



# **Electricity distribution network service providers**

## **Cost allocation guidelines**

**June 2008**



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Inquiries concerning the currency of these guidelines should be addressed to:

Australian Energy Regulator  
GPO Box 520  
Melbourne VIC 3001  
Ph: (03) 9290 1444  
Fax: (03) 9290 1457  
Email: [AERInquiry@aer.gov.au](mailto:AERInquiry@aer.gov.au)

**AMENDMENT RECORD**

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# 1. Nature and authority

## 1.1 Introduction

These *Guidelines* set out arrangements to manage the attribution of *direct costs* and the allocation of *shared costs* by *Distribution Network Service Providers (DNSPs)* between different categories of *distribution services*.

## 1.2 Authority

Clause 6.15.3(a) of the *National Electricity Rules (NER)* requires the *AER* to make, in accordance with the *distribution consultation procedures*, *Cost Allocation Guidelines (Guidelines)* relating to the preparation by a *DNSP* of its *Cost Allocation Method*.

## 1.3 Specific provisions applying to the ACT, NSW, and Victoria

- (a) The *Guidelines* will not apply to the *AER*'s first electricity distribution determinations for *DNSPs* within NSW and the ACT for the regulatory period commencing in 2009 and ending in 2014. Separate transitional arrangements under the *NER* specify the *Guidelines* to be adopted by *DNSPs* within the ACT and NSW during this period.
- (b) NSW and ACT *DNSPs* do not have to submit a *Cost Allocation Method* in accordance with these *Guidelines* as they will already have submitted a *Cost Allocation Method* under transitional chapter 6 of the *NER*. The *Cost Allocation Methods* developed under transitional chapter 6 will then apply for future periods, subject to any amendments allowed or required under clauses 6.15.4(f) and 6.15.4(g) of the *NER*.
- (c) These *Guidelines* do not apply to Victorian *DNSPs*. Guidelines for Victorian *DNSPs* can be found in Appendix A.

## 1.4 Role of these guidelines

The role of these *Guidelines* is to detail the process and approach for each of the following:

- A *DNSP* preparing and submitting its proposed *Cost Allocation Method* to the *AER* for approval;
- The *AER* approving or rejecting a *DNSP*'s proposed *Cost Allocation Method* or approving or rejecting a *DNSP*'s amended *Cost Allocation Method*;
- Amending and reviewing a *DNSP*'s approved *Cost Allocation Method* from time to time; and

- A *DN*SP applying its *Cost Allocation Method*.

## 1.5 Relationship between these guidelines, cost allocation method and the *NER*

- Each *DN*SP must develop a proposed *Cost Allocation Method* for submission to the *AER* in accordance with the requirements of these *Guidelines*. A *DN*SP's *Cost Allocation Method* must give effect to and be consistent with these *Guidelines*.
- The *Cost Allocation Method* approved by the *AER* must be used by the relevant *DN*SP for the purposes of allocating costs in accordance with the requirements of the *NER*.
- The *AER* will monitor, report on and enforce compliance with the *DN*SP's *Cost Allocation Method* in accordance with the requirements of the *NER*.

## 1.6 Confidentiality

The *AER*'s obligations regarding confidentiality and the disclosure of information provided to it by a *DN*SP are governed by the *Trade Practices Act 1974*, the *National Electricity Law* and the *NER*.

## 1.7 Definitions and interpretation

- (a) In these *Guidelines*:
- (1) The words and phrases presented in italics *such as this* are defined in the Glossary of these *Guidelines* and have the meaning given to them in:
    - A. The Glossary; or
    - B. If not defined in the Glossary, the *NER*;
  - (2) The words 'shall' and 'must' indicate mandatory requirements, unless the overall meaning of the phrase in which one of these words appears, is otherwise.
- (b) Explanations in these *Guidelines* about why certain information is required are provided for guidance only. They do not limit in any way the *AER*'s objectives, functions or powers.

## 1.8 Processes for revision

The *AER* may amend or replace these *Guidelines* from time to time to meet changing needs, in accordance with clause 6.15.3(d) of chapter 6 of the *NER* and the *distribution consultation procedures*.

## **1.9 Version history and effective date**

A version number and an effective date of issue will identify every version of these *Guidelines*.



## 2. Principles and policies for attributing and allocating costs

### 2.1 Developing principles and policies

Each *DNSP* is responsible for developing the detailed principles and policies for attributing costs to, or allocating costs between the categories of *distribution services* that it provides. These detailed principles and policies must be included in the proposed *Cost Allocation Method* that the *DNSP* submits to the *AER* for approval.

Promoting these principles is the primary purpose of these *Guidelines* to ensure that only efficient costs are allocated to different services and that the prices paid by end customers for these services are not inappropriately inflated or discounted.

Further, to give effect to the national electricity objective the *Guidelines* promote transparency in:

- the information provided by the regulated business, so that the *AER* can adequately understand the business that it is regulating; and
- the decisions made by the *AER*.

### 2.2 Requirements of *DNSP*'s principles and policies

A *DNSP*'s detailed principles and policies for attributing costs directly to, or allocating costs between categories of *distribution services* must meet the following requirements. These requirements give effect to, and are consistent with, the *Cost Allocation Principles*.

