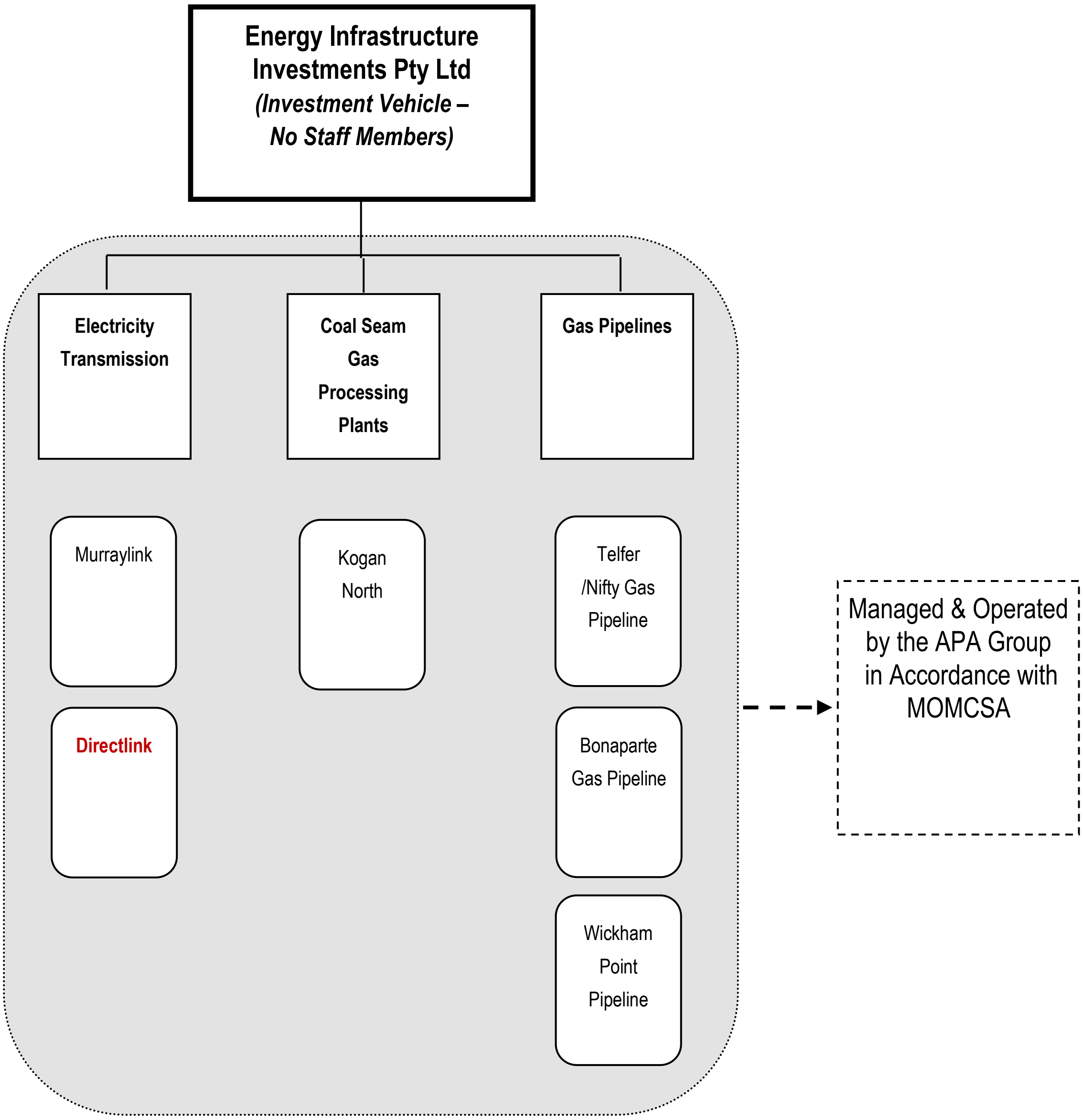
3.2 EII's Asset Categories

EII has the following asset categories (as shown in Appendix B):

- Electricity Transmission Interconnectors;
- a Gas processing facility; and
- Gas Transmission Pipelines;

A EII Assets and Asset Categories

The EII structure below is broadly indicative of how EII assets are categorised and managed. It does not represent the actual detailed corporate structure of EII.



B Cost Allocation Summary Tables

Where a cost cannot be directly attributed to an asset, it is allocated based on a revenue driver. The revenue driver is based on the overall revenue contribution of the asset as a percentage of EII's total revenue.

Table 1 Allocation of Shared Costs to Directlink

Cost Category	Description	Costs Shared Between	Basis of Allocation (Driver)
Finance	Costs include: • Business advisory services • Treasury functions • Accounting services • Taxation	Each of EII's assets	Proportional to the contribution to group revenue
Operations Management	Costs of the office of high level management of operations	Each of EII's assets	Proportional to the contribution to group revenue
Commercial Management	Costs of commercial functions	Each of EII's assets	Proportional to the contribution to group revenue
Engineering Management	Costs include: • Engineering advisory services • Operational Planning	Each of EII's assets	Proportional to the contribution to group revenue
Strategic Planning	Costs include: • Business advisory services • Business Planning/Business Strategy	Each of EII's assets	Proportional to the contribution to group revenue
Legal and Regulatory	Costs include: • Legal advice and compliance • Regulatory services	Each of EII's assets	Proportional to the contribution to group revenue
Company Secretariat	Costs include: • Secretariat • Corporate governance	Each of EII's assets	Proportional to the contribution to group revenue
Insurance	Costs include: • Industrial Special Risks Insurance • Liability Insurance	Each of EII's assets	Direct attribution of stand-alone premiums