

Directlink Interconnector Cost Allocation Methodology

APA Submission to the Australian Energy Regulator

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1 Introduction

The Directlink asset is owned by the Directlink Joint Venture. The Directlink Joint Venture's ABN is 16 779 340 889. The Directlink Joint Venture is 100 per cent owned by the APA Group (APA). APA is a major owner and operator of energy infrastructure in Australia owning over 10,000km of gas transmission pipelines, over 2,300 km of gas distribution networks, coal seam gas processing plants, gas-fired power stations, gas storage facilities and high voltage direct current electricity interconnector systems.

The Directlink asset is operated and maintained by a team within the APA Operations Division, which reports to the APA General Manager Transmission who reports to the APA Group Manager Operations and then to the Managing Director of the APA Group. This team is supported by APA officers from finance, legal, regulatory and other support functions as appropriate. (An APA organisation structure is shown in Attachment D).

Directlink is an 180MW capacity High Voltage Direct Current transmission link which interconnects the Queensland and New South Wales AC power grids. Directlink is a bi-directional facility. The link was commissioned in 2000.

The purpose of this submission is to set out Directlink's proposed cost allocation methodology, as required under clause 6A.19.4 (a) of the *National Electricity Rules* (NER). Clause 6A.19.4 (a) requires the Directlink Joint Venturers' (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.

1.1 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.

¹ AER (2007). *Electricity Transmission Network Service Providers Cost Allocation Guidelines – Final*. September.

The proposed cost allocation methodology also covers the allocation of corporate costs to Directlink from the APA Group.

The APA Group owns and operates gas transmission, gas distribution, electricity transmission and other assets within Australia. Directlink is owned by the Directlink Joint Venture which consists of three partners being Directlink (No 1) Pty Ltd, Directlink (No 2) Pty Ltd and Directlink (No 3) Pty Ltd. The Directlink Joint Venture is 100 per cent owned by the APA Group.

Section 4 explains the broad structure of the APA Group, the nature of the services provided to Directlink from other parts of the APA Group and the basis for allocating the costs associated with those services.

1.2 Overview of Approach

The proposed approach is the current cost allocation methodology used to prepare Directlink's regulatory accounts, which are submitted annually to the AER. This method essentially involves:

- costs associated with the operation and maintenance of the network which are directly incurred by the Directlink Joint Venture; and
- corporate costs allocated to the Directlink Joint Venture.

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 is the current cost allocation methodology used to prepare Directlink's regulatory accounts, which are submitted annually to the AER. Although the proposed cost allocation methodology will not formally apply until it is approved by the AER, in the interests of consistency between reporting periods, the proposed cost allocation methodology will be used to prepare Directlink's 2007-08 regulatory accounts and each reporting period thereafter, until revisions to this methodology are approved.

All direct and shared costs, as defined in the cost allocation methodology, are recorded in the APA Group's financial systems. These costs will be allocated in accordance with Directlink's approved cost allocation methodology and recorded in the APA Group's

financial systems. This information will be used to prepare Directlink's regulatory accounts. Furthermore these costs will be used to prepare Directlink's:

- 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 and will be applied by officers reporting to the Chief Financial Officer of the APA Group.

APA 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 and officers reporting to the Chief Financial Officer of the APA Group.

Independent verification (audit), on the application of and compliance with the cost allocation methodology, will be conducted on an annual basis 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; and
- allocation of direct and shared costs in accordance with Directlink's approved cost allocation methodology.

This report is prepared in accordance with the Australian Competition and Consumer Commission's (ACCC) *Statement of Principles for the Regulation of Transmission Revenues: Reporting Guidelines* (Revenue Guidelines)².

A signed copy of Directlink's Director's Statement which confirms the accuracy of the proposed approach and Directlink's intention to comply with the cost allocation methodology as approved by the AER is included in Appendix A.

² ACCC (2002). *Statement of Principles for the Regulation of Transmission Revenues – Transmission Ring-Fencing Guidelines: Reporting Guidelines*. October.

2 Directlink's Transmission Services and Costs

2.1 Transmission Services

Directlink provides one Prescribed Transmission Service which is made available (exclusively) to NEMMCO 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 APA Group acquired the Directlink Group on 28 February 2007. The APA Group has had no access to information with regard to any Related Party prior to that date and does not expect there be any Related Party transactions in the future.

The cost allocation guidelines therefore provide an explanation of how costs are allocated between the APA Group and Directlink's prescribed service.

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

2.2 Transmission Costs

Directlink's electricity transmission costs comprise the following components:

- direct network operations, including management fees and expenses, communications, energy costs and connection costs;
- direct maintenance costs;
- direct other costs, including insurance, contracted services, staff costs, taxes, travel costs, utilities expenses, accounting and audit fees and legal fees, and other direct expenses which can be attributed to the asset;
- state office support costs, which, if they exist, are allocated on the basis of the proportion of the state office resource which is utilised by the asset; and
- corporate overhead costs for services provided by APA Group.