#### 2.2.1 Detailed principles and policies

- (a) A *DNSP*'s detailed principles and policies for attributing costs directly to, or allocating costs between categories of *distribution services* must be sufficiently detailed to enable:
  - (1) The *AER* to replicate the reported outcomes through the application of those principles and policies; and
  - (2) The *DNSP* to demonstrate that it is meeting the requirements of these *Guidelines*.
- (b) For the avoidance of doubt, section 2.2.1(a) means that a *DNSP* must include information on the following matters only to the extent necessary to enable the *AER* to replicate its reported outcomes:
  - (1) For *directly attributable* costs:
    - A. The nature of each cost item;

- B. The category of *distribution services* to which the cost item is to be *directly attributed*;
  - C. The characteristics of the cost item that associate it uniquely with a particular category of *distribution service* in order to make it a directly attributable cost; and
  - D. How and where records will be maintained to enable the basis of attribution to be audited or otherwise verified by a third party, including the *AER*.
- (2) For *shared costs*:
- A. The nature of each cost item;
  - B. The categories of *distribution services* between which each cost item is to be allocated;
  - C. The nature of the allocator, or allocators, to be used for allocating each cost item;
  - D. The reasons for selecting the allocator, or allocators, for each cost item and an explanation of why it is the most appropriate available allocator, or set of allocators, for the cost item;
  - E. Whether the numeric quantity or percentage of the allocator, or allocators, to be applied for each cost item will:
    - (i) Remain unchanged over the *regulatory control period*; or
    - (ii) Change from time to time throughout the *regulatory control period*.
  - F. If clause 2.2.1(b)(2)E(i) applies:
    - (i) Details of the numeric quantity or percentage of the allocator, or allocators; and
    - (ii) An explanation of how the numeric quantity or percentage has been calculated, including where the data for determining this numeric quantity or percentage have been sourced.
  - G. If clause 2.2.1(b)(2)E(ii) applies, an explanation of how the *DNSP* intends to calculate the numeric quantity or percentage throughout the *regulatory control period*, including where the data for determining the changing numeric quantities or percentages are to be sourced; and
  - H. How and where records will be maintained to enable the allocation to be audited or otherwise verified by a third party, including the *AER*.

## 2.2.2 Substance over legal form

- (a) A *DNISP* shall attribute costs directly to, or allocate costs between categories of *distribution services* based on the substance of the underlying transaction or event.
- (b) Where the substance and legal form<sup>1</sup> differ, the substance rather than the legal form of a transaction or event shall be used as the basis of cost attribution or allocation.
- (c) In determining the substance of a transaction or event, all of its aspects and implications shall be considered, including the expectations of and motivations for, the transaction or event.
- (d) For the purposes of determining the substance of a transaction or event, a group or series of transactions or events that achieves, or is designed to achieve, an overall commercial effect shall be viewed in aggregate.

## 2.2.3 Attribution of direct costs

- (a) In accordance with the requirements of *NER* clause 6.15.2(3)(i), only costs that are *directly attributable* to the provision of a particular category of *distribution services* may be *directly attributed* to that category of services.
- (b) A cost may be *directly attributable* to a *DNISP* but not *directly attributable* to a particular category of *distribution services* provided by the *DNISP*. In this circumstance, the allocation of costs between categories of *distribution services* may only be made in accordance with clause 2.2.4 of these *Guidelines*.

## 2.2.4 Allocation of shared costs

- (a) In accordance with the requirements of *NER* clause 6.15.2(3)(ii), *shared costs* incurred in providing several categories of *distribution services* must be allocated between those categories using an appropriate *causal* allocator, except to the extent that:
  - (1) The *shared costs* are *immaterial*; or
  - (2) A *causal relationship* cannot be established without undue cost and effort.
- (b) For the avoidance of doubt, a *DNISP* must allocate its *shared costs*:
  - (1) Between the categories of *distribution services* that it provides; and
  - (2) Within the different types of negotiated distribution services that it provides for the purposes of determining its prices for these services in accordance with clause 6.7.1(1).

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<sup>1</sup> Substance over form emphasises the economic substance of an event even though its legal form may provide a different result.

- (c) If a *shared cost* is *immaterial* or a *causal relationship* cannot be established without undue cost and effort, then the *DNISP* may allocate the *shared cost* to a particular category of *distribution services* using a *non-causal* allocator provided that:
- (1) The *non-causal* allocator accords with an *AER* approved *Cost Allocation Method*;
  - (2) The *non-causal* basis of allocation is approved in writing by the *AER*; and
  - (3) The *DNISP* provides a supporting work paper to the *AER* documenting for each such *shared cost*:
    - A. The basis of allocation;
    - B. The reason chosen for that basis;
    - C. A demonstration that the *shared cost* is *immaterial* or an explanation of why no *causal relationship* could be established without undue cost and effort; and
    - D. A numeric quantity or percentage of the *non-causal* allocator applied to each category of *distribution service* and in total.
- (d) The bases of *non-causal* allocation will be subject to review by the *AER*. The *AER* expects only to accept a *non-causal basis* of allocation if the *DNISP* can demonstrate that there is likely to be 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.
- (e) A *DNISP* is not permitted to allocate *shared costs* using an *avoided cost* approach without prior approval by the *AER*.

