ELECTRICITY TRANSMISSION NETWORK owners forum

1 May 2007

Mr Steve Edwell
Chairman
Australian Energy Regulator
GPO Box 520
MELBOURNE VIC 3001

Ms Michelle Groves
Chief Executive Officer
Australian Energy Regulator
GPO Box 520
MELBOURNE VIC 3001

Dear Steve & Michelle,

FIRST PROPOSED GUIDELINES

The AER has issued the first proposed guidelines and accompanying explanatory statements for the following guidelines associated with revenue regulation for electricity transmission businesses.

1. Post-tax revenue model
2. Roll-forward model
3. Efficiency benefit sharing scheme
4. Service Target Performance incentive scheme
5. Submission guidelines
6. Cost allocation guidelines

All of these first proposed guidelines were required by the NER to be issued by the AER by 1 January 2007 and are required to be finalised by 30 September 2007. These guidelines are important documents for all electricity transmission businesses, most particularly because the NER requires transmission businesses to comply with the guidelines.

While ETNOF appreciates the short amount of time the AER had to prepare these first proposed guidelines, ETNOF considers that substantial revisions are required to many of the guidelines in order for them to perform the role ETNOF understands was intended by the Rules – namely to enhance the certainty and efficiency of the process for a revenue determination.

A submission on each of the guidelines has been prepared highlighting ETNOF's concerns with the first proposed guidelines. ETNOF businesses would be happy to provide additional information and discuss our material concerns with the guidelines with AER staff to facilitate an effective outcome.

However, prior to finalising the guidelines, the ETNOF businesses request the AER to conduct a further round of consultation, at a minimum with the businesses subject to revenue determinations, if not more broadly should procedural fairness require it. As our view is that substantial revisions are required to the guidelines ETNOF considers further consultation on the guidelines is essential to producing documents that genuinely enhance the process of revenue determinations.

I would be happy to discuss this matter further with you in person and look forward to your agreement to additional consultation with transmission businesses on this important aspect of revenue determinations.

Yours sincerely,

Gordon Jardine
CHAIRMAN

ELECTRICITY TRANSMISSION NETWORK owners

Cost Allocation Guidelines

Response to AER's First Proposed Guidelines

1 May 2007

TransGrid ElectraNet Powerlink TRANSEND SP AusNet

Cost Allocation Guidelines

Response to AER's First Proposed Guidelines

1. Introduction

This submission is made by the Electricity Transmission Network Owners Forum, which comprises ElectraNet Pty Limited, Powerlink Queensland, SP AusNet, Transend Networks Pty Ltd and TransGrid ("ETNOF"). Collectively, this group own and operate over 40,000 km of high voltage transmission lines and have assets in service with a current regulatory value in excess of $9.1 billion. ETNOF welcomes the opportunity to respond to the Australian Energy Regulator's ("AER's") First Proposed Electricity Transmission Network Service Providers Cost Allocation Guidelines ("Cost Allocation Guidelines")[1] and the accompanying Explanatory Statement and Issues Paper ("Issues Paper").[2]

ETNOF appreciates the short timeframe within which the AER was required to develop the Cost Allocation Guidelines, and the incorporation of comments from ETNOF members provided in response to an early draft of these Guidelines in November 2006. Nevertheless, ETNOF considers that further work is required to permit the Guidelines to perform the role intended by the Rules.

This submission provides ETNOF's views on the Issues Paper and the Cost Allocation Guidelines. Additional information regarding these issues can be provided. In addition, ETNOF would be happy to discuss any matters raised in this submission with the AER. While this submission does not identify separately a response to each of the questions in the AER's Issues Paper the matters raised are addressed in the body of this submission.

In preparing this submission, ETNOF sought the advice of KPMG.

2. Role of the Cost Allocation Guidelines

The role of the Cost Allocation Guidelines is set out in Clause 6A.19.3 of the National Electricity Rules (the "Rules"). They "must give effect to and be consistent with the Cost Allocation Principles"[3] and are also required to set out the "format", "detailed information", "categories of transmission services which are to be addressed" and "acceptable allocation methodologies" that are to be included in the Cost Allocation Methodology.

