

14 March 2013



Australian Energy Market Commission
P O Box A2449
Sydney South NSW 1235

positive energy

Re: Consultation Paper – Changes to Cost Allocation Method ERC0150

Energex welcomes the opportunity to respond to the Australian Energy Market Commission's (AEMC) Consultation Paper on the rule change request from Trans Tasman Energy Group (TTEG).

Energex does not support the changes proposed by TTEG. The issues and concerns are summarised below:

- Energex questions the appropriateness and timing of the proposed rule change by TTEG. The Australian Energy Regulator (AER) is currently undertaking a large work program (Better Regulation) in response to the recent changes to Chapter 6 of the National Electricity Rules (NER). Prior to the NER changing there were opportunities for TTEG to propose changes to the NER. If the proposed changes by TTEG were implemented, then the AER would have to make further changes to accommodate for this.
- The distribution network service providers' (DNSP) cost allocation method (CAM) is prepared in accordance with the AER's cost allocation guidelines which are subject to extensive consultation. The DNSP's approved CAM is then published on both the AER and DNSP's websites. Energex believes that this is the appropriate level of consultation and information for stakeholders.
- Energex believes that publishing numeric values in the CAM may compromise the commercial position of those businesses that also provide non regulated services within a competitive market, particularly where competitors not subject to similar transparency.
- The CAM is business specific and provided it complies with the Guideline, as assessed by the AER, there is no clear economic or performance benefit arising from consultation on specific business structures and operations.
- Energex is not able to reconcile the additional regulatory and compliance costs that would be incurred by all parties under the proposed changes against the potential benefits, not including the potential access to commercially sensitive information.

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- The CAM currently provides details on the methodology of how the DNSP allocates costs. This allows the CAM to operate from year to year with no requirement for annual review or modification. Any inclusion of numeric values for cost allocators would result in the CAM being subject to review periodically resulting in an inefficient burden for the AER and the DNSP with questionable benefits for customers.

The responses to the specific questions raised in the AEMC's consultation paper are included in Attachment 1. If any further information is required, please contact Shirley Paxton on (07) 3664 4912.

Yours sincerely

A handwritten signature in black ink that reads "Kevin Kehl". The signature is written in a cursive, slightly slanted style.

Kevin Kehl
Executive General Manager
Customer and Corporate Relations

Attachment 1

Attachment 1

Question 1 Is the assessment framework presented in this consultation paper appropriate for assessing this rule change request?

In general, Energex regards the criteria presented in the assessment framework as appropriate for assessing the rule change requested by Trans Tasman Energy Group. Energex considers that the framework could be strengthened with the addition of the criterion 'improved information for decision making'.

Energex considers that it is not appropriate for an individual distribution network service provider (DNSP)'s cost allocation method (CAM) to be subject to the distribution consultation procedures (Part G). Energex believes Part G is designed to apply to the AER's guidelines, methodologies, models, schemes, or tests.

An individual DNSP's CAM sets out the detailed principles and policies for attributing direct costs and allocation of indirect costs across a range of services, both regulated and unregulated. Allocation of indirect costs requires detailed business knowledge as well as specialised system knowledge which stakeholders may not possess. These allocations also impact the commercial viability of non regulated services, and are therefore commercial in confidence.

Accordingly, Energex considers that the methodology is a business decision and not appropriate for public consultation.

Question 2 How often is the cost allocation method likely to change? What are the costs for stakeholders, including the AER, of public consultation for a change in the cost allocation method?

Energex is of the view that once a cost allocation method is set for the regulatory control period, there will be minimal likelihood of change as amendments to the individual DNSP's CAM will require not only approval from the AER but also changes to the DNSP's system processes and policies.

If Energex changed the methodology regarding how costs are allocated then the CAM would need to be updated and approved by the AER, in line with the CAM guidelines. For example Energex currently allocates overheads based on direct spend. If overheads were to be allocated based on a different allocator (i.e. labour hours), this would be a change in methodology, and hence a need for the CAM to be updated.