### **2.2.5 Not allocate the same cost more than once**

- (a) A *DNISP* must not allocate the same cost more than once.
- (b) For the avoidance of doubt, clause 2.2.5(a) means that:
- (1) The same cost may not be treated as both a *direct cost* and a *shared cost*;
  - (2) A *direct cost* may only be attributed once to a single category of *distribution services*;
  - (3) A *shared cost* may only be allocated once between categories of *distribution services*; and
  - (4) A *DNISP* may only recover the same cost once through the charges that it levies for its *distribution services*.

### **2.2.6 Consistency with distribution ring-fencing guidelines**

The detailed principles, policies and approach that a *DNSP* uses to attribute costs directly to, or to allocate costs between, categories of *distribution services* must be consistent with clause 6.17 of the *NER*.

### **2.2.7 Reallocation of costs between categories of distribution services**

Costs that have been attributed or allocated to *distribution services* must not be reattributed or reallocated to another service during the course of a regulatory control period.

## 3. Preparing and submitting a cost allocation method

### 3.1 DNSP to develop proposed cost allocation method

- (a) Each *DNSP* must develop a proposed *Cost Allocation Method* for submission to the *AER* in accordance with the requirements of these *Guidelines*.
- (b) The proposed *Cost Allocation Method* must give effect to, and be consistent with, these *Guidelines*.

### 3.2 Format and contents of cost allocation method

- (a) A *DNSP's* proposed *Cost Allocation Method* must include the following information:
  - (1) A version number;
  - (2) The *DNSP's* commitment to history and date of issue for the document;
  - (3) A statement of the nature, scope and purpose of the document and the way in which it is to be used by the *DNSP*;
    - A. Details of the accountabilities within the *DNSP* for implementing the *Cost Allocation Method*; and
    - B. Responsibilities within the *DNSP* for updating, maintaining and applying the *Cost Allocation Method* and for internally monitoring and reporting on its application.
  - (4) A description of the *DNSP's* corporate and operational structure in order to enable the *AER* to understand how the *DNSP* is organised to provide its *distribution services*;
  - (5) A specification of the categories of *distribution services* that the *DNSP* provides to which costs are to be attributed or allocated and the types of persons to whom those services are provided;
  - (6) The *DNSP's* detailed principles and policies to be used for attributing costs directly to, or allocating costs between, categories of *distribution 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 *related party transactions*;
  - (7) A description of how the *DNSP* will maintain records of the attribution or allocation of costs to, or between, categories of *distribution services* in order 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.
- (8) A description of how the *DNISP* will monitor its compliance with the *Cost Allocation Method* and these *Guidelines*;
  - (9) Details of the proposed date on which the *Cost Allocation Method* will commence, having regard for clause 4.1(d) of these *Guidelines*; and
- (b) A *DNISP* must submit its proposed *Cost Allocation Method* to the *AER* in both electronic and printed form. Before doing so, a *DNISP* must ensure that its submission can be transmitted in an electronic format that is compatible with the *AER's* information systems.

### **3.3 Timing for submission of cost allocation method**

Subject to the transitional provisions, a *DNISP* is required under clause 6.15.4(a) to:

- (a) submit to the *AER* for its approval a document setting out its proposed *Cost Allocation Method*:
  - (1) within 12 months after the commencement of the Rules; or
  - (2) in the case of an entity that is not a *DNISP* more than 6 months after the commencement of the Rules, within 6 months of being required to do so by the *AER*.

## 4. Approving or rejecting a proposed cost allocation method

### 4.1 AER's assessment of proposed cost allocation method

- (a) The *AER* will approve or refuse to approve a *DNSP's* proposed *Cost Allocation Method* having regard to whether the proposed *Cost Allocation Method* gives effect to, and is consistent with, these *Guidelines*.
- (b) If, in accordance with clause 6.15.4(c) of the *NER*, the *AER* refuses to approve a *DNSP's* proposed *Cost Allocation Method* then the *AER* will notify the relevant *DNSP* and provide reasons for its decision.
- (c) If, in accordance with clause 6.15.4(e) of the *NER*, the *AER* amends a *DNSP's* proposed *Cost Allocation Method* after consulting with the relevant *DNSP* then the *AER* will provide reasons for its decision.
- (d) The *AER* may make its approval of a *DNSP's Cost Allocation Method* conditional on:
  - (1) The *Cost Allocation Method* either taking effect immediately upon approval or at some future date determined by the *AER*; and
  - (2) A defined basis for the relevant *DNSP* transitioning between its existing cost allocation arrangements and those set out in the approved *Cost Allocation Method* so that the *DNSP's* actual and forecast costs can be compared over time.
- (e) Subject to Clause 6.15.4(d) of the *NER*, the *AER* must approve or refuse the cost allocation method within 6 months of its submission, failing which the *AER* will be taken to have approved it.