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

3 Allocation of Costs to Directlink

APA's portfolio comprises a mix of gas transmission and distribution assets, electricity transmission and generation assets, and complementary assets. APA'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 6.2.2 of the Guidelines requires the cost allocation methodology to be consistent with the *Transmission Network Ring-fencing Guidelines*³. As shown in Appendix B, APA owns/performs a related business (as defined in the ring-fencing guidelines) as it owns generation assets. These assets represent less than 5 per cent of APA's total annual revenue⁴.

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 to Directlink, APA's related businesses and other assets. This allocation approach is used consistently across all assets/services owned/provided by APA in the preparation of Directlink and APA's financial accounts.

All shared costs are incurred by the APA Group. These are represented as 'Corporate Overhead Costs'. These costs are allocated each year to an individual asset as a percentage (%) of revenue the asset contributes to corporate revenue. That is, total 'Corporate Overhead Costs' are allocated, on a percentage basis, to individual APA assets. This should result in 'Corporate Overhead Costs' costs only being allocated once and APA has no intention to allocate costs more than once. This allocation basis is considered appropriate as it reflects a causal relationship.

3.1 Corporate Overhead Costs

The corporate services provided by the APA Group include:

- Directors

³ AER (2005) *Compendium of Electricity Transmission Regulatory Guidelines*. August. Pp 71 -82.

⁴ APA Group (2007) Annual Report.

- Chief Executive Officer / Managing Director;
- Chief Financial Officer, including Accounting, Treasury and Taxation;
- GM Operations
- GM Commercial
- Corporate Engineering
- Human resources;
- Strategic Planning
- Legal and Regulatory
- Company Secretariat;
- Internal audit;
- Information Technology; and
- Business Support Services.

An annual cost allocation is undertaken for all shared costs arising from the provision of the above services by the APA Group. The allocation of these shared costs is made on the basis of revenue. As shown in Table 1, each business unit is allocated corporate overhead costs in proportion to their contribution to the APA Group's total revenue.

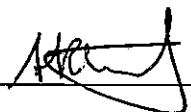
Based on historical performance, Directlink believes revenue is an appropriate driver for allocating 'Corporate Overhead Costs' as corporate overheads are a necessary cost for the generation of revenue. Furthermore, a causal relationship exists between revenue generation and corporate overheads. Revenue is therefore considered an appropriate driver for the allocation of 'Corporate Overhead Costs' to each of the APA Group's assets. It should be noted that in previous gas infrastructure regulatory decisions relating to APA gas assets the ACCC has accepted revenue as an appropriate allocator for corporate costs.

It should be noted that in instances where a corporate 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.

A Directors' Statement

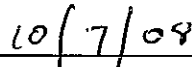
Directors' Statement Regarding Cost Allocation Methodology

In the opinion of the Directors of the partners of Directlink Joint Venture the information contained in the Directlink cost allocation methodology is accurate and the Directors of Directlink Joint Venture confirms Directlink's intention to comply with the cost allocation methodology as approved by the AER.

