



Final decision

Transend
Cost Allocation Methodology

May 2008



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Shortened forms

AER	Australian Energy Regulator
CAM	Cost Allocation Methodology
NEL	National Electricity Law
NER	National Electricity Rules
NEM	National Electricity Market
TNSP	Transmission Network Service Provider

1 Introduction

1.1 Summary

The Australian Energy Regulator (AER) has assessed Transend's proposed cost allocation methodology (CAM), and has determined that it:

- is in accordance with the National Electricity Rules (NER)
- gives effect to and is consistent with the AER's cost allocation guidelines for electricity transmission network service providers (TNSPs).

Accordingly, the AER has approved Transend's proposed CAM under clause 6A.19.4(c) of the NER.

1.2 Background

Under the National Electricity Law (NEL) and the NER, AER is responsible for the economic regulation of transmission services in the National Electricity Market (NEM).

Cost allocation concerns the attribution of a regulated business's direct costs to prescribed, negotiated and other services and the allocation of shared costs between these different services.

Part G of chapter 6A of the NER outlines the cost allocation principles and methods that TNSPs must comply with. In particular, Part G includes:

- a requirement for TNSPs to submit cost allocation methodologies to the AER in accordance with its cost allocation guidelines (the guidelines)
- conditions for the AER's consideration, approval and amendment of the TNSPs' cost allocation methodologies.

In accordance with the guidelines, each TNSP is responsible for developing the detailed principles and policies for attributing costs to, or allocating costs between, the categories of transmission services that it provides. These detailed principles and policies must be included in the proposed CAM that it submits to the AER for approval.

Effective cost allocation has an important role to play in promoting the national electricity objective which is stated in section 7 of the NEL and reads as follows:

The objective of this Law is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to –

- (a) price, quality, safety, reliability and security of supply of electricity; and
- (b) the reliability, safety and security of the national electricity system.

Effective cost allocation requirements support the national electricity objective by:

- Promoting the appropriate allocation of costs between prescribed, negotiated and other services to reflect the consumption or utilisation of a resource or service by a business, or part of a business.
- Preventing cross-subsidisation between prescribed, negotiated and other services and the prices paid by end customers for any of these services being inappropriately inflated or discounted.
- Making the treatment of direct and shared costs transparent and so ensure that only efficient costs relevant to the provision of a service are passed through to customers.
- Promoting consistency and comparability in the provision and reporting of financial information over time in relation to the various services.

The NER requires that the CAM proposed by each TNSP must give effect to and be consistent with the guidelines. This document sets out the AER's final decision regarding the proposed CAM submitted by Transend.

2 NER requirements and process

2.1 NER requirements

A TNSP's CAM is governed by the NER and the guidelines and assessment of Transend's CAM must comply with those requirements. Part G of the NER sets out a number of CAM requirements.

Clause 6A.19.1 requires:

A Transmission Network Service Provider must comply with the Cost Allocation Methodology that has been approved in respect of that provider from time to time by the AER under this rule 6A.19.

Clause 6A.19.3 states:

(b) The *Cost Allocation Guidelines*:

- (1) must give effect to and be consistent with the *Cost Allocation Principles*¹; and
- (2) may be amended by the AER from time to time in accordance with the *transmission consultation procedures*.

(c) Without limiting the generality of paragraph (b), the *Cost Allocation Guidelines* may specify:

- (1) the format of a *Cost Allocation Methodology*;
- (2) the detailed information that is to be included in a *Cost Allocation Methodology*;
- (3) the categories of *transmission services* which are to be separately addressed in a *Cost Allocation Methodology*, such categories being determined by reference to the nature of those service, the persons to whom those services are provided or such other factors as the AER considers appropriate; and
- (4) the allocation methodologies which are acceptable and the supporting information that is to be included in relation to such methodologies in a *Cost Allocation Methodology*.

Clause 6A.19.4(a) to (e) sets out the approval process for the CAM:

- (a) Each *Transmission Network Service Provider* must submit to the AER for its approval a document setting out its proposed *Cost Allocation Methodology*:
 - 1) by no later than 28 March 2008; or
 - 2) in the case of an entity that is not a *Transmission Network Service Provider* as at 28 September 2007, within 6 months of being required to do so by the AER.
- (b) The *Cost Allocation Methodology* proposed by a *Transmission Network Service Provider* must give effect to and be consistent with the *Cost Allocation Guidelines*.
- (c) The AER may approve or refuse to approve a *Cost Allocation Methodology* submitted under paragraph (a).

¹ Cost Allocation Principles can be found under cl.6A.19.2 of the NER and cl.2.2 of the Guidelines.

- (d) The *AER* must notify the relevant *Transmission Network Service Provider* of its decision to approve or refuse to approve the *Cost Allocation Methodology* submitted to it under paragraph (a) within 6 months of its submission, failing which the *AER* will be taken to have approved it.
- (e) As part of giving any approval referred to in paragraph (c), the *AER* may, after consulting with the relevant *Transmission Network Service Provider*, amend the *Cost Allocation Methodology* submitted to it, in which case the *Cost Allocation Methodology* as so amended will be taken to be approved by the *AER*.

The *AER*'s assessment of Transend's CAM compliance with the aforementioned rules is discussed in section 3.

2.2 Process of review

Transend submitted a final proposed CAM to the *AER* on 28 March 2008 as required by 6A.19.4(a)(1) of the *NER*.