### 4.2 Amending approved cost allocation method

- (a) A *DNSP* can only amend its approved *Cost Allocation Method* under clause 6.15.4(f) if:
  - (1) The *DNSP* applies in writing to the *AER* to make such an amendment; and
  - (2) The *AER* issues written approval of the amendment.
- (b) If a *DNSP* makes an application to the *AER* to amend its *Cost Allocation Method* and the *AER* does not explicitly approve the amended *Cost Allocation Method* within 6 months the amended *Cost Allocation Method* will be deemed to be approved.
- (c) Subject to clause 4.2(b), the *AER* will only approve a *DNSP's* request to amend its *Cost Allocation Method* if the *DNSP* can demonstrate to the *AER* that:



- (1) There has been a *material* change in the *DNSP'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 *DNSP* to the *AER*.
  - (5) The *DNSP* can quantify and demonstrate to the *AER* the impact of the proposed amendment.
- (d) An amended *Cost Allocation Method* can only take effect from the start of a new regulatory year or such other date as agreed with the *AER*.
  - (e) A *DNSP* can only make an application to amend its *Cost Allocation Method* prior to the start of the regulatory year in which the amendment will take effect.
  - (f) The *AER* may make its approval to amend a *DNSP's Cost Allocation Method* conditional on the relevant *DNSP* restating its historic or forecast financial information on a basis consistent with the amended *Cost Allocation Method*.
  - (g) A *DNSP* must amend its approved *Cost Allocation Method* if the *AER* requires it to do so under clause 6.15.4(g) of the *NER*.

### **4.3 Reviewing approved cost allocation method**

The *AER*, in consultation with the *DNSP*, will review the *DNSP's Cost Allocation Method* as part of each distribution determination for the relevant *DNSP*.

## 5. Applying cost allocation method

### 5.1 Obligation to apply cost allocation method

- (a) In accordance with clause 6.15.1 of the *NER*, a *DNISP* must comply with the *Cost Allocation Method* that has been approved from time to time by the *AER* in respect of that *DNISP*.
- (b) Without limiting the application of the *Cost Allocation Method*, a *DNISP* is to apply its *Cost Allocation Method* in preparing:
  - (1) Forecast operating expenditure to be submitted to the *AER* in accordance with clause 6.5.6;
  - (2) Forecast capital expenditure to be submitted to the *AER* in accordance with clause 6.5.7;
  - (3) Prices for a negotiated distribution service determined in accordance with clause 6.7.1;
  - (4) Annual statements in accordance with a future *regulatory information instrument*; and
  - (5) Actual or estimated capital expenditure for the purposes of increasing the value of its regulatory asset base under *NER* schedule 6.2.1(f).

### 5.2 Demonstrating application of cost allocation method

- (a) A *DNISP* must submit a supporting work paper to the *AER* whenever it provides financial information to the *AER* that has been prepared by applying the *Cost Allocation Method*, if requested by the *AER*.
- (b) The supporting work paper must:
  - (1) Demonstrate how the *DNISP* has applied the detailed principles and policies in its approved *Cost Allocation Method*;
  - (2) Provide details of the numeric quantity or percentage of the allocator, or allocators, applied to each cost item; and
  - (3) Provide an explanation of how the numeric quantity or percentage of each allocator has been calculated for each cost item, including where the data for determining the numeric quantity or percentage have been sourced.

### **5.3 Assurance requirements regarding the application of cost allocation method**

- (a) Where the *AER* requests a review to be performed of financial information that has been prepared by applying a *DNSP's* approved *Cost Allocation Method*, the scope of that review or the form of independent assurance must include an assessment of whether a sample of allocations of shared costs accords with the *DNSP's* approved *Cost Allocation Method*. Details of assurance requirements will be placed in future *regulatory information instruments*.

### **5.4 Publication of cost allocation method**

In accordance with the requirement of clause 6.15.4(h), a *DNSP* must maintain a current copy of its approved *Cost Allocation Method* on its website.

## 6. Glossary

**auditor** means a registered company auditor independent of a *DNSP*.

**Australian Energy Markets Commission** or **AEMC** has the meaning set out in the *National Electricity Law*.

**Australian Energy Regulator** or **AER** has the meaning set out in the *National Electricity Law*.

**Australian Accounting Standards Board** is the body established under subsection 226(1) of the Australian Securities and Investments Commission Act 1989 which is continued in existence by section 261 of Australian Securities and Investments Commission Act 2001.

**avoided cost** is a cost that a *DNSP* would avoid incurring by virtue of taking an alternative course of action.

**directly attributable** or **directly attributed**. An item is directly attributable or directly attributed to an object such as a business segment of a *DNSP*, if it is wholly and exclusively associated with that segment.

**direct costs** are those costs that can be *directly attributed* to the provision of a particular category of *distribution services*.

**Guidelines** means these *Cost Allocation Guidelines*.

**immaterial** means not *material*.

**material** or **materiality**. An item is material if its omission, misstatement or non-disclosure has the potential to prejudice the understanding of the financial position of the *DNSP*, gained by an assessment of financial information relating to the *DNSP*.

**National Electricity Law** means the *National Electricity Law* set out in schedule to the National Electricity (South Australia) Act 1996.

**National Electricity Rules or NER** means the rules, as defined in the *National Electricity Law*.

A **non-causal** or **non-causation, basis or relationship** in relation to a basis of allocation, is one that is other than a *causal or causation, basis or relationship*.

**regulatory accounting period** means a period on which a single set of regulatory financial statements report.

**shared costs** are those costs that cannot be *directly attributed* to the provision of a particular category of *distribution services* but which are allocated between different categories of *distribution services*.



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Inquiries concerning the currency of these guidelines should be addressed to:

Australian Energy Regulator  
GPO Box 520  
Melbourne VIC 3001  
Ph: (03) 9290 1444  
Fax: (03) 9290 1457  
Email: [AERInquiry@aer.gov.au](mailto:AERInquiry@aer.gov.au)

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# 1. Nature and authority

## 1.1 Introduction

These Guidelines set out arrangements to manage the attribution of direct costs and the allocation of shared costs by Victorian *Distribution Network Service Providers* (*DNSPs*) between different categories of *distribution services*.

