Final decision

Electricity Transmission Network Service Providers

Directlink & Murraylink amended

Cost Allocation Methodologies

March 2010

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Shortened forms

AER	Australian Energy Regulator
CAM	Cost allocation methodology
Capex	Capital expenditure
NEL	National Electricity Law
NEM	National Electricity Market
NER	National Electricity Rules
Opex	Operating and maintenance expenditure
TNSP	Transmission Network Service Provider

1 Introduction

1.1 Summary

In July 2008, the Australian Energy Regulator (AER) released its *Final Decision: Electricity Transmission Network Service Providers, Cost Allocation Methodologies*, approving the cost allocation methodologies (CAM) for Directlink and Murraylink, then owned by the APA Group. In December 2008, ownership of Directlink and Murraylink transferred to the newly formed Energy Infrastructure Investments Group (EII Group). EII contracts out the management and operations of the Directlink and Murraylink interconnectors to the APA Group.

In October 2009, EII applied to the AER for the Directlink and Murraylink CAMs to be amended under clause 4.2 of the *Electricity Transmission Network Service Providers Cost Allocation Guidelines* (Guidelines). EII submitted that this was due to its acquisition of Murraylink representing a material change to Murraylink's operations, and to ensure consistency between the approved cost allocation methodology and the allocation of costs.

1.2 Background

The AER is responsible for regulating the revenues of TNSPs in the National Electricity Market (NEM) in accordance with the National Electricity Rules (NER) and National Electricity Law (NEL). Chapter 6A of the NER deals with the economic regulation of electricity transmission services.

Under the NER, Directlink and Murraylink operate electricity transmission assets and are classified as electricity transmission network service providers (TNSPs). Directlink is a 180MW capacity high voltage direct current transmission link which interconnects the Queensland and New South Wales AC power grids. Murraylink is a direct current transmission link which interconnects the South Australian and Victoria AC power grids.

A TNSP's cost allocation methodology deals with the attribution of its direct costs to prescribed, negotiated and other services and the allocation of shared costs between these different services. The Guidelines only deal with cost attribution down to the level of services, not individual prices for different categories of services. Cost allocation for pricing purposes is dealt with separately through the Pricing Methodology Guidelines released by the AER on 29 October 2007.

Effective cost allocation has an important role to play in promoting the national electricity objective which is stated in section 7 of the NEL, 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 to 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 CAMs set out arrangements to manage the attribution of direct costs and the allocation of shared costs between different categories of transmission services. 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.

The NER requires that the CAM proposed by each TNSP must give effect to and be consistent with the Guidelines.

2 Process and NER requirements

In relation to a TNSP amending its CAM, clause 6A.19.4(f) of the NER provides:

> (f) A Transmission Network Service Provider may amend its Cost Allocation Methodology from time to time but the amendment only comes into effect:
>
> (1) 6 months after the submission of the amendment, together with detailed reasons for the amendment, to the AER (unless the AER approves that amendment earlier, in which case it will come into effect when that earlier approval is given); and
>
> (2) subject to such changes to the Cost Allocation Methodology (including the proposed amendment) as the AER notifies to the Transmission Network Service Provider within that period, being changes that the AER reasonably considers are necessary or desirable as a result of that amendment.

Clause 4.2(c) of the AER's *Electricity Transmission Network Service Providers Cost Allocation Guidelines*, provides that 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 to effectively promote the Cost Allocation Principles.
>
> (3) The resultant amended Cost Allocation Method would give effect to, and be consistent with, these Guidelines.
>
> (4) The amendment will not 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.

Further, clause 4.2(d) provides:

> The AER will only approve an amended Cost Allocation Methodology to take effect from the start of a new regulatory year or such other date as agreed with the AER.

In assessing the proposed CAMs for Murraylink and Directlink, the AER has followed the Guidelines and requirements of the NER. The overall content of a TNSP's CAM is governed by the Guidelines which must give effect to and be consistent with the Cost Allocation Principles as set out at clause 6A.19.2 of the NER. Further, clause 6A.19.3(c) of the NER provides:

> 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 services, 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.

