



Final

**Electricity transmission network service providers  
Cost allocation guidelines**

September 2007

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## **AMENDMENT RECORD**

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# 1. Nature and authority

## 1.1 Introduction

These *guidelines* set out arrangements to manage the attribution of *direct costs* and the allocation of *shared costs* by *Transmission Network Service Providers (TNSPs)* between and within different categories of *transmission services*.

## 1.2 Authority

- (a) Clause 6A.19.3(a) of the *National Electricity Rules* requires the *Australian Energy Regulator (AER)* to make, in accordance with the transmission consultation procedures, *Cost Allocation Guidelines* relating to the preparation by a *TNSP* of its *cost allocation methodology*.

## 1.3 Role of these guidelines

The role of these *guidelines* is to detail the basis for:

- (1) a *TNSP* preparing and submitting its proposed *cost allocation methodology* to the *AER* for approval
- (2) the *AER* approving or rejecting a *TNSP's* proposed *cost allocation methodology* or approving or rejecting a *TNSP's* amended *cost allocation methodology*
- (3) amending and reviewing a *TNSP's* approved *cost allocation methodology* from time to time, and
- (4) a *TNSP* applying its *cost allocation methodology*.

## 1.4 Relationship between these guidelines, cost allocation methodology and the National Electricity Rules

- (1) Each *TNSP* must develop a proposed *cost allocation methodology* for submission to the *AER* in accordance with the requirements of these guidelines.
- (2) The *cost allocation methodology* approved by the *AER* must be used by the relevant *TNSP* for the purposes of allocating costs in accordance with the requirements of the *National Electricity Rules*.
- (3) The *AER* will monitor, report on and enforce compliance with the *TNSP's* *cost allocation methodology* in accordance with the requirements of the *National Electricity Rules*.

## 1.5 Confidentiality

The *AER's* obligations regarding confidentiality and the disclosure of information provided to it by a *TNSP* are governed by the *Trade Practices Act 1974*, the *National Electricity Law* and the *National Electricity Rules*.

## 1.6 Definitions and interpretation

(a) In these *guidelines*:

(1) the words and phrases presented in italics such as this are defined in the glossary of these *guidelines* and have the meaning given to them in:

a. the glossary or

b. if not defined in the glossary, the *National Electricity Rules*

(2) the words 'shall' and 'must' indicate mandatory requirements, unless the overall meaning of the phrase in which one of these words appears, is otherwise.

(b) Explanations in these *guidelines* about why certain information is required are provided for guidance only. They do not limit in any way the *AER's* objectives, functions or powers.

## 1.7 Processes for revision

The *AER* may amend or replace these *guidelines* from time to time to meet changing needs, in accordance with clause 6A.19.3(d) of the *National Electricity Rules* and the *transmission consultation procedures*.

## 1.8 Version history and effective date

A version number and an effective date of issue will identify every version of these *guidelines*.

## **2. Principles and policies for attributing and allocating costs**

### **2.1 Developing principles and policies**

Each *TNSP* is responsible for developing the detailed principles and policies for attributing costs to, or allocating costs between or within, the categories of *transmission services* that it provides. These detailed principles and policies must be included in the proposed *cost allocation methodology* that the *TNSP* submits to the *AER* for approval.

### **2.2 Requirements of TNSP's principles and policies**

A *TNSP's* detailed principles and policies for attributing costs directly to, or allocating costs between or within, categories of *transmission services* must meet the following requirements. These requirements give effect to, and are consistent with, the *cost allocation principles*.

#### **2.2.1 Detailed principles and policies**

- (a) A *TNSP's* detailed principles and policies for attributing costs directly to, or allocating costs between, different categories of transmission services must be sufficiently detailed to enable:
  - (1) the *AER* to replicate the reported outcomes through the application of those principles and policies and
  - (2) the *TNSP* to demonstrate that it is meeting the requirements of these *guidelines*.
- (b) For the avoidance of doubt, clause 2.2.1(a) means that a *TNSP* must include information on the following matters only to the extent necessary to enable the *AER* to replicate its reported outcomes:
  - (1) For *directly attributable costs*:
    - A. the nature of each cost item
    - B. the category of *transmission services* to which the cost item is to be *directly attributed*
    - C. the characteristics of the cost item that associate it uniquely with a particular category of *transmission service* in order to make it a directly attributable cost and
    - D. how and where records will be maintained to enable the basis of attribution to be audited or otherwise verified by a third party, including the *AER*.