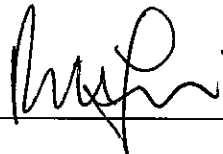


Stephen Ohl

Director

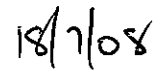


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Rick Francis

Director

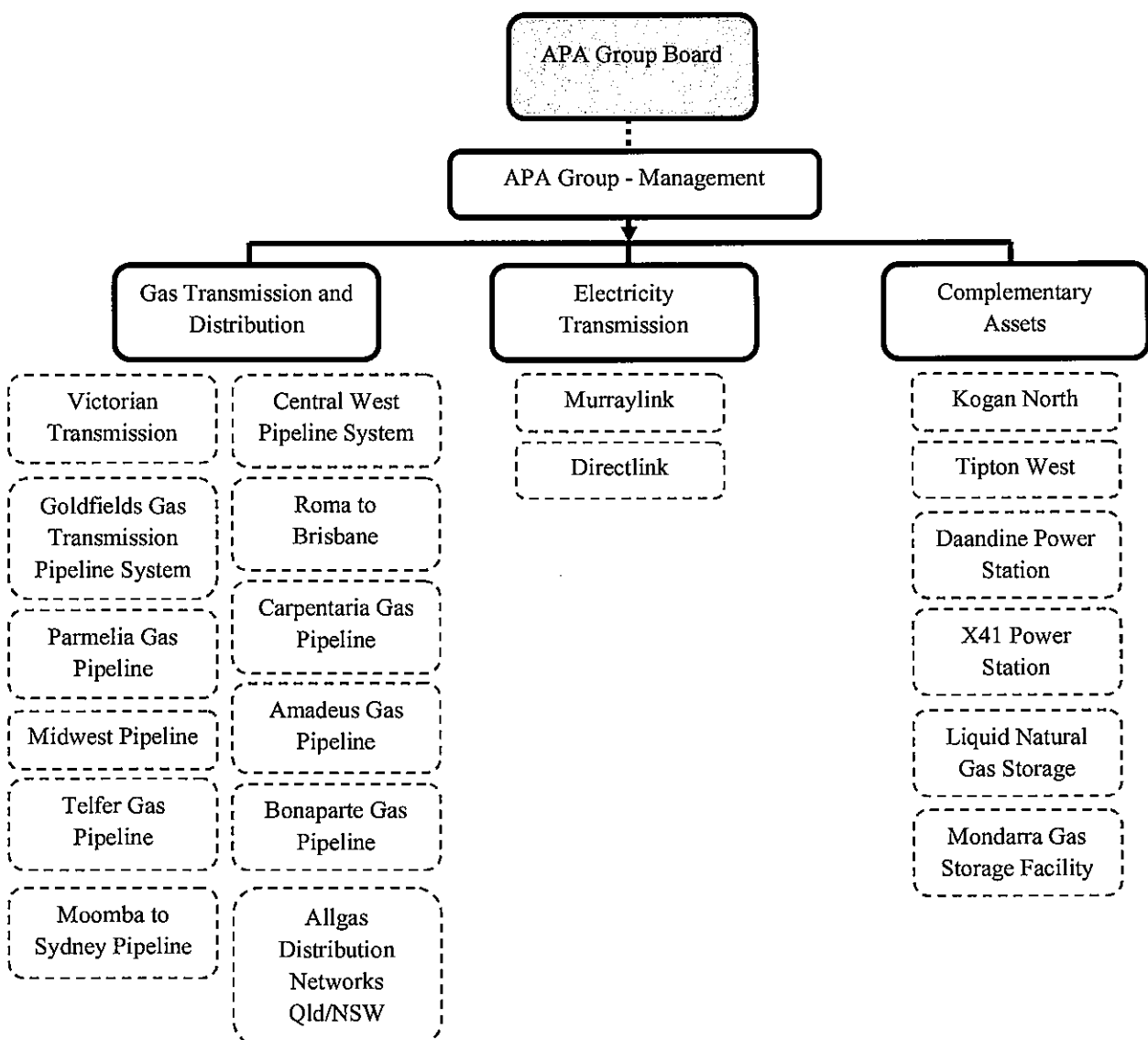


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B APA Asset Categories

Note that this structure is broadly indicative of how APA assets are categorised and managed. It does not represent the actual corporate structure of APA Group.

The structure below does not capture all minor assets, such as minor gas pipeline laterals.



C Cost Allocation Summary Tables

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

Table 1 Allocation of Corporate Costs to Directlink

Cost Category	Description	Costs Shared Between	Basis of Allocation (Driver)
Directors	Costs of the offices of directors in conducting their corporate governance and strategic leadership roles	Each of APA's assets	Proportional to the contribution to group revenue
CEO/Managing Director	Costs of the offices of both the Chief Executive Officer and Managing Director	Each of APA's assets	Proportional to the contribution to group revenue
CFO/Corporate Finance	Costs include: <ul style="list-style-type: none"> • Business advisory services • Treasury functions • Accounting services • Taxation 	Each of APA's assets	Proportional to the contribution to group revenue
GM Operations	Costs of the office of GM Operations	Each of APA's assets	Proportional to the contribution to group revenue
GN Commercial	Costs of the office of GM Commercial	Each of APA's assets	Proportional to the contribution to group revenue
Engineering	Costs include: <ul style="list-style-type: none"> • Business advisory services • Engineering Advisory services • Operational Planning 	Each of APA's assets	Proportional to the contribution to group revenue
Human Resources	Costs include: <ul style="list-style-type: none"> • Corporate Services HR • Remuneration and benefits • Employees relations • HR Strategy 	Each of APA's assets	Proportional to the contribution to group revenue
Strategic Planning	Costs include: <ul style="list-style-type: none"> • Business advisory services • Business Planning/Business Strategy 	Each of APA's assets	Proportional to the contribution to group revenue
Legal and Regulatory	Costs include: <ul style="list-style-type: none"> • Legal advice and compliance • Regulatory services 	Each of APA's assets	Proportional to the contribution to group revenue
Company Secretariat	Costs include: <ul style="list-style-type: none"> • Secretariat • Corporate governance 	Each of APA's assets	Proportional to the contribution to group revenue
Internal Audit	The internal audit section provides services as directed by the Board and Executives	Each of APA's assets	Proportional to the contribution to group revenue

Cost Category	Description	Costs Shared Between	Basis of Allocation (Driver)
Information Technology	Costs include <ul style="list-style-type: none"> • IT Research and Development • Asset Management • Business Systems • Telecommunications 	Each of APA's assets	Proportional to the contribution to group revenue
Business Support Services	Costs include general administration and operations management services	Each of APA's assets	Proportional to the contribution to group revenue

D APA Organisational Structure