The Cost Allocation Methodology is to be developed by each TNSP to establish 'allocators' of costs between transmission services (prescribed, negotiable, and unregulated). The prime purpose of the Cost Allocation Methodology (as set out in the Cost Allocation Principles) is to enable the AER to replicate reported outcomes through the application of detailed policies and principles used by a TNSP to allocate costs between different categories of service (Clause 6A.19.2 (1)).

ETNOF has considered the proposed Cost Allocation Guidelines against the requirements of the Rules, as well as the requirements of generally accepted accounting concepts and practices. In this regard, ETNOF is of the view that the Cost Allocation Guidelines need considerable development to meet the requirements of the Rules.

1 AER, 2007, First Proposed Electricity Transmission Network Service Providers Cost Allocation Guidelines, Version No: 01, January 2007.

2 AER, 2007, First Proposed Electricity Transmission Network Service Providers Cost Allocation Guidelines Explanatory Statement and Issues Paper, January 2007.

3 These Cost Allocation Principles are set out in Section 6A.19.2 of the Rules.

It is against these requirements that the scope and form of the AER's proposed Cost Allocation Guidelines ought to be assessed. In summary, ETNOF's analysis is that:

- The Rules contemplate scope for each TNSP to have a different Cost Allocation Methodology by enabling each company to submit its methodology separately for approval. ETNOF considers this to be a sound approach that is consistent with the different business structures, accounting and information systems of most, if not all, TNSPs. Implementation of a prescriptive (or intrusive) approach, as proposed by the AER, would be costly for TNSPs to implement and maintain. More importantly, it would fail to achieve the desired outcome of a Cost Allocation Methodology, which is to provide a fair and reasonable representation of allocated costs.
- The Cost Allocation Guidelines could provide for a range of possible Cost Allocation Methodologies.
- The primary criterion for the AER's acceptance of a Cost Allocation Methodology should be that it provides for the achievement of the Cost Allocation Principles contained in the Rules.
- The Cost Allocation Principles are very focussed e.g. they apply only to the methods for establishing cost allocators for specific categories of costs across different transmission services. The principles do not require the Cost Allocation Guidelines to deal with information provision (these are dealt with by the AER's Information Guidelines (Clause 6A.17.2)) or audit process requirements (which are presumably dealt with by the Information Guidelines and/or Submission Guidelines).
- The Cost Allocation Guidelines need to be clear on what Cost Allocation Methodologies are acceptable. However, the proposed guidelines could simultaneously take care not to rule out alternative Methodologies proposed by a TNSP that contribute to the achievement of the Cost Allocation Principles.
- The Cost Allocation Guidelines could establish a 'safe harbour' by developing the detailed principles and policies acceptable for inclusion in a Cost Allocation Methodology necessary to enable meaningful and repeatable attribution of costs to different transmission services.

The remainder of this submission sets out these issues in more detail and proposes further engagement with the AER, possibly in conjunction with the imminent consultation on the Information Guidelines. ETNOF's intention is to be constructive and it is keen to work with the AER to ensure development of Guidelines that enable the AER to effectively and efficiently perform its regulatory functions.

3. Inconsistency with Intent of the Rules

ETNOF's principal concerns with the Cost Allocation Guidelines is that it contains too much detail and prescription regarding the process to be applied, and inappropriately attempts to apply the same cost allocation process to forecast costs as it does to historical costs.

In particular, the proposed Guidelines:

- seek a lot of information which is more appropriate to the Information Guidelines or Submission Guidelines;
- seek information to a level which is more prescriptive than required to give effect to the Cost Allocation Principles in the Rules and inconsistent with Accounting Standards;
- do not focus on the primary outcome of a cost allocation process as set out in the Cost Allocation Principles, namely, to establish transparent bases of allocation; and
- do not explicitly recognise that a 'one size fits all' cost allocation methodology is not appropriate, given the specific business environments within which each TNSP operates.

Each of these matters is discussed in more detail below.

3.1 Substantive Financial Reporting Requirements

Much of the information and disclosure sought in the proposed Guidelines is concerned with substantive financial reporting requirements. While such information may be potentially appropriate to the Information Guidelines (which have not yet been released for consultation) or the Submission Guidelines, ETNOF does not consider that such requirements pertain to, or should form part of, a TNSP's Cost Allocation Methodology.