(2) For *shared costs*:

- A. the nature of each cost item
- B. the categories of *transmission services* between or within which each cost item is to be allocated
- C. the nature of the allocator, or allocators, to be used for allocating each cost item
- D. the reasons for selecting the allocator, or allocators, for each cost item and an explanation of why it is the most appropriate available allocator, or set of allocators, for the cost item
- E. whether the numeric quantity or percentage of the allocator, or allocators, to be applied for each cost item will:
  - (i) remain unchanged over the *regulatory control period* or
  - (ii) change from time to time throughout the *regulatory control period*.
- F. if clause 2.2.1(b)(2)E(i) applies:
  - (i) details of the numeric quantity or percentage of the allocator, or allocators and
  - (ii) an explanation of how the numeric quantity or percentage has been calculated, including where the data for determining this numeric quantity or percentage have been sourced.
- G. if clause 2.2.1(b)(2)E(ii) applies, an explanation of how the *TNSP* intends to calculate the numeric quantity or percentage throughout the *regulatory control period*, including where the data for determining the changing numeric quantities or percentages are to be sourced and
- H. how and where records will be maintained to enable the allocation to be audited or otherwise verified by a third party, including the *AER*.

### **2.2.2 Substance over legal form**

- (a) A *TNSP* shall attribute costs directly to, or allocate costs between or within, categories of *transmission services* based on the substance of the underlying transaction or event.
- (b) Where the substance and legal form differ, the substance rather than the legal form of a transaction or event shall be used as the basis of cost attribution or allocation.

- (c) In determining the substance of a transaction or event, all of its aspects and implications shall be considered, including the expectations of and motivations for, the transaction or event.
- (d) For the purposes of determining the substance of a transaction or event, a group or series of transactions or events that achieves, or is designed to achieve, an overall commercial effect shall be viewed in aggregate.

### **2.2.3 Attribution of direct costs**

- (a) In accordance with the requirements of clause 6A.19.2(3)(i) of the *National Electricity Rules*, only costs that are *directly attributable* to the provision of a particular category of transmission services may be *directly attributed* to that category of services.
- (b) A cost may be *directly attributable* to a *TNSP* but not *directly attributable* to a particular category of *transmission services* provided by the *TNSP*. In this circumstance, the allocation of costs between or within categories of *transmission services* may only be made in accordance with clause 2.2.4.

### **2.2.4 Allocation of shared costs**

- (a) In accordance with the requirements of clause 6A.19.2(3)(ii) of the *National Electricity Rules*, *shared costs* incurred in providing several categories of *transmission services* must be allocated between or within those categories using an appropriate causal allocator, except to the extent that:
  - (1) the *shared costs* are *immaterial* or
  - (2) a *causal relationship* cannot be established without undue cost and effort.
- (b) For the avoidance of doubt, a *TNSP* must allocate its *shared costs*:
  - (1) between the *prescribed transmission services* and *negotiated transmission services* that it provides and
  - (2) within the different types of *negotiated transmission services* that it provides for the purposes of determining its prices for these services in accordance with clause 6A.9.1(1) of the *National Electricity Rules*.
- (c) If a *shared cost* is *immaterial* or a *causal relationship* cannot be established without undue cost and effort, then the *TNSP* may allocate the *shared cost* to, or within, a particular category of *transmission services* using a *non-causal* allocator provided that:
  - (1) the *non-causal* allocator accords with an *AER* approved *cost allocation methodology*
  - (2) the aggregate of all *shared costs* subject to *non-causal* bases of allocation is not *material*
  - (3) the *non-causal* basis of allocation is approved in writing by the *AER* and