## 1.2 Authority

Clause 6.15.3(a) of the *National Electricity Rules* (*NER*) requires the *AER* to make, in accordance with the distribution consultation procedures, *Cost Allocation Guidelines* (*Guidelines*) relating to the preparation by a *DNSP* of its *Cost Allocation Method*.

Under Clause 11.17.5(a) of the *NER*, Victorian *DNSPs* must submit their proposed *Cost Allocation Method* together with their building block proposal.

Clause 11.17.5(d) of the *NER* states that the *AER*:

- (a) Must, in deciding whether to approve a *Cost Allocation Method* submitted by a Victorian *DNSP*, have regard to previous cost allocation in accordance with the *ESC* distribution pricing determination;
- (b) Must not approve the *Cost Allocation Method* unless it allows effective comparison of historical and forecast cost allocation between the period to which the *ESC* distribution pricing determination applies and later *regulatory control periods*; and
- (c) May, subject to the relevant *Guidelines*, refuse to approve the *Cost Allocation Method* if it differs from the method previously used by the Victorian *DNSP*.

## 1.3 Role of these guidelines

The role of these *Guidelines* is to detail the basis for:

- (a) A Victorian *DNSP* preparing and submitting its proposed *Cost Allocation Method* to the *AER* for approval;
- (b) The *AER* approving or rejecting a Victorian *DNSP's* proposed *Cost Allocation Method* or approving or rejecting a Victorian *DNSP's* amended *Cost Allocation Method*;
- (c) Amending and reviewing a Victorian *DNSP's* approved *Cost Allocation Method* from time to time; and
- (d) A Victorian *DNSP* applying its *Cost Allocation Method*.

## **1.4 Relationship between these guidelines, cost allocation method and the *NER***

- (a) Victorian *DNSPs* must develop a proposed *Cost Allocation Method* for submission to the *AER* in accordance with the requirements of these *Guidelines*.
- (b) The *Cost Allocation Method* approved by the *AER* must be used by the relevant *DNSP* for the purposes of allocating costs in accordance with the requirements of the *NER*.
- (c) The *AER* will monitor, report on and enforce compliance with the *DNSP's Cost Allocation Method* in accordance with the requirements of the *NER*.

## **1.5 Confidentiality**

The *AER's* obligations regarding confidentiality and the disclosure of information provided to it by a *DNSP* are governed by the *Trade Practices Act 1974*, the *National Electricity Law* and the *NER*.

## **1.6 Definitions and interpretation**

- (a) In these *Guidelines*:
  - (1) The words and phrases presented in italics *such as this* are defined in the Glossary of these *Guidelines* and have the meaning given to them in:
    - A. The Glossary; or
    - B. If not defined in the Glossary, the *NER*;
  - (2) The words 'shall' and 'must' indicate mandatory requirements, unless the overall meaning of the phrase in which one of these words appears, is otherwise.
- (b) Explanations in these *Guidelines* about why certain information is required are provided for guidance only. They do not limit in any way the *AER's* objectives, functions or powers.
- (c) These *Guidelines* apply specifically to Victorian *DNSPs* and any further reference made to *DNSPs* in this document applies to Victorian *DNSPs* exclusively.

## **1.7 Processes for revision**

The *AER* may amend or replace these *Guidelines* from time to time to meet changing needs, in accordance with clause 6.15.3(d) of Chapter 6 of the *NER* and the *distribution consultation procedures*.

## **1.8 Version history and effective date**

A version number and an effective date of issue will identify every version of these *Guidelines*.

## 2. Principles and policies for attributing and allocating costs

### 2.1 Developing principles and policies

Each *DNSP* is responsible for developing the detailed principles and policies for attributing costs to, or allocating costs between the categories of *distribution services* that it provides. These detailed principles and policies must be included in the proposed *Cost Allocation Method* that the *DNSP* submits to the *AER* for approval.

Promoting these principles is the primary purpose of these *Guidelines* which is to ensure that only efficient costs are allocated to different services and that the prices paid by end customers for these services are not inappropriately inflated or discounted.

However, to give effect to the national electricity objective the *Guidelines* promote transparency in:

- The information provided by the regulated business, so that the *AER* can adequately understand the business that it is regulating; and
- The decisions made by the *AER*.

### 2.2 Requirements of *DNSP*'s principles and policies

A *DNSP*'s detailed principles and policies for attributing costs directly to, or allocating costs between categories of *distribution services* must meet the following requirements. These requirements give effect to, and are consistent with, the *Cost Allocation Principles*.

