Proposed Cost Allocation Guidelines

Electricity Distribution Network Service Providers
ETSA Utilities Submission

Q1: Are the working assumptions used to prepare this discussion paper and the proposed guidelines appropriate?

ETSA Utilities considers the working assumptions developed by the AER to be appropriate.

In addition, subject to the comments made in this response, the proposed guidelines are also appropriate.

Q2: Is it possible to derive a single set of allocators applicable to all network service providers?

Q3: If yes, would it be appropriate to do so?

Page 11 of the AER's Discussion Paper identifies significant differences between DNSPs. It is these differences that make it difficult to derive a single set of allocators that are meaningful. The risk is that the use of a single set of allocators may well lead to businesses failing to appropriately reflect the underlying substance of transactions, which is and should be a primary responsibility of the DNSP.

In our view, the pursuit of a single set of allocators requires caution. The use of a single set of allocators to increase the level of comparable costs between different regulated businesses is of limited value if in attempting to do so the reliability of information and reporting is compromised.

Q4: Should the regulated business or the AER select the allocators for shared costs?

ETSA Utilities agrees with the AER that it is more appropriate that DNSPs select the allocators for shared costs. This recognises the DNSP's underlying knowledge of their business, the potentially unique nature of the business and their responsibility to ensure costs are allocated to reflect the underlying substance of transactions. In turn the AER are well positioned to assess and approve the chosen allocators as part of their broader consideration of the cost allocation method.

Q5: *Is there merit in the regulated businesses working together to produce a future industry standard for the attribution and allocation of costs?*

For the reasons noted above we consider this suggestion has limited merit.

Q6: *Should cost allocation be allowed using the avoided cost method and, if so, under what circumstances should it be allowed?*

The AER position in the proposed Guidelines is that the avoided cost approach is not permitted without prior approval of the AER.

ETSA Utilities accepts this position. However, we believe that it is important to recognise that there are likely to be circumstances where the use of avoided cost is appropriate and where its use can be applied to the benefit of regulated customers. In some circumstances, such as IT, the cost structure of a business reflects what is necessary for the efficient operation of the regulated business and may be well in excess of what is required for the running of an ancillary unregulated activity. This can lead to an allocation of costs to the unregulated business, in the absence of avoided cost, in excess of what would be required to operate that business in the ordinary course. To the extent this makes the unregulated business uncompetitive then this is to the detriment of the regulated customer as it will reduce the potential allocation of other shared costs to the unregulated business.

ETSA Utilities considers there may be circumstances where the use of avoided cost is appropriate. The guidelines, as currently drafted, provide sufficient protection against the inappropriate use of avoided cost in the allocation of shared costs.

Q7: *Is it appropriate that the scope of the regulatory audit (as it relates to cost allocation) only assesses whether costs have been appropriately attributed or allocated, not whether the allocators themselves are most suitable?*

The proposed guidelines require the AER to approve a DNSPs cost allocation method. ETSA Utilities considers it is therefore appropriate to limit the scope of the regulatory audit to whether costs have been allocated in a manner that is consistent with its AER approved Cost Allocation Method.

Other Comments

The Guidelines at Clause 2.2.4(c) state:

> "*(c) If a shared cost is immaterial or a causal relationship cannot be established without undue cost and effort, then the DNSP may allocate the shared cost to, or within, a particular category of distribution services using a non-causal allocator provided that:*
>
> *...*
>
> *(2) The aggregate of all shared costs subject to non-causal bases of allocation* is not *material*;
>
> ..."

ETSA Utilities considers this to be inconsistent with the Cost Allocation Principles set out in clause 6.15.2 of the NER and as required by clause 6.15.3(b)(1). In particular, the rules state at clause 6.15.2(3)(ii):

> "*(ii) costs which are not directly attributable to the provision of those services but which are incurred in providing those services, in which case costs must be allocated to the provision of those services using an appropriate allocator which should:*
>
> *(A) except to the extent the cost is immaterial or a causal based method of allocation cannot be established without undue cost and effort, be causation based; and*
>
> *(B) to the extent the cost is immaterial or a causal based method of allocation cannot be established without undue cost and effort, be an allocator that accords with a well accepted cost allocation method;"*

The guidelines as currently worded require costs that are considered to be material in nature to be allocated using a causal allocator. This requirement appears inconsistent with the rules. In addition, it requires use of a causal allocator even if it can be shown that a causal relationship cannot be established without undue cost and effort in circumstances where the use of a causal allocator is unlikely to improve the underlying reporting of the substance of the cost.

ETSA Utilities considers that the requirement that shared costs must be allocated using causal allocators unless it can be shown that either the cost is immaterial or that a causal relationship cannot be established without undue cost and effort is sufficient in circumstances where the bases of non-causal allocation are subject to review by the AER.

We also note that there is an additional safeguard in that the guidelines also require the DNSP to demonstrate 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.