3.2 Excessive Level of Detail

The proposed Guidelines seek information to a level of detail and disclosure that is more than, and is inconsistent with, what is required by the Rules. In practice, these requirements also appear unworkable. A primary example of this is in relation to the provision of detailed principles and policies.

The extended information requirements contemplated by the Guidelines introduce a number of practical inconsistencies with clause 6A.19.4 of the Rules. These inconsistencies are unlikely to arise if the Guidelines required a Cost Allocation Methodology to be developed under generally accepted definitions of principles and policies. For example, clause 2.2.1(b) requires the disclosure of detailed cost item specific information about the basis of calculation. However, while clause 6A.19.2(4) suggests some information requirements, it does not require the information be provided on a specific cost item basis.

At a detailed cost item level, the information required above will vary from period to period according to factors such as business accounting requirements, the level of business activity and changes which may allow more appropriate bases of allocation to be utilised. Contrary to what is proposed in the Guidelines, these are matters of calculation which cannot be determined in advance.

Further, clause 4.2 of the proposed Guideline and clause 6A.19.4 of the Rules require a TNSP to amend its approved Cost Allocation Methodology in advance of the start of the year to which it applies. While this is conceivably workable for matters of principle and policy, it is unworkable if the cost allocation methodology must include the specific details set out in clause 2.2.1 of the Guideline. In effect, TNSPs would have no basis for predicting requirements for cost specific changes in advance of the relevant accounting period. Notwithstanding this, once identified (necessarily in retrospect), the TNSP could not change its cost specific allocations as this would represent a change in the cost allocation methodology.

A similar inconsistency exists between clause 2.2.4 of the Guideline and the approval requirements in the Rules. The proposed Guidelines contemplate that TNSPs would prepare historical cost reports in advance of the events they report on. As currently drafted, TNSPs would be required to report inappropriately allocated costs under some circumstances.

ETNOF also notes that the Rules require TNSPs to maintain a current copy of its approved Cost Allocation Methodology on its website. While such disclosure appears feasible if limited to principles and policies envisaged in the Rules (that is, at a high level), ETNOF is very concerned that the detailed nature of the information currently sought by the AER could involve the disclosure of commercially sensitive information.

ETNOF considers that the proposed disclosure requirements for principles and policies extend beyond well established definitions, which seek fundamental or general information or rationales about principles, bases, conventions, rules and practices as opposed to the cost item specific information and calculation data sought by the AER.

On the basis of advice from KPMG, ETNOF also believes that the level of detail required by the AER is inconsistent with Australian and international accounting and financial reporting standards for disclosure of accounting principles and, therefore, with requirements under the Corporations Act. Information contained in publicly available financial statements indicates that the disclosures contained therein are consistent with the definitions of principles and policies set out above and do not comprise detailed disclosure of specific bases of calculation for individual account items such as costs, revenues, assets, liabilities or capital. This provides further evidence that the AER's requirements unreasonably extend beyond that required to give effect to the Cost Allocation Principles.

3.3 Outcomes focus for cost allocation

ETNOF supports an outcome requirement for the bases of forecast costs to be transparent and capable of replication by the AER (as required by the Rules). However, the wording in the proposed Guideline, which requires the Cost Allocation Methodology to be applied in preparing forecast cost estimates is not appropriate and should be amended to better reflect normal business practices, and relevant Auditing Standards, in cost forecasting. This could be achieved by requiring TNSPs to prepare expenditure forecasts in a manner consistent with its Cost Allocation Methodology used to prepare historical financial information. A detailed discussion of the wording in the proposed Guidelines in relation to this issue follows.

Clauses 5.1(b)(1) and (2) of the proposed Guidelines require that the Cost Allocation Methodology be applied when preparing forecasts of operating and capital expenditure. It is clear that operating and capital expenditure forecasts need to be prepared consistently with the way in which historic costs have been incurred. However, the detailed principles and policies which form the basis of any Cost Allocation Methodology largely reflect accounting practices for <u>historical costs</u> which are set out in a range of regulatory accounting guidelines developed in Australia, and internationally, over the past 10 years. The proposed Guidelines include requirements such as causal allocations and the qualification of allocators, which may be workable where relevant historical accounting records exist to provide relevant detailed accounting records and allocation information. This is not the case for forecast expenditure.

