



# AusNet Services Cost Allocation Method

**AER Decision**

October 2018

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AER Reference: 64082

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## Shortened forms

### Table text heading

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

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# 1 Introduction

## 1.1 Summary

On 13 September 2018 AusNet Electricity Services Pty Limited (AusNet Services) submitted a Cost Allocation Method (CAM) to the AER for approval — see Appendix A to this paper. AusNet Services provides electricity distribution services in Victoria. A CAM is used to separately account for the costs of providing electricity distribution services, including from other services the distributor might provide.

We have determined AusNet Services' proposed CAM:

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

Accordingly, we have approved AusNet Services' proposed CAM under clause 6.15.4(c) of the rules.

## 1.2 Background

The AER is responsible for regulating revenues of the electricity distribution businesses in Victoria in accordance with the NEL and the rules. Chapter 6 of the rules provides further details on the economic regulation of electricity distribution services in Victoria.

Cost allocation concerns attributing a regulated business' costs, or allocating shared costs, between distribution service categories and non-regulated business sections. The different services provided by DNSPs are defined in the NEL and the rules. They are:

- 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 to the above categories based on factors specified by the rules. The prices DNSPs 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 an approved CAM to determine prices charged, or revenues raised, by distributors such as AusNet Services.

Distribution regulatory proposals, or the regulatory arrangements proposed by DNSPs to us for a particular regulatory control period, must comply with an approved CAM. The CAM subject to this decision paper will be used by AusNet Services to develop its distribution

regulatory proposals. AusNet Services will also use its CAM to report to us annually for its regulated distribution business.

Following our approval, AusNet Services' approved CAM will remain relevant to its regulatory accounts, reporting and regulatory proposals until we approve a further CAM variation.

## 2 Rule requirements and assessment

### 2.1 The rule requirements

For DNSPs:

- Clause 6.15.4(a) of the rules requires a DNSP 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 distribution guidelines.
- Clause 6.15.4(c) provides for us to approve or refuse to approve a CAM submitted under paragraph (a).
- Clause 6.15.4(f) provides for a DNSP to amend its CAM from time to time, subject to our approval.

### 2.2 Assessment process

AusNet Services informally submitted a pre-draft copy of its proposed CAM on 21 June 2018. AusNet Services intended to amend its current approved CAM only to the extent necessary to reflect its:

- changed organisational and corporate structure
- amended services to align with our Electricity Distribution Ring-Fencing Guideline.

AusNet Services did not propose to make material changes to its cost allocation approach.

Upon preliminary assessment, we recommended AusNet Services remove from the CAM references to surveys and substitute these with explicitly defined shared cost allocators. In other respects only minor changes were recommended.

As a result of our feedback on the informal iteration of its CAM, staff from AusNet Services and the AER liaised on the issues created by inclusion of surveys in the CAM. While we retain our view that surveys are inappropriate, we have accepted AusNet Services' proposal to:

- retain surveys in the new CAM iteration
- use the new CAM iteration to develop its distribution regulatory proposal, due for submission to the AER no later than 31 July 2019
- submit to the AER during calendar 2019 a further revised CAM with all survey references removed.

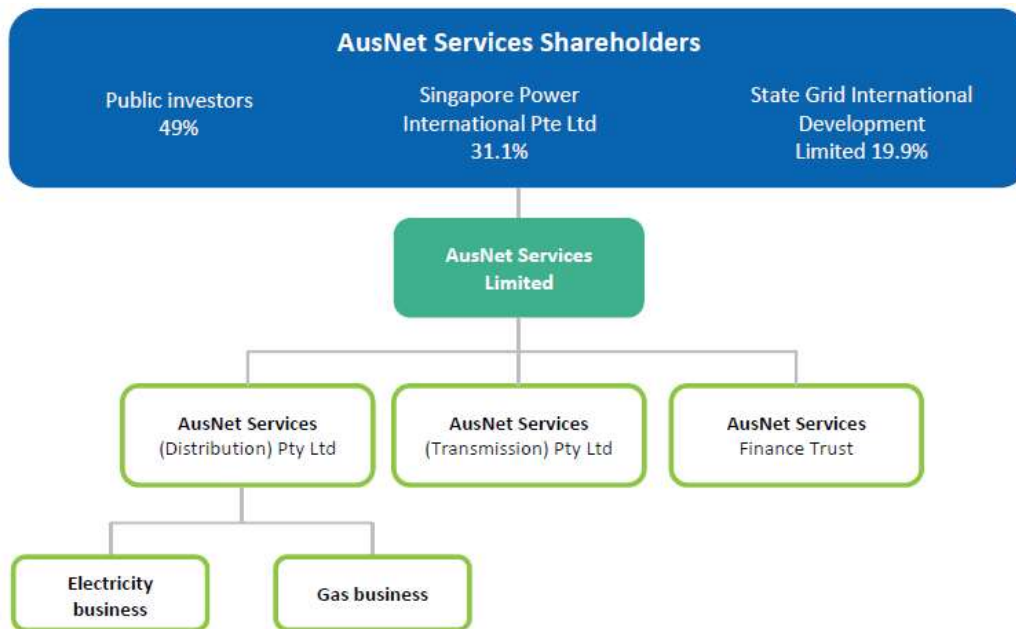
Having made minor required changes to the draft CAM in response to our other feedback, AusNet formally submitted the proposed CAM for approval. We have assessed the CAM against the requirements of the rules and our guidelines. Details of our assessment are provided below.