3 AER considerations

Details of the amendments to the CAMs for Directlink and Murraylink, and other AER considerations are provided below. Copies of the CAMs are attached at Appendix A to this decision.

3.1 Directlink and Murraylink's CAMs

Directlink and Murraylink submitted proposed amendments to their CAMs to the AER in October 2009. Directlink's and Murraylink's CAMs govern the allocation of direct and shared costs to their transmission networks. All direct costs are allocated to prescribed transmission services. As Directlink and Murraylink are owned by EII, which manages a number of regulated gas and electricity assets, the CAMs also cover the allocation of shared corporate overhead costs between Directlink, Murraylink and other EII's related businesses.

The corporate overhead costs are allocated according to the percentage of revenue the asset contributes to EII's total revenue. Corporate overhead costs include costs associated with the following:

- Accounting, Treasury and Taxation
- Operations Management
- Commercial Management
- Engineering Management
- Strategic Planning
- Legal and Regulatory
- Company Secretariat

Directlink and Murraylink allocate corporate costs according to the percentage of revenue the asset contributes to total revenue as:

- Shared costs are unavoidably incurred as part of Directlink's revenue generation;
- There is a casual relationship between revenue and shared costs; and
- This cost allocation approach has been previously accepted as an appropriate approach by the AER for the shared corporate costs in relation to Directlink and Murraylink.

3.2 Amendments to the CAMs

The AER is satisfied that there has been a material change in the circumstances of Directlink and Murraylink that requires an amendment to the CAM.

The AER considers amendments are necessary for EII to effectively promote the cost allocation principles in the NER. The proposed amendments satisfy the cost allocation principles in the NER as the underlying costing and accounting practices of the interconnectors has changed and a new set of direct and shared costs are required to be allocated. The proposed amendments also allocate the new set of direct and shared costs in a manner which is consistent with the previous CAMs. The amended CAMs give effect to, and are consistent with, the cost allocation guidelines for this reason.

As the CAMs as amended are similar to the existing CAMs, the amendment will not jeopardise the comparability of the resultant financial information with earlier information provided by Murraylink and Directlink to the AER.

Directlink and Murraylink have not quantified and demonstrated to the AER the impact of the proposed amendment. Correspondence with APA management staff outlined that services provided by APA to Directlink and Murraylink will be provided at a margin. APA management has stated that this margin will be offset by cost reductions as a result of the change in ownership. The AER has not reviewed the quantum of this margin as part of the review of Directlink and Murraylink's CAMs. The AER will review the quantum of this margin as part of its revenue determinations for Directlink and Murraylink.

Clause 3.4 of the cost allocation guidelines provides that the AER, in consultation with TNSPs, will review their CAMs as part of each of their revenue determinations. This review will consider the prudency of any change in cost that resulting from the change in ownership in accordance with the relevant requirements of Chapter 6A.

3.3 Retrospective application of the cost allocation methodology

Murraylink and Directlink have requested that the CAM apply retrospectively to the reporting period 1 July 2008 to 31 December 2009.

The AER does not approve of the retrospective application of the amended CAM on the grounds that clause 6A.19.4(f) of the NER only provides for an amendment to the CAM to only come into effect six months after its submission, or the date that the CAM is approved by the AER, subject to such changes the AER reasonably considers are necessary or desirable as the AER notifies to the TNSP within that period.

To ensure that the CAMs are compliant with the NER the AER considers it necessary that the second sentence in section 1.3 of the proposed CAMs be removed. That sentence states '[a]lthough the proposed cost allocation methodology will not formally apply until it is approved by the AER, it will be used to prepare (Directlink's/Murraylink's) regulatory accounts from the current accounting period (1 July 2008 – 31 December 2009) and each reporting period thereafter, until revisions to this methodology are approved'.

3.4 Decision

The AER considers that the proposed amendments to the CAMs give effect to and are consistent with the Guidelines. The AER therefore approves the CAMs proposed by these TNSPs under clause 4.2 of the Guidelines. The AER makes this decision subject to the second sentence in section 1.3 of the proposed amended CAMs being removed from the CAMs.