Normal business practice (for both TNSPs and businesses generally) is not to use a cost allocation process in forecasting future expenditures. Rather, businesses normally forecast cost outcomes on the basis of relevant assumptions such as historical and anticipated trends of cost and levels of activity, demand or other cost drivers. Historical costs reflect a TNSP's Cost Allocation Methodology and as such the application of a Cost

Allocation Methodology is implicit in business forecasts rather than explicit as suggested by the wording in Clause 5.1(b).

Similarly, the wording in Clause 5.1(b) which requires the Cost Allocation Methodology to be applied in the preparation of operating and capital expenditure forecasts could lead to TNSPs being required to provide working papers regarding the application of the methodology (including percentage allocators) and have audits of forecast financial information under Clauses 5.2 and 5.3 of the Guideline. This is considered inappropriate for the following reasons:

- information inputs including, for example, sources of "data for determining the numeric quantity or percentage" of allocators will not exist. Hypothetical assumptions would need to be made; and
- Auditing Standard AUS 804 issued by the Australian Government Auditing and Assurance Standards Board, *The Audit of Prospective Financial Information,* permits an auditor to report only on the basis of preparation of forecast financial information and does not allow an auditor to provide assurance on the forecasts themselves.

ETNOF considers that the Guidelines should require a TNSP to state that expenditure forecasts have been developed in a manner consistent with its Cost Allocation Methodology used to prepare historical financial information.

3.4 One size fits all

Neither the proposed Guideline nor the Issues Paper rule out development of a single cost allocation methodology being developed and applying to TNSPs across the board. This is despite such an approach being neither practical nor workable as cost allocators are, by their very nature, specific to different businesses (and to a lesser extent, to different accounting periods). The selection of appropriate cost allocators will vary depending upon organisational and costs structures, charts of accounts and information systems which record allocators.

Consequently, there is a need to review cost allocators at each reporting period to determine whether they remain appropriate. As the Guidelines stand, if there were disregard for the realities of accounts preparation, and a 'one size fits all' approach was adopted by the AER, the result would in all likelihood, prescribe the "wrong answer" with no comparability of cost allocation outcomes over time.

ETNOF therefore considers that the Guidelines should explicitly recognise that individual TNSPs may develop their own cost allocation methodology, providing the methodology fairly presents costs and provides the AER with the required understanding of how the TNSP allocates costs. Indeed, as discussed in section 2, the Rules have been developed to expressly permit this approach.

4. Other high level issues

ETNOF also has a number of other high level concerns, including:

- the proposed Guidelines do not address the allocation of costs to a TNSP providing prescribed transmission services where that TNSP is part of a larger business structure;
- the proposed Guideline's audit and assurance requirements are inappropriate to a Cost Allocation Methodology;
- the proposed Guideline inappropriately prohibits the use of an avoided cost basis of allocation;

- the inter-relationship between the guideline for cost allocation and the pricing of negotiated transmission services; and
- the inappropriate and unfounded inclusion of a comment regarding differences in cost allocation methodology due to public or private ownership of transmission businesses.

Each of these matters is discussed in more detail in turn.

4.1 Allocation to a TNSP which is part of a larger business structure.

Clause 6A.19.2(3) of the Rules indicates that only the following costs may be allocated to a particular category of transmission services:

(i) costs which are directly attributable to the provision of those services; and

(ii) costs which are not directly attributable to the provision of those services but which are incurred in providing those services.

Clause 6A.19.2(3)(ii) above necessarily includes costs which may need to be attributed to the transmission business (as distinct from other businesses within the same company such as a distribution business) or a transmission service within the transmission business.

In practice, different business units within a group or a reporting entity may be accounted for separately and shared management services (eg. accounting, HR, procurement, IT) are most efficiently structured as a centralised service provider whose costs are necessarily shared between other business units. Other forms of corporate or management costs from a larger business structure might equally require such an allocation.

The proposed Guideline does not appear to contemplate that shared costs may arise which are outside of a TNSP but are attributable to the provision of transmission services by the TNSP. The inclusion of these costs is a matter of mechanical necessity to completely account for the costs of transmission services.