#### 2.2.1 Detailed principles and policies

- (a) A *DNSP*'s detailed principles and policies for attributing costs directly to, or allocating costs between categories of *distribution services* must be sufficiently detailed to enable:
  - (1) The *AER* to replicate the reported outcomes through the application of those principles and policies; and
  - (2) The *DNSP* to demonstrate that it is meeting the requirements of these *Guidelines*.
- (b) Without limiting the generality of section 2.2.1(a), a *DNSP*'s detailed principles and policies must specify:
  - (1) for *directly attributable* costs:
    - A. the nature of each cost item;

- B. the category of *distribution services* to which the cost item is to be *directly attributed*;
  - C. the characteristics of the cost item that associate it uniquely with a particular category of *distribution service* in order to make it a directly attributable cost; and
  - D. how and where records will be maintained to enable the basis of attribution to be audited or otherwise verified by a third party, including the *AER*.
- (2) For *shared costs*:
- A. the nature of each cost item;
  - B. the categories of *distribution services* between which each cost item is to be allocated;
  - C. the nature of the allocator, or allocators, to be used for allocating each cost item;
  - D. the reasons for selecting the allocator, or allocators, for each cost item and an explanation of why it is the most appropriate available allocator, or set of allocators, for the cost item;
  - E. whether the numeric quantity or percentage of the allocator, or allocators, to be applied for each cost item will:
    - i. Remain unchanged over the *regulatory control period*; or
    - ii. Change from time to time throughout the *regulatory control period*.
  - F. if clause 2.2.1(b)(2)E(i) applies:
    - i. Details of the numeric quantity or percentage of the allocator, or allocators; and
    - ii. An explanation of how the numeric quantity or percentage has been calculated, including where the data for determining this numeric quantity or percentage have been sourced.
  - G. if clause 2.2.1(b)(2)E(ii) applies, an explanation of how the *DNISP* intends to calculate the numeric quantity or percentage throughout the *regulatory control period*, including where the data for determining the changing numeric quantities or percentages are to be sourced; and
  - H. how and where records will be maintained to enable the allocation to be audited or otherwise verified by a third party, including the *AER*.

### 2.2.2 Substance over legal form

- (a) A *DNISP* shall attribute costs directly to, or allocate costs between categories of *distribution services* based on the substance of the underlying transaction or event.
- (b) Where the substance and legal form<sup>2</sup> differ, the substance rather than the legal form of a transaction or event shall be used as the basis of cost attribution or allocation.
- (c) In determining the substance of a transaction or event, all of its aspects and implications shall be considered, including the expectations of and motivations for, the transaction or event.
- (d) For the purposes of determining the substance of a transaction or event, a group or series of transactions or events that achieves, or is designed to achieve, an overall commercial effect shall be viewed in aggregate.

### 2.2.3 Attribution of direct costs

- (a) In accordance with the requirements of clause 6.15.2(3)(i) of chapter 6, only costs that are *directly attributable* to the provision of a particular category of *distribution services* may be *directly attributed* to that category of services.
- (b) A cost may be *directly attributable* to a *DNISP* but not *directly attributable* to a particular category of *distribution services* provided by the *DNISP*. In this circumstance, the allocation of costs between categories of *distribution services* may only be made in accordance with clause 2.2.4 of these *Guidelines*.

### 2.2.4 Allocation of shared costs

- (a) In accordance with the requirements of clause 6.15.2(3)(ii), *shared costs* incurred in providing several categories of *distribution services* must be allocated between those categories using an appropriate *causal* allocator, except to the extent that:
  - (1) The *shared costs* are *immaterial*; or
  - (2) A *causal relationship* cannot be established without undue cost and effort.
- (b) For the avoidance of doubt, a *DNISP* must allocate its *shared costs*:
  - (1) Between the categories of *distribution services* that it provides; and
  - (2) Within the different types of negotiated distribution services that it provides for the purposes of determining its prices for these services in accordance with clause 6.7.1(1).

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<sup>2</sup> Substance over form emphasises the economic substance of an event even though its legal form may provide a different result.

- (c) If a *shared cost* is *immaterial* or a *causal relationship* cannot be established without undue cost and effort then the *DNISP* may allocate the *shared cost* to a particular category of *distribution services* using a *non-causal* allocator provided that:
- (1) The *non-causal* allocator accords with an *AER* approved *Cost Allocation Method*;
  - (2) The *non-causal* basis of allocation is approved in writing by the *AER*; and
  - (3) The *DNISP* provides a supporting work paper to the *AER* documenting for each such *shared cost*:
    - A. The basis of allocation;
    - B. The reason chosen for that basis;
    - C. A demonstration that the *shared cost* is *immaterial* or an explanation of why no *causal relationship* could be established without undue cost or effort; and
    - D. A numeric quantity or percentage of the *non-causal* allocator applied to each category of *distribution service* and in total.
- (d) The bases of *non-causal* allocation will be subject to review by the *AER*. The *AER* expects only to accept a *non-causal basis* of allocation if the *DNISP* can demonstrate that there is likely to be 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.
- (e) A *DNISP* is not permitted to allocate *shared costs* using an *avoided cost* approach without prior approval by the *AER*.

### **2.2.5 No double-counting of shared costs**

- (a) A *DNISP* must not allocate the same cost more than once.
- (b) For the avoidance of doubt, clause 2.2.5(a) means that:
  - (1) The same cost may not be treated as both a *direct cost* and a *shared cost*;
  - (2) A *direct cost* may only be attributed once to a single category of *distribution services*;
  - (3) A *shared cost* may only be allocated once between categories of *distribution services*; and
  - (4) A *DNISP* may only recover the same cost once through the charges that it levies for its *distribution services*.



### **2.2.6 Consistency with distribution ring-fencing guidelines**

The detailed principles, policies and approach that a *DNSP* uses to attribute costs directly to, or to allocate costs between categories of *distribution services* must be consistent with clause 6.17 of the *NER*.

### **2.2.7 Reallocation of costs between categories of distribution services**

Costs that have been attributed or allocated to *distribution services* must not be reattributed or reallocated to another service during the course of a regulatory control period.

