

# Ausgrid Cost Allocation Method

AER Final Decision

October 2022

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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 Law
NEM	National Electricity Market
Rules, NER	National Electricity Rules
Guidelines, Cost Allocation Guidelines	Distribution Cost Allocation Guidelines

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# 1 Introduction

## 1.1 Summary

On 13 October 2022 Ausgrid submitted a Cost Allocation Method (CAM) to the AER for approval — see Appendix A to this paper. Ausgrid provides electricity distribution services in New South Wales (NSW). 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 Ausgrid’s proposed CAM:

- accords with the requirements of the National Electricity 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 Ausgrid’s 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 NSW 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 NSW.

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 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 Ausgrid.

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

Following our approval, Ausgrid's approved CAM will remain relevant to its regulatory accounts, reporting and regulatory proposals until we approve a further CAM variation. Note that the effective date for this CAM amendment is 1 July 2024. This means Ausgrid will continue to submit regulatory information to the AER in accordance with its previously approved CAM until the 2024-25 regulatory year. The delayed effective date for the CAM which is the subject of this decision paper relates to reporting of operating costs. It is considered appropriate for the amended CAM to take effect from the first day of the upcoming 5 year regulatory control period.

## 2 Rule requirements and assessment

### 2.1 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

Ausgrid staff advised AER staff on Ausgrid's intention to amend its CAM several months ahead of Ausgrid formally submitting its amended CAM to the AER. This early engagement facilitated discussions about Ausgrid's objectives and how to achieve them.

Ausgrid informally submitted to the AER a draft of its amended CAM in August 2022 for AER staff comment. Having reviewed Ausgrid's amended CAM informally, AER staff advised Ausgrid that it may be formally submitted.

The material change to cost allocation proposed by Ausgrid, compared to its current approved CAM, is to streamline its shared cost allocators (sometimes known as 'cost drivers').

Ausgrid's current approved CAM allocates shared costs using:

- staff numbers
- weighted average revenue
- the nature of various insurance products (for insurance costs)
- floor space (for building costs)
- directly attributed fleet costs (for fleet costs)
- audit plans (for audit costs)
- contact centre workload (for contact centre costs).

Ausgrid's amended CAM will see the above cost allocators replaced with weighted average revenue. Two variants of weighted average revenue will be used:

- Weighted average revenue including unregulated revenue will be applied to shared costs applicable to both Ausgrid's regulated and unregulated activities, such as legal, finance and insurance.

- Weighted average revenue without unregulated revenue will be applied to shared costs applicable only to Ausgrid's regulated activities, such as its contact centre and regulatory team.

We consider Ausgrid's proposed cost drivers are reasonable. We note streamlining cost allocators is a beneficial change which should lead to Ausgrid achieving efficiencies in administering its regulatory accounts.

Alongside its amended CAM, Ausgrid submitted to the AER an assessment of time series impacts on data previously provided to us through regulatory information notices (or 'RINs'). This is important because we use time series data to inform our assessment of regulatory proposals. 'Breaks' in time series data caused by amended CAMs can distort our analysis. Where an amended CAM causes such breaks we may require DNSPs to resubmit time series information.

We advised Ausgrid that limited back casting of previously submitted information would be required for:<sup>1</sup>

- public lighting
- metering
- standard control service operational expenditure (opex).

AER staff are working with Ausgrid to confirm the minimum level of back casting required to inform our assessments. While satisfying ourselves that we have appropriate and accurate time series information to inform our assessment of Ausgrid's regulatory proposals, we aim to minimise regulatory burden. Doing so reduces administrative costs which ultimately are recovered through bills levied on electricity customers connected to Ausgrid's network.

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<sup>1</sup> 'Back casting' is the practice of re-collating historical data according to a new set of cost drivers. While sometimes necessary to provide the AER with accurate time series data, we try to minimise back casting due to the administrative effort and cost it can entail.



### **3 Consistency with our cost allocation guidelines**

This section sets out our assessment of Ausgrid’s proposed CAM against the requirements of our Cost Allocation Guidelines.

### 3.1 Ausgrid CAM assessment

The format and content of Ausgrid’s CAM are regulated by NER chapter 6 and clause 3.2(a) of our Cost Allocation Guidelines. Table 1 compares Ausgrid’s proposed CAM against the requirements of NER chapter 6 and clause 3.2(a).

**Table 1 CAM assessment table**

#### General obligations

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

#### Contents of Cost Allocation Method

Guidelines	Requirements	Addressed
3.2(a)(1)	Version number	Page 2
3.2(a)(2)	DNBP’s commitment to history and date of issue	Page 2
3.2(a)(3)	Statement of nature, scope and purpose of document and way it is to be used	Section 1.2
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 1.1
3.2(a)(5)	Specification of service categories and types of persons to whom services provided	Section 2

Guidelines	Requirements	Addressed
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 3
3.2(a)(7)	Description of how will maintain records of attribution and allocation	Section 4.1
3.2(a)(8)	Description of how will monitor compliance with CAM and Guidelines	Section 4.2
3.2(a)(9)	Commencement date	Page 2

### Cost allocation principles and policies

Rules	Guidelines	Requirements	Addressed
6.15.2(1)	2.2.1(a)	Include sufficiently detailed principles and policies for attributing costs to, and allocating costs between, categories of distribution services to enable:	Compliant
		AER to replicate reported outcomes	
		DNSP to demonstrate that it is meeting requirements	
6.15.2(2)	2.2.2	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
		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
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:	Compliant
		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	
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	Compliant

Rules	Guidelines	Requirements	Addressed
<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