While the Rules do not appear to address this requirement in the context of the Cost Allocation Guidelines, it needs to be addressed as a matter of practical necessity. Clarification of how this matter is dealt with in the regulatory framework is required, including any inter-relationship between the Cost Allocation Guideline and the Ring Fencing Guideline. Amendment of the Cost Allocation Guideline may be required to achieve such clarity.

4.2 Requirement for Directors statement

ETNOF considers that the Directors' statement which is required to be included in the Cost Allocation Methodology (Clause 3.2(a)(10)) is an extension of the requirements in the Rules and may be beyond the AER's powers.

In addition, the requirement appears to confuse a statement by Directors regarding the Cost Allocation Methodology with a responsibility statement Directors might complete concerning any financial statements produced using the methodology. Any Directors' statements regarding the financial statements would normally include assertions about the fairness of the presentation and basis of preparation of the statements as a whole. For example, they may include reference to the Cost Allocation Methodology as well as the other principles that would govern their preparation.

However, it is not clear how the Directors could make a statement about the methodology in isolation from any financial statements that may be prepared using the methodology. It is also difficult to understand what the AER may be seeking in a statement that the methodology is 'accurate'. The results of applying a methodology may be accurate if there is a framework by which accuracy can be measured, assuming that other inputs and data are appropriate. However a cost methodology itself does not possess accuracy or precision.

In addition, 'accurate' or 'accuracy' is not a concept accommodated by Auditing Standards or Accounting Standards. Auditors and Directors cannot fairly opine on whether substantive accounting information is accurate. Rather, they may opine on whether information is "fairly presented" in accordance with a defined framework (such as Accounting Standards or perhaps a Cost Allocation Methodology). While it is beyond the scope of this submission to discuss the technical reasons for this, ETNOF could provide the AER with further information on this topic if that would be of assistance.

ETNOF suggests that clause 3.2(a)(10) of the Guideline be removed given the basis of the Directors' statement in the Cost Allocation Methodology is unclear and is not required by the Rules.

4.3 Avoided cost basis

The proposed Guideline prohibits the use of an avoided cost basis of allocation (clause 2.2.4(e)), which ETNOF considers is inappropriate.

An avoided cost approach is not prohibited by the Rules. In fact, such an approach is fully consistent with the requirements of clause 6A.19.2.3 (ii) (A) of the Rules for a causation basis of allocation. Avoided cost identifies the costs triggered or caused by the activity being costed. Appropriate disclosure can be used to demonstrate that an avoided cost allocator meets the requirements of clause 6A.19.2.5 of the Rules such that costs are not over allocated.

ETNOF also notes that the definition of avoided cost in the proposed Guideline's glossary would be clearer if it defined "avoided cost" as the costs that remain after a TNSP determines the costs that it is unable to avoid.

As with all allocations, and in accordance with the Cost Allocation Principles, the outcome of the allocation is more important than the particulars of the process. While the above paragraph demonstrates that the avoided cost methodology meets the cost allocations principles of the Rules set out in clause 6A.19.2, the use or otherwise of avoided cost as a basis of allocation is not the key issue. ETNOF considers that the more significant issue is whether the resulting cost allocation is fair and reasonable.

In addition, constraining the use of avoided cost to immaterial items serves no purpose. If avoided cost (or any other allocator) has merit, there would be no reason to exclude its application to material costs. If the cost is immaterial, then by the Guidelines' definition, the user of the financial information would be indifferent to the choice of allocator for immaterial costs. This is because the allocated cost would not provide meaningful information in any event.

Further, at a meeting with ETNOF Regulatory and Financial Managers in December 2006 on the Cost Allocation Guidelines, AER officers stated that the AER's intention was that the Guidelines allow acceptance of current practice, including avoided cost.

ETNOF therefore considers that clause 2.2.4(e) which prohibits the allocation of shared costs using an avoided cost approach, be deleted from the Guidelines.

4.4 Pricing of negotiated transmission services

The proposed Guideline necessarily sets out historical cost accounting requirements. This is entirely appropriate as a cost allocation methodology must relate to historic cost allocations. However, the Rules construct an inter-relationship between the cost allocation methodology and the prices TNSPs determine for the provision of negotiated services (Clause 6A.9.1 of the Rules).

