



Energex Ltd and Ergon Energy Ltd Cost Allocation Method

AER Final Decision

November 2018

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Shortened forms

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

1 Introduction

1.1 Summary

On 18 October 2018 Energy Queensland Ltd (EQL), the parent holding company for the two distribution network service providers in Queensland, Energex Ltd (Energex) and Ergon Energy (Ergon), submitted amendments to approved Cost Allocation Methods (CAM) to the AER for approval — see Appendix A to this paper. Energex and Ergon provide electricity distribution services in Queensland. A CAM is used to separately account for the costs of providing electricity distribution services, including from other services the distributor might provide. EQL proposed amendments to its

- current CAM for Energex effective from 1 December 2018
- current CAM for Ergon effective from 1 December 2018

Further EQL also submitted a new combined Energex and Ergon CAM take effect from 1 July 2020.

We have determined that the proposed amended CAMs:

- accord with the requirements of the National Electricity Law (NEL) and National Electricity Rules (the rules)
- give effect to and are consistent with our Distribution Cost Allocation Guidelines (our guidelines).

Accordingly, we have approved all three proposed amended CAMs under clause 6.15.4(c) of the rules.

1.2 Background

The AER is responsible for regulating revenues of an electricity distribution business in Queensland 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 South Australia.

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 Distribution Network Service Providers (DNSPs) are defined in the NEL and the rules. They are:

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

A further category of services is identifiable—non—distribution services. We do not, nor are we able to, regulate these 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 Energex Ltd and Ergon Energy.

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 amended CAM subject to this decision paper will be used by EQL to develop its distribution regulatory proposals for Energex and Ergon. EQL will also use its CAM to report to us annually for its two regulated distribution businesses.

Following our approval, EQL's approved amended 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

EQL informally submitted a new combined CAM for Energex and Ergon on 1 April 2018. The combined CAM is proposed to take effect from 1 July 2020.

At the same time EQL also proposed short term amendments to the two existing CAMs for Energex and Ergon to reflect changes to its organisational structure. In effect the amended Energex and Ergon CAMs will become interim CAMs to be replaced by the joint CAM in 2020. The two interim CAMs will apply from 1 December 2018 to the end of the 2015-20 regulatory control period. Application of the combined CAM is timed to align with the beginning of the 2020-25 regulatory control period. Energex and Ergon regulatory proposals submitted to us by Energy Qld for the 2020-25 regulatory period will comply with the combined CAM.

Upon preliminary assessment of all three CAMs, we advised EQL the CAMs were approvable but we raised a small number of minor presentational issues.

As a result of our feedback on informal iterations of its proposed CAMs, EQL formally submitted CAMs on 18 October 2018 for our approval. With respect to the combined CAM, Appendix 2 of the CAM provides a detailed compliance matrix against the requirements of our guidelines and the rules.

2.3 Energex and Ergon CAM proposal and structure

EQL sought AER approval of the attached three CAMs under clause 6.15.4 (c) and (d) of the rules. The CAMs provide details on corporate structure, attribution of direct costs, allocation of indirect costs, cost recording and record keeping systems.

In the following sections, we discussed the key aspects of the two interim CAMs and the combined Energex Ergon CAM.