### **2.2.8 Consistency with previous cost allocation methods**

A *DNSP's Cost Allocation Method* must:

- (a) Have regard to previous cost allocation methods in accordance with the *ESC* distribution pricing determination; and
- (b) Allow for effective comparison of historical and forecast cost allocation between the period to which the *ESC* distribution pricing determination applies and later regulatory control periods.

## 3. Preparing and submitting a cost allocation method

### 3.1 DNSP to develop proposed cost allocation method

- (a) Each *DNSP* must develop a proposed *Cost Allocation Method* for submission to the *AER* in accordance with the requirements of these *Guidelines*.
- (b) The proposed *Cost Allocation Method* must give effect to, and be consistent with, these *Guidelines*.

### 3.2 Format and contents of cost allocation method

- (a) A *DNSP's* proposed *Cost Allocation Method* must include the following information:
  - (1) A version history and date of issue for the document;
  - (2) A statement of the nature, scope and purpose of the document and the way in which it is to be used by the *DNSP*;
  - (3) Details of the accountabilities within the *DNSP* for the document in order to set out clearly:
    - A. the *DNSP's* commitment to implementing the *Cost Allocation Method*; and
    - B. responsibilities within the *DNSP* for updating, maintaining and applying the *Cost Allocation Method* and for internally monitoring and reporting on its application.
  - (4) A description of the *DNSP's* corporate and operational structure in order to enable the *AER* to understand how the *DNSP* is organised to provide its *distribution services*;
  - (5) A specification of the categories of *distribution services* that the *DNSP* provides to which costs are to be attributed or allocated and the types of persons to whom those services are provided;
  - (6) The *DNSP's* detailed principles and policies to be used for attributing costs directly to, or allocating costs between, categories of *distribution 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 *related party transactions*;
  - (7) A description of how the *DNSP* will maintain records of the attribution or allocation of costs to, or between, categories of *distribution services* in order 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.
- (8) A description of how the *DNISP* will monitor its compliance with the *Cost Allocation Method* and these *Guidelines*;
- (9) Details of the proposed date on which the *Cost Allocation Method* will commence, having regard to clause 4.1(d) of these *Guidelines*; and
- (b) A *DNISP* must submit its proposed *Cost Allocation Method* to the *AER* in both electronic and printed form. Before doing so, a *DNISP* must ensure that its submission can be transmitted in an electronic format that is compatible with the *AER*'s information systems.

### **3.3 Timing for submission of cost allocation method**

Each *DNISP* is required under clause 11.17.5 of the *NER* to submit to the *AER* for its approval a document setting out its proposed *Cost Allocation Method* together with the first building block proposal after the commencement Chapter 6 of the *NER*. The *building block proposal* is part of a *regulatory proposal* (clause 6.8.2(c)(2)) which must be submitted (in accordance with clause 6.8.2(b) of the *NER*):

- (a) at least 13 months before the expiry of a distribution determination that applies to the service provider; or
- (b) if no distribution determination applies to the service provider, within 3 months after being required to do so by the *AER*.

## **4. Approving or rejecting proposed cost allocation method**

### **4.1 AER's assessment of proposed cost allocation method**

- (a) The *AER* will approve or refuse to approve a *DNISP's* proposed *Cost Allocation Method* having regard to whether:
  - (1) The proposed *Cost Allocation Method* gives effect to, and is consistent with, these *Guidelines*; and
  - (2) The proposed *Cost Allocation Method* satisfies clause 11.17.5(d) by allowing for effective comparison of historical and forecast cost allocation between the period to which the *ESC* distribution pricing determination applies and later regulatory control periods.
- (b) If, in accordance with clause 6.15.4(c), the *AER* refuses to approve a *DNISP's* proposed *Cost Allocation Method* then the *AER* will notify the relevant *DNISP* and provide reasons for its decision.
- (c) If, in accordance with clause 6.15.4(e), the *AER* amends a *DNISP's* proposed *Cost Allocation Method* after consulting with the relevant *DNISP* then the *AER* will provide reasons for its decision.
- (d) The *AER* may make its approval of a *DNISP's Cost Allocation Method* conditional on:
  - (1) the *Cost Allocation Method* either taking effect immediately upon approval or at some future date determined by the *AER*; and
  - (2) a defined basis for the relevant *DNISP* transitioning between its existing cost allocation arrangements and those set out in the approved *Cost Allocation Method* so that the *DNISP's* actual and forecast costs can be compared over time.
- (e) The *AER* may, subject to clause 11.17.5(d)(3) of the *NER*, refuse to approve the *Cost Allocation Method* if it differs from the method previously used by the *DNISP*.
- (f) Subject to Clause 6.15.4(d) of the *NER*, the *AER* must approve or refuse the cost allocation method within 6 months of its submission, failing which the *AER* will be taken to have approved it.