Given the correct focus of the cost allocation methodology on historic cost allocation, it is unclear what needs to be included in the Guideline or the methodology to give effect to the linkage with the pricing of negotiated services. By way of example, the price of a negotiated service will include economic costs such as returns on and of the cost of assets providing the service and allowances for any risks transferred to the TNSP. These matters are not recorded in financial accounting records.

ETNOF considers the Cost Allocation Guideline clarify that determination of broader economic costs necessary for the pricing of negotiated services be addressed in the negotiating frameworks submitted to the AER, rather than the Cost Allocation Methodology.

4.5 AER Issues Paper – public/private ownership

ETNOF is also concerned with the AER's assertion in the Issues Paper that ownership arrangements influence cost allocations. ETNOF, which comprises both publicly and privately owned TNSPs, believes this assertion is not only unsupported but bears no relevance whatsoever to the development of a Cost Allocation Methodology. Instead, the comment appears to be a value judgement about the behaviour of either publicly or privately owned TNSPs which is unfounded and has no place in such a consultation. This comment should be removed from any subsequent discussions in relation to this and other issues.

5. Matters of detail

5.1 Approval for non causal bases of allocation

ETNOF considers most of the approval criteria for non causal bases of allocation in clause 2.2.4(c) of the proposed Guideline are unnecessary and several are unworkable. Clause 6A.19.2(3)(B) of the Rules permits non causal bases of allocations if the cost is immaterial or a causal basis of allocation cannot be established without undue cost and effort.

In the proposed Guidelines:

- clause 2.2.4(c) of the Guideline sets out the criteria by which such an allocation may be approved by the AER; and
- clause 2.2.4(c)(2) requires that the aggregate of all shared costs subject to non-causal basis of allocation are not material.

If a shared cost is immaterial, then according to the Guideline's definition of materiality, it has no potential to prejudice an understanding or the financial position of the TNSP if it is omitted, misstated or not disclosed. However, notwithstanding this, the Guidelines:

- clause 2.2.4(c)(1) requires these costs be allocated in accordance with an allocation that accords with an AER approved Cost Allocation Methodology;

- clause 2.2.4(c)(3) requires the basis of allocation to be approved in writing by the AER;
- clause 2.2.4(c)(4) requires a work paper documenting for each immaterial shared cost a range of items specified in that clause; and
- clause 2.2.4(d) sets out approval criteria the non-causal allocation will have to meet to gain approval.

The effect of these requirements is to present a significantly wider range of disclosure criteria for costs which, by the Guideline's own definition, "do not matter" than for those that do. This appears to be an error in drafting. The application of clauses 2.2.4(c) and (d) do not appear to serve any practical purpose but imposes unreasonable additional processes and costs on a TNSP, its auditor and the AER.

In any event, clause 2.2.4(c)(3) which requires the basis of allocation to be approved in writing by the AER is redundant and inappropriate. Once the AER has approved a Cost Allocation Methodology, no purpose is served by additionally requiring the approval of this component of the methodology.

Again this outcome appears to have arisen as a result of the proposed Guidelines' adoption of wording from Information Guidelines designed for a different purpose and different circumstances namely, to provide a form of regulatory control or approval in the limited circumstances where:

- a regulated business might be obliged to adopt a basis of fully distributed historical cost allocation different to that set out in regulatory information guidelines; and
- <u>there is an absence of any approved Cost Allocation Methodology</u>.

ETNOF considers that the Guideline should be amended <u>to exclude</u>:

- costs that are immaterial to a TNSP or a transmission service from the Cost Allocation Methodology; and
- the requirement of clause 2.2.4(c) for non-causal bases of allocation to be approved in writing by the AER.

5.2 Disclosure requirements

Where material costs are subject to allocation, the disclosure requirements of clause 2.2.4 again extend beyond the disclosure of principles and policies. The disclosure requirements set out in clause 2.2.4(c) are very similar to the requirements of many Australian regulatory accounting guidelines for working papers to support <u>historical cost calculations</u>.