In accordance with clause 6A.19.4(f) of the NER, the amendments to the CAM will come into effect on 31 March 2010.

Appendix A

The CAMs submitted by Directlink and Murraylink to the AER are attached as separate documents. Electronic copies of these are available at www.aer.gov.au

Appendix B: clause by clause comparison of Directlink's and Murraylink's CAMs with the requirements of the Guidelines

Clause 3.2 of the AER's Cost Allocation Guidelines	**Relevant sections of Directlink's CAM**	**Relevant sections of Murraylink's CAM**	**Findings**
(1) A version history and date of issue for the document;	Version History (Pg 3)	Version History (Pg 3)	Compliant: A version history and date of issue are provided.
(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;	1.1 Scope of Methodology 1.2 Overview of Approach (Pgs 6-7)	1.1 Scope of Methodology 1.2 Overview of Approach (Pgs 6-7)	Compliant: This is in accordance with the Guidelines.
(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 CAM; and B. responsibilities within the TNSP for updating, maintaining and applying the CAM and for internally monitoring and reporting on its application.	1.3. Implementation and Accountabilities (Pg 7)	1.3. Implementation and Accountabilities (Pg 7)	Compliant: A. Directlink's and Murraylink's commitment to implementing their CAMs are outlined in section 1.3, Implementation and Accountabilities of each document. This is in accordance with the requirements of the guidelines and the NER. B. The responsibilities for maintaining, updating and applying the CAMs are outlined in section 1.3, Implementation and Accountabilities. These are in accordance with the requirements of the guidelines and the NER.

Clause 3.2 of the AER's Cost Allocation Guidelines	**Relevant sections of Directlink's CAM**	**Relevant sections of Murraylink's CAM**	**Findings**
(4) A description of the TNSP's corporate and operational structure to enable the AER to understand how the TNSP is organised to provide its transmission services;	1. Introduction (Page 1). 2. Directlink's Transmission Services and Costs (pg 9).	1. Introduction (Page 1). 2. Murraylink's Transmission Services and Costs (pg 9).	Compliant: The description of Directlink's and Murraylink's corporate and operational structure is sufficiently detailed to enable the AER to understand how it 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;	2. Directlink's Transmission Services and Costs (pg 9).	2. Murraylink's Transmission Services and Costs (pg 9).	Compliant: Directlink and Murraylink have provided appropriate information regarding the categories of transmission services.

Clause 3.2 of the AER's Cost Allocation Guidelines	Relevant sections of Directlink's CAM	Relevant sections of Murraylink's CAM	Findings
(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 the Guidelines. For the avoidance of doubt, this includes the attribution or allocation of costs relating to any related party transactions;	3. Allocation of Costs to Directlink (Page 11). Attachments B-C	3. Allocation of Costs to Murraylink (Page 11) Attachments B-C	Compliant: Directlink's and Murraylink's detailed principles and policies used to allocate costs are outlined within their CAMs. The cost allocation approach is consistent with the approach applied by Directlink and Murraylink previously. The AER will review the cost allocation approach as part of its revenue determinations for Directlink and Murraylink.

Clause 3.2 of the AER's Cost Allocation Guidelines	**Relevant sections of Directlink's CAM**	**Relevant sections of Murraylink's CAM**	**Findings**
(7) A description of how the TNSP will maintain records of the attribution or allocation of costs to, or between, categories of transmission services 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.	1.3. Implementation and Accountabilities (Pg 7)	1.3. Implementation and Accountabilities (Pg 7)	Compliant: A. The maintenance of records is demonstrated to be in accordance with clause 5.2 of these Guidelines B. The records can be audited or otherwise verified as required.
(8) A description of how the TNSP will monitor its compliance with the CAM and the Guidelines;	1.3. Implementation and Accountabilities (Pg 7)	1.3. Implementation and Accountabilities (Pg 7)	Compliant: A description of how Directlink and Murraylink will monitor its compliance with the CAM and the guidelines is provided.