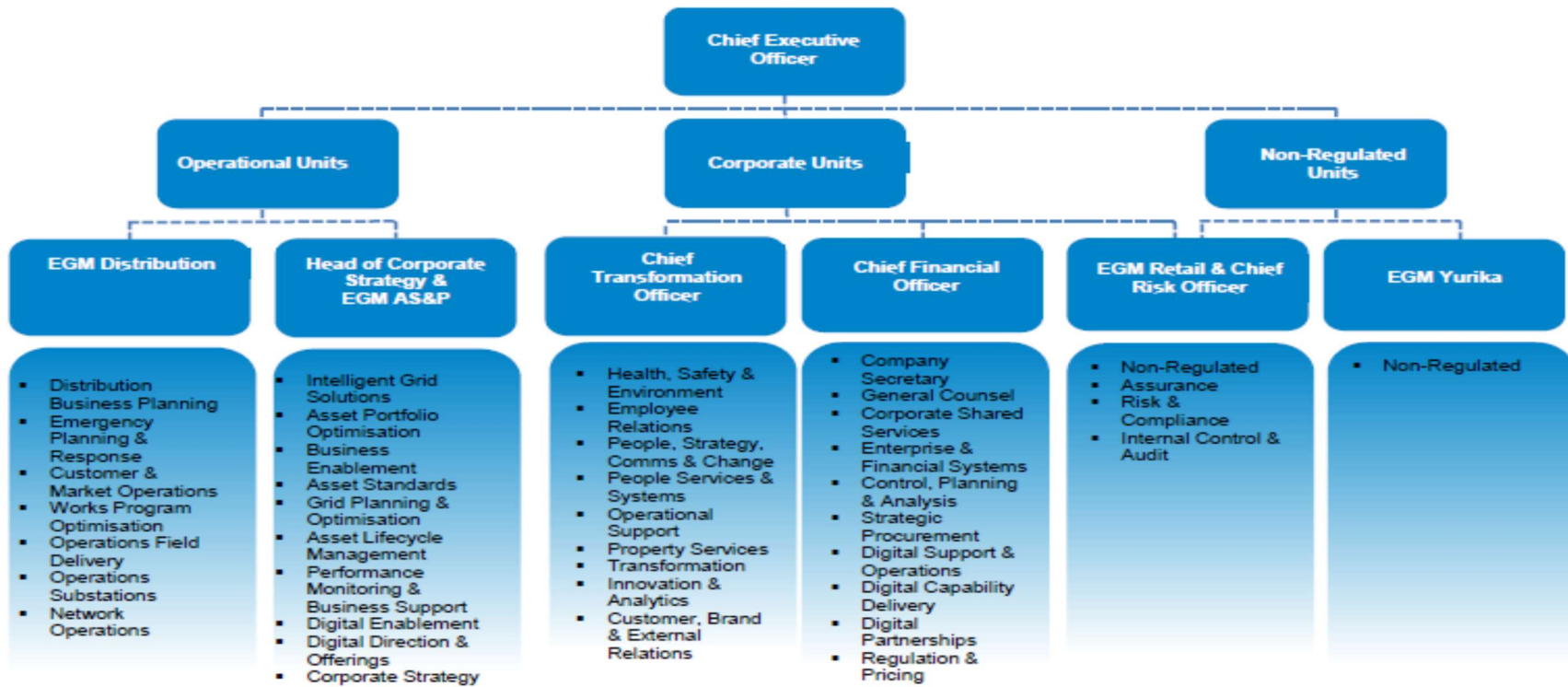
Amendments to existing CAMs for Energex and Ergon Energy

The only major change to the two interim CAMs for Energex and Ergon is the modification to the organisational structure. All other aspects of CAM such as allocation of shared costs, attribution of direct costs, accountability and responsibilities for CAM are a continuation of the principles provided on the existing approved CAM.

The Energex, Ergon Energy combined CAM

The new combined CAM for Energex and Ergon Energy describes the operational structure in further detail. Energex and Ergon, the two DNSP business units share corporate services with other subsidiary companies functional under Energy Queensland as shown in the figure below.

Figure 1: Energy Queensland Operational Structure¹



¹ Energex Ergon CAM, section 7 *Operational Structure*, p. 10 of 28

The CAM describes that costs incurred are entered into a recording system via account code. This code is mapped to a specific distribution service, unregulated activity or shared cost. In addition to the cost records, the supporting systems are used for determining inputs such as calculating allocation percentages for overheads.

The CAM describes which costs are directly attributed to service categories.² These include capital and operational expenditures related to labour, inventory, third party contractor costs and other miscellaneous costs which have direct line of sight between the cost incurred and the service provided.

The CAM classifies its shared costs into network overheads, corporate overheads and non-network overheads. These include the cost of corporate functions such as HR, finance and payroll teams, costs related to network functions such as asset management and field services and cost of non-network functions such as information technology, fleet and facility management activities.

Other amendments are relatively minor. The revised CAM incorporates updated terminology to reflect that used in EQL's internal record keeping systems. Also, descriptions of service groups no longer list individual services and their service classifications—we support this approach as it precludes the need to process further CAM updates in response to service classification changes.

In terms of cost allocation changes the combined CAM adopts the 3-factor method currently used by Energex to allocate its shared costs. The Energex and Ergon Energy CAM applies:

- Corporate 3 factor method to allocate corporate costs amongst various business units.
- Distribution 3 factor method to allocate distribution business costs amongst Energex and Ergon divisions.

The CAM applies each of the three factor methods to each year's budget. The process also includes a review requirement linked to a material change in size, scale and scope of various regulated and unregulated services. Other changes to cost allocation are insignificant.

² Energex Ergon Energy, *Cost Allocation Method*, October 2018, pp. 15–16.

3 Consistency with our Cost Allocation Guidelines

This section sets out our assessment of EQL's proposed amended CAMs for Energex Ltd and Ergon Energy against the requirements of our Cost Allocation Guidelines.