For example, the wording of clause 2.2.4(c) is very similar to that of sections 3.5.9 to 3.5.11 of the Office of the Regulator General's Electricity Industry Guideline No 3, 'Regulatory Information Requirements', November 1997. ETNOF understands that this wording:

- was drafted to provide supporting schedules for historic financial reports; and
- was not drafted with the purpose of setting out principles or policies to be applied to forecast information.

Nonetheless, the proposed Guidelines utilise this wording for disclosure in the Cost Allocation Methodology instead of supporting information. ETNOF considers that this needs to be amended.

5.3 AER initiated changes

The proposed Guideline is largely silent on the circumstances in which the AER may initiate changes to a Cost Allocation Methodology and the Guideline even though the Guideline prescribes closely the circumstances under which a TNSP may seek approval of a change to its methodology (for example see clause 4.2). This is a potentially significant asymmetric risk for TNSPs, who may be required to invest significant expenditure, time and effort in processes and procedures to meet and maintain a methodology in accordance with the AER's requirements.

ETNOF considers that the Guidelines should more clearly specify the circumstances in which the AER may seek changes to a Cost Allocation Methodology and the Guidelines.

5.4 Approval Criteria

The approval criteria in clause 4.2(c) of the proposed Guideline omit what ETNOF considers to be the most important criteria, namely, that a change to the Cost Allocation Methodology should:

- enable costs to be presented fairly (in line with the emphasis on substance rather than form contained in the Cost Allocation Principles); or
- improve the fairness of their presentation.

ETNOF considers that clause 4.2 should be amended to include an overriding criterion which allows a change to the methodology to be approved if it provides for cost allocations to be fairly presented or improves the fairness of the presentation of costs.

5.5 Restating financial forecasts

For the reasons explained in section 3.3, it does not necessarily follow that a change in a cost allocation methodology developed to allocate historical costs, will result in changes to forecast costs. Further, where a change may arise it would not necessarily be material to the precision with which forecasts can be reasonably made.

ETNOF considers that clause 4.2(f) of the proposed Guideline should be amended such that any requirement to restate financial information applies only where the change in the Cost Allocation Methodology may result in a material restatement of historical costs.

5.6 Additional Matters of Detail

As proposed in the Guidelines, much of the required format and contents of the Cost Allocation Methodology is inappropriate. Clause 3.2 of the proposed Guideline sets out requirements that include matters of substantive detail rather than a description of a methodology. In particular:

- clause 3.2(5) is redundant. The Rules already address the different categories of transmission service, and the types of person to whom services are provided have no bearing on a Cost Allocation Methodology. While clause 6A.19.3 of the Rules permit the AER to request this information if it thinks it appropriate, it does not require the Guideline to obtain this information;
- the reference of clause 3.2(6) to detailed principles and policies is impractical, for the reasons explained earlier in this submission, and is unnecessary. Clause 6A.19.3(6) of the Rules require the Cost Allocation Guidelines to give effect to, and be consistent with, the Cost Allocation Principles. Provided this outcome is met, further description is unnecessary;

- the requirements of clause 3.2(7) relate to requirements for substantive information provision, not cost allocation principles and policies, which are best dealt with by Information Guidelines. Further, TNSPs are subject to overriding corporate regulatory requirements to maintain accounting records. The proposed Guidelines cannot alter those existing requirements dealt with by the corporate regulatory framework; and
- clause 3.2(8) is redundant. "Compliance" has no meaning in isolation from, and is a consideration that is secondary to the fairness of presentation of, any substantive financial reports to which a Cost Allocation Methodology may be applied. The appropriate approach for the AER is to seek assurance that financial information is presented fairly in accordance with the approved Cost Allocation Methodology among the other relevant requirements that may govern the preparation of that information. Again, this should be dealt with in Information or Submissions Guidelines and not a Cost Allocation Methodology.

6. Further consultation

As a consequence of the issues raised, ETNOF considers that a second round of consultation on the Cost Allocation Guidelines should be undertaken. ETNOF notes that there is substantial time still available between the receipt of these comments and the required date for finalising the Guidelines, which provides the opportunity for the AER to issue a second draft that takes account of submissions received on this draft. Moreover, ETNOF is willing to assist the AER to address the matters raised in this submission, or to provide other assistance the AER considers would aid in bringing this process to a successful completion.