AER staff reviewed Transend's CAM compliance with the *NER* and the guidelines. An independent consultant, McGrathNicol Corporate Advisory (McGrathNicol), was also engaged to review the CAM and provide advice to the *AER* in relation to its compliance with the *NER* and the guidelines.

In performing its review, McGrathNicol assessed:

- The proposed CAM's compliance with the *NER* and the guidelines.
- The *AER*'s ability to replicate Transend's reported outcomes.
- The proposed CAM's consistency with the *AER*'s Transmission Ring Fencing Guidelines.

McGrathNicol submitted its review of Transend's CAM to the *AER* on 21 April 2008. The review of Transend's CAM identified a number of minor issues. These relevant issues were addressed through consultation with Transend and McGrathNicol. Subsequently, Transend updated its CAM on 1 May 2008 to address these concerns.

3 AER Considerations

3.1 Transend's CAM

Transend's proposed CAM allocates costs between different regulatory business segments. Transend allocates costs that are wholly and exclusively associated with a regulatory business segment directly to that business segment. Costs that are shared between business segments (shared costs) are predominantly allocated by Transend according to their direct labour hour costs. Transend defines shared costs as being costs that may need to be allocated to more than one Regulatory Business Segment.

3.2 Assessment of Transend's CAM

To assess Transend's proposed CAM, the AER must have regard to the requirements of the NER and the guidelines.

In conducting its review on the compliance of Transend's CAM, McGrathNicol found that it appeared to be consistent with the guidelines. Specifically, McGrathNicol's review found:

- Transend's proposed CAM appears to be compliant with the AER's guidelines.
- Transend's proposed CAM appears to be broadly compliant with the NER's cost allocation principles.
- Transend's proposed CAM appears sufficient to enable the AER to replicate its reported outcomes.
- Nothing came to the attention of McGrathNicol that Transend's proposed CAM was not compliant with the TRFG.

3.2.1 AER assessment

The AER's assessment of Transend's CAM found it to be consistent with the requirements of the NER and the guidelines. A clause by clause assessment of Transend's CAM compliance with the guidelines is shown in Appendix B. Specifically, the AER's review found:

- Transend's proposed CAM is compliant with the cost allocation principles found in clause 6A.19.2 of the NER, including:
 - The detailed principles and policies used by Transend to allocate the costs between different categories of transmission services are described in sufficient detail to enable the AER to replicate reported outcomes through the application of the principles and policies – clause 6A.19.2(1).
 - The principles, policies and approach used by Transend to allocate their costs is consistent with the TRFG – clause 6A.19.2(6)
- Transend's proposed CAM gives effect to and is consistent with the guidelines as outlined in NER clause 6A.19.4(b).

4 Decision

The AER considers Transend's proposed CAM to be in accordance with the NER and gives effect to and is consistent with the guidelines. The AER therefore approves the CAM proposed by Transend under clause 6A.19.4(c) of the NER.

Appendix A: CAM submitted by Transend

The CAM submitted by Transend is attached as a separate document. An Electronic copy of this document is available at www.aer.gov.au.

Appendix B: Clause by clause assessment of Transend’s compliance with the guidelines

AER’s comments on Transend’s CA M

This table sets out AER Board’s comments on Transend’s CAM relative to the requirements of clause 3.2 of the AER’s Cost Allocation Guidelines. Clause 3.2 sets out the format and contents of a TNSP’s CAM.

Clause 3.2 of the AER’s Cost Allocation Guidelines	Relevant sections of Transend’s CAM	AER Board comment
A version history and date of issue for the document.	Version History – page 2 Clause 1.8 – Version History and Date of Issue	Compliant
A statement of the nature, scope and purpose of the document and the way in which it is to be used by the TNSP.	Clause 1.1 – Purpose	Compliant
Details of the accountabilities within the TNSP for the document in order to set out clearly: A. the TNSP’s commitment to implementing the costs allocation methodology B. responsibilities within the TNSP for updating, maintaining and applying the cost allocation methodology and for internally monitoring and reporting on its application.	Clause 1.3 – Accountabilities and Responsibilities	Compliant
A description of the TNSP’s corporate and operational structure in order to enable the AER to understand how	A.1 – General Overview Figure 2 – Operations Structure	Compliant

the TNSP is organised to provide its transmission services.		
Specification of the categories of transmission services that the TNSP provides to which costs can be attributed or allocated and the types of persons to whom those services are provided.	A.1.3 – Categories of Transmission Services	Compliant
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 third party transactions.	A.2 – Cost Attribution and Allocation	Compliant
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:	Clause 1.4 – Maintenance of an audit trail and record retention	Compliant
A. demonstrated to the AER in accordance with clause 5.2 of the Cost Allocation Guidelines	Clause 1.4.2 – Working Papers	Compliant
B. audited or otherwise verified by a third party, including the AER, as required.	Clause 1.5 – Monitoring Compliance A.2.3.1 – Directly Attributable Costs	Compliant

<p>A description of how the TNSP will monitor its compliance with the Cost Allocation Methodology and Cost Allocation Guidelines.</p>	<p>Clause 1.5 – Monitoring Compliance</p>	<p>Compliant</p>
<p>Details of the proposed date on which the cost allocation methodology will commence having regard for clause 4.1 (d) of these guidelines.</p>	<p>Clause 1.6 – Date of Commencement</p>	<p>Compliant</p>
<p>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.</p>	<p>A.3 – Director’s Statement</p>	<p>Compliant</p>