- (4) the *TNSP* provides a supporting work paper to the *AER* documenting for each such *shared cost*:
- A. the basis of allocation
  - B. the reason chosen for that basis
  - C. a demonstration that the *shared cost* is *immaterial* or an explanation of why no *causal relationship* could be established and
  - D. a numeric quantity or percentage of the *non-causal* allocator applied to each category of *transmission service* and in total.
- (d) The bases of *non-causal* allocation will be subject to review by the *AER*. The *AER* expects only to accept a *non-causal basis* of allocation if the *TNSP* can demonstrate that there is likely to be a strong positive correlation between the *non-causal basis* of allocation and the actual cause of the resource or service consumption or utilisation that those shared costs represent.
- (e) A *TNSP* is not permitted to allocate *shared costs* using an *avoided cost* approach unless approved by the *AER*.

### **2.2.5 Not allocate cost more than once**

- (a) A *TNSP* must not allocate the same cost more than once.
- (b) For the avoidance of doubt, clause 2.2.5(a) means that:
- (1) the same cost may not be treated as both a *direct cost* and a *shared cost*
  - (2) a *direct cost* may only be attributed once to a single category of *transmission services*
  - (3) a *shared cost* may only be allocated once between or within categories of *transmission services* and
  - (4) a *TNSP* may only recover the same cost once through the charges that it levies for its *transmission services*.

### **2.2.6 Consistency with transmission ring-fencing guidelines**

The detailed principles, policies and approach that a *TNSP* uses to attribute costs directly to, or to allocate costs between or within, categories of *transmission services* must be consistent with the *transmission ring-fencing guidelines*.

### **2.2.7 Reallocation of costs between or within categories of transmission services**

- (a) Costs that have been attributed or allocated to *prescribed transmission services* must not be reattributed or reallocated to *negotiated transmission services* and

- (b) Costs that have been attributed or allocated to negotiated transmission services may be reattributed or reallocated to prescribed transmission services to the extent that doing so otherwise satisfies this clause 2.2.

### **3. Preparing and submitting cost allocation methodology**

#### **3.1 TNSP to develop proposed cost allocation methodology**

Each *TNSP* must develop a proposed *cost allocation methodology* for submission to the *AER* in accordance with the requirements of these guidelines.

The proposed *cost allocation methodology* must give effect to, and be consistent with, these guidelines.

#### **3.2 Format and contents of cost allocation methodology**

A *TNSP*'s proposed *cost allocation methodology* must include the following information:

- (1) a version history and date of issue for the document
- (2) a statement of the nature, scope and purpose of the document and the way in which it is to be used by the *TNSP*
- (3) details of the accountabilities within the *TNSP* for the document in order to set out clearly:
  - A. the *TNSP*'s commitment to implementing the *cost allocation methodology*; and
  - B. responsibilities within the *TNSP* for updating, maintaining and applying the *cost allocation methodology* and for internally monitoring and reporting on its application.
- (4) a description of the *TNSP*'s corporate and operational structure in order to enable the *AER* to understand how the *TNSP* is organised to provide its *transmission services*
- (5) a specification of the categories of *transmission services* that the *TNSP* provides to which costs are to be attributed or allocated and the types of persons to whom those services are provided
- (6) the *TNSP*'s detailed principles and policies to be used for attributing costs directly to, or allocating costs between, categories of *transmission services* that meet the requirements of clause 2.2 of these *guidelines*. For the avoidance of doubt, this includes the attribution or allocation of costs relating to any *related party transactions*
- (7) a description of how the *TNSP* will maintain records of the attribution or allocation of costs to, or between, categories of *transmission services* in order 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.
- (8) a description of how the *TNSP* will monitor its compliance with the *cost allocation methodology* and these *guidelines*
  - (9) details of the proposed date on which the *cost allocation methodology* will commence, having regard for clause 4.1(d) of these *guidelines* and
  - (10) statement signed and dated by not less than two directors of a *TNSP*, which states whether in the directors' opinion, the information contained in the *cost allocation methodology* is accurate and which confirms the *TNSP's* intention to comply with the *cost allocation methodology* as approved by *AER*.

