Final decision

Jemena

Revised Cost Allocation Method

19 December 2014

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Contents

Shortened forms

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

1 Introduction

1.1 Summary

On 23 July 2014, Jemena (JEN) submitted a revision to their Cost Allocation Method (CAM—see Appendix A to this paper). Jemena 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. JEN submitted their proposed revised CAM in anticipation of a new regulatory control period commencing 1 January 2016. However, as the CAM is also used for regulatory reporting purposes JEN did not specify this as the start date for the amended CAM. The start date is 1 January 2015.

We have determined that JEN'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 JEN'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 Jemena.

[1] AER, *Electricity distribution network service providers – Cost allocation guidelines*, June 2008.

JEN'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 Jemena's transition from a state-based regulatory framework, administered by the Essential Services Commission Victoria (ESCV), to the national framework which we regulate.

Distribution regulatory proposals, or the regulatory arrangements proposed by distributors to us for a particular regulatory control period, must comply with an approved CAM. JEN submitted their proposed revised CAM in anticipation of the 2016–20 regulatory control period. The revised CAM will be used by JEN to develop their regulatory proposal, which must be submitted to us by 30 April 2015.

Following our approval, Version 1 of JEN's CAM will remain relevant to their respective statutory accounts, reporting and regulatory proposals until 31 December 2014. Version 2.1 will take effect from 1 January 2015.

[2] NER, clause 11.16.3.

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

Jemena submitted a draft of their proposed CAM on 23 July 2014. We assessed the draft proposed CAM. Resulting from this assessment, JEN was provided with feedback that the CAM did not specify a start date as required by clause 3.2(a)(9) of the AER's guideline. JEN stated that it did not specify a start date as it would be dependent on the receipt of approval of the AER for the amendments. JEN and the AER have agreed that the CAM will commence operation on 1 January 2015. This is the commencement of the next regulatory reporting period for JEN. No other corrections were required to permit approval of the CAM. The amended CAM is attached to this decision.

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

2.3 Jemena's CAM revisions and structure

JEN sought AER approval of the attached amended Cost Allocation Methods (CAM) under clause 6.15.4(f) of the National Electricity Rules. Jemena state that the CAM was amended because there has been a material change in JEN’s circumstances due to major changes in JEN’s organisational and cost centre structures, as well as due to the introduction of enhanced IT systems (i.e. 'time writing') which allow more detailed data to be gathered on some costs and the drivers for those costs. JEN describe the changes made as being 'incremental' as they have not altered the basis of allocation of costs but will improve the accuracy of reported costs in future.

Although the changes in ownership and corporate governance structures described by JEN does 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 found not to be efficient costs. We accept these changes are material.

JEN has also taken the opportunity to rewrite substantial sections of the CAM to simplify the language used. We have reviewed this drafting. We accept that the drafting does not change the basis of allocation of costs to services. We agree the enhanced use of time writing to attribute management time to specific activities is likely to improve the accuracy of the management costs allocated to the affected service classifications. As this change does not affect the basis of allocation of these costs, we accept this change should be adopted. We note that as the CAM is used for regulatory reporting, it is appropriate to adopt the changed CAM from the commencement of the next regulatory reporting year, which commences on 1 January 2015. This date was proposed by JEN.

3 Consistency with our cost allocation guidelines

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

3.1 Jemena's CAM Assessment

The format and content of CAM are regulated by clause 3.2(a) of our guidelines. Table 1 compares Jemena'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 4.
(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 6.
(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 sections 7-8 and appendix 1.
(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 5.
(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 section 5.
(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 7.
(8) A description of how the distributor will monitor its compliance with the CAM and the Guidelines.	Compliant. See section 8.
(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 6.

4 Decision

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

Appendix A: Jemena's CAM

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