## 2.3 AusNet Services' CAM proposal and structure

AusNet Services sought AER approval of the attached CAM under clause 6.15.4 (c) and (d) of the rules. The CAM provides details on corporate structure, attribution of direct costs, allocation of indirect costs, cost recording and record keeping systems, compliance and capitalisation policies.

AusNet Services proposed CAM describes its corporate structure, illustrated in Figure 1 below.

**Figure 1 AusNet Services corporate structure<sup>1</sup>**



AusNet Services' electricity distribution services are contained within the operating subsidiary of AusNet Services (Distribution) Ltd, namely AusNet Electricity Services Pty Ltd.

In addition to its corporate structure, AusNet Services' CAM describes its operational structure. Its operational divisions are split along functional lines:<sup>2</sup>

- Regulated Energy Services Division
- Commercial Energy Services Division
- Corporate Groups Division.

The CAM describes most of AusNet Services' network service provider activities as undertaken by its Regulated Energy Services Division. Commercial Energy Services Division

<sup>1</sup> AusNet Services, *Cost Allocation Method*, September 2018, p. 10.

<sup>2</sup> AusNet Services, *Cost Allocation Method*, September 2018, p. 11.



provides a range of 'regulated and unregulated niche asset services' to both the Regulated Energy Services Division and to external customers. Corporate Groups Division provides corporate support services to the other divisions and includes the office of the managing director.

The CAM sets out how AusNet tracks its costs using cost centres, accounts and project numbers. Individual project costs are mapped to categories of capex, opex and services.<sup>3</sup>

The CAM describes which costs are directly attributed to service categories.<sup>4</sup> These include network assets, normal and overtime labour costs, regulated levies and charges, and contractor costs.

The CAM also describes which costs are indirect/shared and therefore are allocated to service categories.<sup>5</sup> These include the cost of corporate functions such as HR, finance and payroll teams.

### **Surveys as shared cost allocators**

AusNet's proposed CAM retains from the current approved CAM a heavy reliance on Activity Based Costing (ABC) surveys to allocate shared costs. Surveys are the sole allocation method for AusNet Services' indirect/shared costs. This contrasts with most approved CAMs which specify one or more allocators, or shared cost drivers, to allocate indirect/shared costs to service categories.

While in the past we have approved the inclusion of surveys in CAMs, including AusNet's current approved CAM, we now consider circumstances have changed. We are now observing increasing interactions between regulated and unregulated services provided by regulated network service providers and their affiliates.

Our ring-fencing work stream is focussed on delineating regulated services and costs from unregulated. Ring-fencing obligations to which distributors such as AusNet Services subject, are founded upon effective cost allocation. Inclusion of surveys in CAMs does not support a clear delineation of regulated and unregulated services and costs. We consider explicitly defined allocators are superior in this regard.

### **AusNet Services circumstances**

In response to our concerns about incorporation of surveys in the CAM, AusNet Services indicated that while the term surveys is used, underlying that is a detailed system of cost allocators operated at cost centre level:

- cost centre managers use allocators to determine how shared costs have been used for service categories
- cost centre managers complete regular surveys on the basis of those detailed allocators

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<sup>3</sup> AusNet Services, *Cost Allocation Method*, September 2018, p. 13.

<sup>4</sup> AusNet Services, *Cost Allocation Method*, September 2018, pp. 14–17.

<sup>5</sup> AusNet Services, *Cost Allocation Method*, September 2018, pp. 18–20..

- survey results are aggregated up and incorporated in regulatory accounts.

This explanation gives us greater comfort around the incorporation of the term ‘surveys’ in the proposed CAM. However, it does not satisfy our requirement for clarity.

We require AusNet to remove surveys from the CAM and substitute explicitly defined allocators for all shared costs. However, we accept that timing of significant changes to its CAM is problematic for AusNet Services.

AusNet Services is required to submit to the AER its 2021–25 electricity distribution regulatory proposal no later than 31 July 2019. We accept that AusNet’s regulatory resources are currently occupied and that imposing a further CAM amendment in the short term would increase its regulatory burden.

AusNet Services submitted that it intends to substitute surveys in the CAM with allocators without affecting resulting cost allocation. AusNet will do this by identifying from its existing suite of allocators a subset which provides data time series’ most closely aligned with its existing historical time series’.