A *TNSP* must submit its proposed *cost allocation methodology* to the *AER* in both electronic and printed form. Before doing so, a *TNSP* must ensure that its submission can be transmitted in an electronic format that is compatible with the *AER's* information systems.

### **3.3 Timing for submission of cost allocation methodology**

- (a) Each *TNSP* must submit its proposed *cost allocation methodology* to the *AER* for approval by no later than 28 March 2008, in accordance with clause 6A.19.4(a)(1) of the *National Electricity Rules*, and
- (b) An entity that is not a *TNSP* as at 28 September 2007 must submit its proposed *cost allocation methodology* to the *AER*, within 6 months of being required to do so by the *AER*, in accordance with clause 6A.19.4(a)(2) of the *National Electricity Rules*.

## **4. Approving or rejecting proposed cost allocation methodology**

### **4.1 AER's assessment of proposed cost allocation methodology**

- (a) The *AER* will approve or refuse to approve a *TNSP's* proposed *cost allocation methodology* having regard for whether the proposed *cost allocation methodology* gives effect to, and is consistent with, these guidelines.
- (b) If, in accordance with clause 6A.19.4(c) of the *National Electricity Rules*, the *AER* refuses to approve a *TNSP's* proposed cost allocation methodology then the *AER* will notify the relevant *TNSP* and provide reasons for its decision.
- (c) If, in accordance with clause 6A.19.4(e) of the *National Electricity Rules*, the *AER* amends a *TNSP's* proposed *cost allocation methodology* after consulting with the relevant *TNSP* then the *AER* will provide reasons for its decision.
- (d) The *AER* may make its approval of a *TNSP's cost allocation methodology* conditional on:
  - (1) the *cost allocation methodology* either taking effect immediately upon approval or at some future date determined by the *AER* and
  - (2) a defined basis for the relevant *TNSP* transitioning between its existing cost allocation arrangements and those set out in the approved *cost allocation methodology* so that the *TNSP's* actual and forecast costs can be compared over time.

### **4.2 Amending approved cost allocation methodology**

- (a) A *TNSP* can only amend its approved *cost allocation methodology* under clause 6A.19.4(f) of the *National Electricity Rules* if:
  - (1) the *TNSP* applies in writing to the *AER* to make such an amendment and
  - (2) the *AER* issues written approval of the amendment.
- (b) If a *TNSP* makes an application to the *AER* to amend its *cost allocation methodology* and the *AER* does not explicitly approve the amended *cost allocation methodology* within six months the amended *cost allocation methodology* will be deemed to be approved.
- (c) In deciding whether to approve a *TNSP's* request to amend its *cost allocation methodology*, the *AER* will have particular regard to whether:
  - (1) there has been a material change in the *TNSP's* circumstances
  - (2) the amendment is necessary for the business effectively to promote the cost allocation principles

- (3) the resultant amended *cost allocation methodology* would give effect to, and be consistent with, these guidelines
  - (4) the amendment will jeopardise the comparability of the resultant financial information with earlier information provided by that *TNSP* to the *AER*
  - (5) the *TNSP* can quantify and demonstrate to the *AER* the impact of the proposed amendment.
- (d) The *AER* will only approve an amended *cost allocation methodology* to take effect from the start of a new regulatory year or such other dates as agreed with the *AER*.
  - (e) The *AER* may make its approval to amend a *TNSP's cost allocation methodology* conditional on the relevant *TNSP* restating its historic or forecast financial information on a basis consistent with the amended *cost allocation methodology*.
  - (f) A *TNSP* must amend its approved *cost allocation methodology* if the *AER* requires it to do so under clause 6A.19.4(g) of the *National Electricity Rules*.

### **4.3 Reviewing approved cost allocation methodology**

The *AER*, in consultation with the *TNSP*, will review the *TNSP's cost allocation methodology* as part of each revenue cap determination for the relevant *TNSP*.