3.1 Energex Ltd and Ergon Energy - CAM assessment

The format and content of all three CAMs submitted by EQL are regulated by clause 3.2(a) of our Cost Allocation Guidelines. Table 1 compares EQL's proposed CAMs against the requirements of clause 3.2(a). It also references relevant NER provisions and elements of our Ring-fencing Guideline.

Table 1 CAM assessment – Amended Energex CAM

1. General obligations

Rules	CAG	Requirements	Addressed
6.15.4(f)(1)(ii)	1.5,3.1	An amended CAM must not take effect unless and until the DNSP notifies the AER of the agreement	Compliant
6.15.4(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	Version history and date of issue

2. Contents of Cost Allocation Method

CAG	RFG	Requirements	Addressed
3.2(a)(1)		Version number	Version history and date of issue
3.2(a)(2)		DNSP's commitment to history and date of issue	Version history and date of issue

CAG	RFG	Requirements	Addressed
3.2(a)(3)		Statement of nature, scope and purpose of document and way it is to be used	Section 5
3.2(a)(3)A		Accountabilities for implementation	Section 5
3.2(a)(3)B		Responsibilities for updating, maintaining and applying document and for internally monitoring and reporting its application	Section 5
3.2(a)(4)		Description of corporate and operational structure	Section 6, Section 7
3.2(a)(5)		Specification of service categories and types of persons to whom services provided	Section 8
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	Section 9
3.2(a)(7)	3.2.2(c)	Description of how will maintain records of attribution and allocation	Section 14
3.2(a)(8)	3.2.2(c)	Description of how will monitor compliance with CAM and CAG	Section 15
3.2(a)(9)		Commencement date	Section 4

3. Cost allocation principles and policies

Rules	CAG	RFG	Requirements	Addressed
6.15.2(1)	2.2.1(a)	3.2.2(a) and 3.2.2(b)	<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"> • AER to replicate reported outcomes • DNSP to demonstrate that it is meeting requirements 	Section 9 and Appendix B
	2.2.1(b)(1)		<p>Include specified information on directly attributable costs to enable AER to replicate reported outcomes</p>	Section 9.4
	2.2.1(b)(2)		<p>Include specified information on shared costs to enable AER to replicate reported outcomes</p>	Section 9
6.15.2(2)	2.2.2		<p>Attribute costs directly to, or allocated costs between, categories of distribution services based on substance of underlying transaction or event not legal form</p>	Section 9
6.15.2(3)(i)	2.2.3		<p>Only directly attribute costs to categories of distribution services if they are directly attributable to the provision of the service</p>	Section 9.4
6.15.2(3)(ii)	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"> • Shared cost is immaterial • Causal relationship cannot be established without undue cost or effort <p>in which case may use non-causal allocator in specified circumstances</p>	Section 9

Rules	CAG	RFG	Requirements	Addressed
6.15.2(4)			Clearly describe the cost allocation method, the reason for using it and the numeric quantity (if any) of the chosen allocator	Section 9
6.15.2(5)	2.2.5		Do not allocate the same cost more than once	Section 9
6.15.2(6)	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	Section 9
6.15.2(7)	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	Section 9

Table 2 CAM assessment – Amended Ergon CAM

1. General obligations

Rules	CAG	Requirements	Addressed
6.15.4(f)(1)(ii)	1.5, 3.1	An amended CAM must not take effect unless and until the DNSP notifies the AER of the agreement	Compliant
6.15.4(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	Version history and

			date of issue
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2. Contents of Cost Allocation Method

CAG	RFG	Requirements	Addressed
3.2(a)(1)		Version number	Version history and date of issue
3.2(a)(2)		DNSP's commitment to history and date of issue	Version history and date of issue
3.2(a)(3)		Statement of nature, scope and purpose of document and way it is to be used	Section 5
3.2(a)(3)A		Accountabilities for implementation	Section 5
3.2(a)(3)B		Responsibilities for updating, maintaining and applying document and for internally monitoring and reporting its application	Section 5
3.2(a)(4)		Description of corporate and operational structure	Section 6, Section 7
3.2(a)(5)		Specification of service categories and types of persons to whom services provided	Section 8
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	Section 9
3.2(a)(7)	3.2.2(c)	Description of how will maintain records of attribution and allocation	Section 11

CAG	RFG	Requirements	Addressed
3.2(a)(8)	3.2.2(c)	Description of how will monitor compliance with CAM and CAG	Section 12
3.2(a)(9)		Commencement date	Section 3