AusNet Services has committed to undertake this work in calendar 2019.<sup>6</sup> For details see AusNet’s letter, submitted with its proposed CAM, published on the AER website. We therefore expect to receive a further revised CAM proposal from AusNet Services during calendar 2019.

In the context of this agreement with AusNet we approve the proposed CAM submitted to us in September 2018. As set out above, we consider this proposed CAM to be an interim CAM only.

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<sup>6</sup> AusNet Services, letter *AusNet Electricity Services’ Cost Allocation Methodology*, 13 September 2018.

### 3 Consistency with our cost allocation guidelines

This section sets out our assessment of AusNet Services' proposed CAM against the requirements of our guidelines.

### 3.1 AusNet Services CAM assessment

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

**Table 1 CAM assessment table**

#### General obligations

Rules	CAG	Requirements	Addressed
<b>6.15.4(a)</b>	1.5, 3.1(a)	DNSP must develop a proposed CAM for submission to the AER	Compliant
<b>6.15.4(b)</b>	1.5, 3.1(b)	DNSP's proposed CAM must give effect to and be consistent with the CAG	Compliant
	5.4	DNSP must maintain current copy of approved CAM on its website	Compliant

#### Contents of Cost Allocation Method

CAG	Requirements	Addressed
<b>3.2(a)(1)</b>	Version number	Page 2
<b>3.2(a)(2)</b>	DNSP's commitment to history and date of issue	Page 2
<b>3.2(a)(3)</b>	Statement of nature, scope and purpose of document and way it is to be used	Section 2.1
<b>3.2(a)(3)A</b>	Accountabilities for implementation	Section 2.2
<b>3.2(a)(3)B</b>	Responsibilities for updating, maintaining and applying document and for internally monitoring and reporting its application	Sections 2.2 and 2.3
<b>3.2(a)(4)</b>	Description of corporate and operational structure	Sections 3.1 and 3.2

CAG	Requirements	Addressed
3.2(a)(5)	Specification of service categories and types of persons to whom services provided	Section 3.3
3.2(a)(6)	Principles and policies for attributing costs to, and allocating costs between, categories of distribution services in accordance with clause 2.2 of CAG	Sections 4 and 5
3.2(a)(7)	Description of how will maintain records of attribution and allocation	Section 2.4
3.2(a)(8)	Description of how will monitor compliance with CAM and Guidelines	Section 2.3
3.2(a)(9)	Commencement date	Section 2.5

### Cost allocation principles and policies

Rules	RFG	CAG	Requirements	Addressed
6.15.2(1)	3.2.2(a)	2.2.1(a)	<p>Include sufficiently detailed principles and policies for attributing costs to, and allocating costs between, categories of distribution services to enable:</p> <ul style="list-style-type: none"> <li>AER to replicate reported outcomes</li> <li>DNSP to demonstrate that it is meeting requirements</li> </ul>	Compliant – subject to our agreement with AusNet Services regarding removal of surveys
		2.2.1(b)(1)	Include specified information on directly attributable costs to enable AER to replicate reported outcomes	Compliant
		2.2.1(b)(2)	Include specified information on shared costs to enable AER to replicate reported outcomes	Compliant
6.15.2(2)		2.2.2	Attribute costs directly to, or allocated costs between, categories of distribution services based on substance of underlying transaction or event not legal form	Compliant
6.15.2(3)(i)		2.2.3	Only directly attribute costs to categories of distribution services if they are directly attributable to the provision of the service	Compliant

Rules	RFG	CAG	Requirements	Addressed
<b>6.15.2(3)(ii)</b>		2.2.4	<p>Allocate shared costs between categories of distribution services using an appropriate causal allocator, except to the extent that:</p> <ul style="list-style-type: none"> <li>• Shared cost is immaterial</li> <li>• Causal relationship cannot be established without undue cost or effort</li> </ul> <p>in which case may use non-causal allocator in specified circumstances</p>	Compliant
<b>6.15.2(4)</b>			Clearly describe the cost allocation method, the reason for using it and the numeric quantity (if any) of the chosen allocator	Compliant
<b>6.15.2(5)</b>		2.2.5	Do not allocate the same cost more than once	Compliant
<b>6.15.2(6)</b>		2.2.6	Detailed principles, policies and approach used to attribute costs directly to, or allocated costs between, categories of distribution services must be consistent with the Distribution Ring Fencing Guidelines	Compliant
<b>6.15.2(7)</b>		2.2.7	Costs that have been attributed or allocated costs to distribution services must not be reattributed or reallocated to another service during the regulatory control period	Compliant

## 4 Decisions

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

## **Appendix A: AusNet Services' CAM**

AusNet Services' CAM is attached as a separate document. Digital copies are available at [www.aer.gov.au](http://www.aer.gov.au).