### **4.2 Amending approved cost allocation method**

- (a) A *DNISP* can only amend its approved *Cost Allocation Method* under clause 6.15.4(f) of the *NER* if:

- (1) the *DNISP* applies in writing to the *AER* to make such an amendment; and
  - (2) the *AER* issues written approval of the amendment.
- (b) If a *DNISP* makes an application to the *AER* to amend its *Cost Allocation Method* and the *AER* does not explicitly approve the amended *Cost Allocation Method* within 6 months the amended *Cost Allocation Method* will be deemed to be approved.
- (c) Subject to clause 4.2(b) of these *Guidelines*, the *AER* will only approve a *DNISP*'s request to amend its *Cost Allocation Method* if the *DNISP* can demonstrate to the *AER* that:
- (1) There has been a *material* change in the *DNISP*'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 *DNISP* to the *AER*.
  - (5) The *DNISP* can quantify and demonstrate to the *AER* the impact of the proposed amendment.
- (d) An amended *Cost Allocation Method* can only take effect from the start of a new regulatory year or such other date as agreed with the *AER*.
- (e) A *DNISP* can only make an application to amend its *Cost Allocation Method* prior to the start of the regulatory year in which the amendment will take effect.
- (f) The *AER* may make its approval to amend a *DNISP*'s *Cost Allocation Method* conditional on the relevant *DNISP* restating its historic or forecast financial information on a basis consistent with the amended *Cost Allocation Method*.
- (g) A *DNISP* must amend its approved *Cost Allocation Method* if the *AER* requires it to do so under clause 6.15.4(g) of the *NER*.

### **4.3 Reviewing approved cost allocation method**

The *AER*, in consultation with the *DNISP*, will review the *DNISP*'s *Cost Allocation Method* as part of each revenue determination for the relevant *DNISP*.

## **5. Applying cost allocation method**

### **5.1 Obligation to apply cost allocation method**

- (a) In accordance with clause 6.15.1 of chapter 6 of the *NER*, a *DNSP* must comply with the *Cost Allocation Method* that has been approved from time to time by the *AER* in respect of that *DNSP*.
- (b) Without limiting the application of the *Cost Allocation Method*, a *DNSP* is to apply its *Cost Allocation Method* in preparing:
  - (1) forecast operating expenditure to be submitted to the *AER* in accordance with clause 6.5.6;
  - (2) forecast capital expenditure to be submitted to the *AER* in accordance with clause 6.5.7;
  - (3) prices for a *negotiated distribution service* determined in accordance with clause 6.7.1;
  - (4) Annual statements in accordance with a future *regulatory information instrument*; and
  - (5) actual or estimated capital expenditure for the purposes of increasing the value of its regulatory asset base under schedule 6.2.1(f).

### **5.2 Demonstrating application of cost allocation method**

- (a) A *DNSP* must submit a supporting work paper to the *AER* whenever it provides financial information to the *AER* that has been prepared by applying the *Cost Allocation Method*, if requested by the *AER*.
- (b) The supporting work paper must:
  - (1) demonstrate how the *DNSP* has applied the detailed principles and policies in its approved *Cost Allocation Method*;
  - (2) provide details of the numeric quantity or percentage of the allocator, or allocators, applied to each cost item; and
  - (3) provide an explanation of how the numeric quantity or percentage of each allocator has been calculated for each cost item, including where the data for determining the numeric quantity or percentage have been sourced.

### **5.3 Assurance requirements regarding the application of cost allocation method**

- (b) Where the *AER* requests a review to be performed of financial information that has been prepared by applying a *DNSP's* approved *Cost Allocation Method*, the

scope of that review or the form of independent assurance must include an assessment of whether a sample of allocations of shared costs accords with the *DNSP's* approved *Cost Allocation Method*. Details of assurance requirements will be placed in future *regulatory information instruments*.

#### **5.4 Publication of cost allocation method**

In accordance with the requirement of clause 6.15.4(h), a *DNSP* must maintain a current copy of its approved *Cost Allocation Method* on its website.

## 6. Glossary

**auditor** means a registered company auditor independent of a *DN*SP.

**Australian Energy Markets Commission** or **AEMC** has the meaning set out in the *National Electricity Law*.

**Australian Energy Regulator** or **AER** has the meaning set out in the *National Electricity Law*.

**Australian Accounting Standards Board** is the body established under subsection 226(1) of the Australian Securities and Investments Commission Act 1989 which is continued in existence by section 261 of Australian Securities and Investments Commission Act 2001.

**avoided cost** is a cost that a *DN*SP would avoid incurring by virtue of taking an alternative course of action.

**directly attributable** or **directly attributed**. An item is directly attributable or directly attributed to an object such as a business segment of a *DN*SP, if it is wholly and exclusively associated with that segment.

**direct costs** are those costs that can be *directly attributed* to the provision of a particular category of *distribution services*.

**Essential Services Commission** or **ESC** is the body established under Essential Services Commission Act 2001, Part 2, Section 7.

**Guidelines** means these *Cost Allocation Guidelines*.

**immaterial** means not *material*.

**material** or **materiality**. An item is material if its omission, misstatement or non-disclosure has the potential to prejudice the understanding of the financial position of the *DN*SP, gained by an assessment of financial information relating to the *DN*SP.

**National Electricity Law** means the *National Electricity Law* set out in schedule to the National Electricity (South Australia) Act 1996.

**National Electricity Rules** means the rules, as defined in the *National Electricity Law*.

A **non-causal** or **non-causation, basis or relationship** in relation to a basis of allocation, is one that is other than a *causal or causation, basis or relationship*.

**regulatory accounting period** means a period on which a single set of regulatory financial statements report.

**shared costs** are those costs that cannot be *directly attributed* to the provision of a particular category of *distribution services* but which are allocated between different categories of *distribution services*.