3. Cost allocation principles and policies

Rules	CAG	RFG	Requirements	Addressed
6.15.2(1)	2.2.1(a)	3.2.2(a) and 3.2.2(b)	Include sufficiently detailed principles and policies for attributing costs to, and allocating costs between, categories of distribution services to enable: AER to replicate reported outcomes DNSP to demonstrate that it is meeting requirements	Section 9 and Appendix A
	2.2.1(b)(1)		Include specified information on directly attributable costs to enable AER to replicate reported outcomes	Section 9.2
	2.2.1(b)(2)		Include specified information on shared costs to enable AER to replicate reported outcomes	Section 9.4
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	Section 9
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	Section 9.2

Rules	CAG	RFG	Requirements	Addressed
6.15.2(3)(ii)	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"> • Shared cost is immaterial • Causal relationship cannot be established without undue cost or effort <p>in which case may use non-causal allocator in specified circumstances</p>	Section 9.4
6.15.2(4)			Clearly describe the cost allocation method, the reason for using it and the numeric quantity (if any) of the chosen allocator	Section 9.4
6.15.2(5)	2.2.5		Do not allocate the same cost more than once	Section 9
6.15.2(6)	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	Section 9
6.15.2(7)	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	Section 9

Table 3 CAM assessment – Energex and Ergon CAM

1. General obligations

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

2. Contents of Cost Allocation Method

CAG	RFG	Requirements	Addressed
3.2(a)(1)		Version number	Version history and date of issue
3.2(a)(2)		DNISP's commitment to history and date of issue	Version history and date of issue
3.2(a)(3)		Statement of nature, scope and purpose of document and way it is to be used	Section 3
3.2(a)(3)A		Accountabilities for implementation	Section 5
3.2(a)(3)B		Responsibilities for updating, maintaining and applying document and for internally monitoring and reporting its application	Section 5
3.2(a)(4)		Description of corporate and operational structure	Section 6, Section 7

CAG	RFG	Requirements	Addressed
3.2(a)(5)		Specification of service categories and types of persons to whom services provided	Section 8
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	Section 9
3.2(a)(7)	3.2.2(c)	Description of how will maintain records of attribution and allocation	Section 11
3.2(a)(8)	3.2.2(c)	Description of how will monitor compliance with CAM and CAG	Section 12
3.2(a)(9)		Commencement date	Section 3

3. Cost allocation principles and policies

Rules	CAG	RFG	Requirements	Addressed
6.15.2(1)	2.2.1(a)	3.2.2(a) and 3.2.2(b)	Include sufficiently detailed principles and policies for attributing costs to, and allocating costs between, categories of distribution services to enable: <ul style="list-style-type: none"> • AER to replicate reported outcomes • DNSP to demonstrate that it is meeting requirements 	Section 9
	2.2.1(b)(1)		Include specified information on directly attributable costs to enable AER to replicate reported outcomes	Section 9.3
	2.2.1(b)(2)		Include specified information on shared costs to enable AER to replicate reported outcomes	Section 9.4
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	Section 9
6.15.2(3)(i)	2.2.3		Only directly attribute costs to categories of distribution services if they are directly	Section 9.3

Rules	CAG	RFG	Requirements	Addressed
			attributable to the provision of the service	
6.15.2(3)(ii)	2.2.4		Allocate shared costs between categories of distribution services using an appropriate causal allocator, except to the extent that: <ul style="list-style-type: none"> • Shared cost is immaterial • Causal relationship cannot be established without undue cost or effort in which case may use non-causal allocator in specified circumstances 	Section 9.4
6.15.2(4)			Clearly describe the cost allocation method, the reason for using it and the numeric quantity (if any) of the chosen allocator	Section 9.4
6.15.2(5)	2.2.5		Do not allocate the same cost more than once	Section 9
6.15.2(6)	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	Section 9
6.15.2(7)	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	Section 9

4 Decisions

We consider the amendments proposed by Energy Queensland on all three CAMs give effect to and are consistent with our guidelines and the rules. We therefore approve, under clause 6.15.4(c) of the rules, Energy Queensland proposed amendments on all three CAMs.

Appendix A: Energex Ltd and Ergon Energy CAMs

Energex and Ergon Energy CAMs are attached as a separate document. Refer to the list below. Digital copies are available at www.aer.gov.au.

Amended Ergon Energy CAM – Effective 1 December 2018

Amended Energex CAM – Effective 1 December 2018

Energex Ltd and Ergon Energy CAM – Effective 1 July 2020