## **5. Applying cost allocation methodology**

### **5.1 Obligation to apply cost allocation methodology**

- (a) In accordance with clause 6A.19.1 of the *National Electricity Rules*, a *TNSP* must comply with the *cost allocation methodology* that has been approved from time to time by the *AER* in respect of that *TNSP*.
- (b) Without limiting the application of the *cost allocation methodology*, a *TNSP* is to allocate expenditure in accordance with its *cost allocation methodology* in preparing:
  - (1) forecast operating expenditure to be submitted to the *AER* in accordance with clause 6A.6.6 of the *National Electricity Rules*
  - (2) forecast capital expenditure to be submitted to the *AER* in accordance with clause 6A.6.7 of the *National Electricity Rules*
  - (3) prices for a negotiated transmission service determined in accordance with clause 6A.9.1 of the *National Electricity Rules*
  - (4) a certified annual statement in accordance with clause 6A.17.1(a) of the *National Electricity Rules*, and
  - (5) actual or estimated capital expenditure for the purposes of increasing the value of its regulatory asset base under clause S6A.2.1(f)(4) of the *National Electricity Rules*.

### **5.2 Demonstrating application of cost allocation methodology**

- (a) A *TNSP* must submit a supporting work paper to the *AER* whenever it provides financial information to the *AER* that has been prepared by applying the *cost allocation methodology*, if requested by the *AER*.
- (b) The supporting work paper must:
  - (1) demonstrate how the *TNSP* has applied the detailed principles and policies in its approved *cost allocation methodology*
  - (2) provide details of the numeric quantity or percentage of the allocator, or allocators, applied to each cost item and
  - (3) provide an explanation of how the numeric quantity or percentage of each allocator has been calculated for each cost item, including where the data for determining the numeric quantity or percentage have been sourced.

### **5.3 Audit of application of cost allocation methodology**

- (a) The audit and verification provisions relating to a *TNSP*'s compliance with its *cost allocation methodology* are found in the *AER*'s information guidelines and submission guidelines.
- (b) Where the *AER* requests an audit, the *TNSP* will be responsible for:
  - (1) employing an auditor to report on the information and
  - (2) ensuring that the *AER* receives the auditor's assurance that the information can be relied upon for regulatory purposes.

### **5.4 Publication of cost allocation methodology**

In accordance with the requirement of clause 6A.19.4(h), a *TNSP* must maintain a current copy of its approved *cost allocation methodology* on its website.



# Glossary

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Auditor	means a registered company auditor independent of a TNSP.
Australian Energy Markets Commission	has the meaning set out in the <i>National Electricity Law</i> .
Australian Energy Regulator	has the meaning set out in the <i>National Electricity Law</i> .
Australian Accounting Standards Board	is the body established under s. 226(1) of the <i>Australian Securities and Investments Commission Act 1989</i> and continued under s. 261 of the <i>Australian Securities and Investments Commission Act 2001</i> .
Avoided cost	is a cost that a TNSP would avoid incurring by virtue of taking an alternative course of action.
Directly attributable or directly attributed	an item is directly attributable or directly attributed to an object such as a business segment of a TNSP, if it is wholly and exclusively associated with that segment.
Direct costs	are those costs that can be directly attributed to the provision of a particular category of transmission services.
Guidelines	means these cost allocation guidelines.
Immaterial	means not material.
Material or materiality	an item is material if its omission, misstatement or non-disclosure has the potential to prejudice the understanding of the financial position of the TNSP, gained by an assessment of financial information relating to the TNSP.
National Electricity Law	means the National Electricity Law set out in schedule to the <i>National Electricity (South Australia) Act 1996</i> .
National Electricity Rules	means the rules, as defined in the National Electricity Law.

Non-causal or non-causation basis or relationship in relation to a basis of allocation	is one that is other than a causal or causation basis or relationship
Regulatory accounting period	means a period on which a single set of regulatory financial statements report.
Shared costs	are those costs that cannot be directly attributed to the provision of a particular category of transmission services but which are allocated between different categories of transmission services.

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