Depending on the individual DNSP's CAM, a company may estimate overhead allocation rates to be applied at the beginning of the year, with a true up of actual expenditure to occur periodically during the year to reflect actual costs. Whilst this may result in a change in allocated dollars, this is not a change in the methodology.

The cost allocation method may change however, if there are amendments to either:

- the cost allocation guidelines (NER 6.15.3); or
- the cost allocation principles (NER 6.15.2).

Amendments to either the guidelines or principles will require reflection in the DNSP's CAM as it is developed in accordance with the AER's cost allocation

guidelines. The CAM guidelines are required to give effect to the cost allocation principles in the rules.

Requiring public consultation for changes to the CAM will increase costs significantly for the DNSP as well as the AER without any demonstrated benefit to consumers or furtherance of the National Electricity Objective.

In addition the complexities and differences in cost allocation methodologies of distributors will require additional resources in the process for:

- the issuance of explanatory statements;
- the understanding of differences between DNSP's methodologies; and
- the summation and provision of response to each issue.

Accordingly, the greater the number of stakeholders involved the greater requirement for time and resources in the process which significantly increases compliance costs. This would be an unnecessary regulatory burden and inefficient for the DNSP.

Energex does not believe there are any additional benefits of requiring the DNSP CAM to be subject to the distribution consultation procedures. The Cost Allocation guidelines prepared by the AER set out the fundamental framework and principles for a DNSP CAM and are subject to public consultation. The DNSP's CAM must comply with the AER guidelines.

Question 3 What information is included in the cost allocation method in practice? How does this differ between DNSPs? Is comparability of cost allocation methods between DNSPs relevant to the negotiation framework? What is the cost of providing more detailed information of allocators?

The minimum requirements for a DNSP's CAM are set out in clause 3.2 of the AER's Cost Allocation Guidelines. The clause specifies the format and content to be included in the CAM document. This includes the following:

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;
4. A description of the DNSP's corporate and operational structure;
5. A specification of distribution services and the types of persons whom services are provided to;
6. Principles and policies to be used for allocating costs;
7. A description of how the DNSP will maintain records;
8. A description of how the DNSP will monitor its compliance of the CAM; and
9. Proposed date on which the CAM will commence.

DNSPs may also include additional information in their cost allocation methodology to provide better understanding.

Differences between DNSPs will exist due to:

- The basis on which costs (direct, indirect) are allocated (e.g. relative costs of underlying activities, revenue or some other indicator of activity levels such as labour hours etc);
- The type and level of services offered;

- How the services have been classified (e.g. SCS, ACS or unregulated); and
- The level of detail included in the cost allocation method.

Energex does not believe that comparability of cost allocation methods between DNSPs is relevant to the negotiation framework as it is an internal business decision.

Energex believes that there will be additional costs if more detailed information on allocators and values is to be provided and questions what benefit this information has. If detailed cost allocators and values are required to be included in the cost allocation method, it is likely that the DNSP will need to update their cost allocation method on a regular basis (at least annually) to reflect current values rather than only when there is a change in actual methodology. This would mean additional costs to both the AER who needs to approve the CAM and the DNSP in terms of additional time and resources.

Question 4 Are the problems that the proponent identified also present in the transmission frameworks for cost allocation method of negotiated services?

Energex is a distribution network service provider and does not consider it appropriate to comment on any transmission related issues.

Question 5 Is additional consultation required? Are the Distribution Consultation Procedures an appropriate framework for consultation in the context? Will the AER have sufficient time to adequately consider stakeholder views with the consultation procedures? Will consultation delay changes to a cost allocation method?

Energex considers that additional consultation on the CAM is not warranted. The CAM is prepared and approved in accordance with the AER guidelines that are subject to extensive public consultation. Energex believes the relationship between the DNSP's CAM and the AER guidelines provides a sufficient level of public information and any further consultation is not justifiable.

Additionally, in regards to distribution consultation procedures, NER 6.16(b) states the following:

"If the AER is required to comply with the distribution consultation procedures in preparing, making, developing, reviewing, amending or replacing any guidelines, methodologies, models, schemes, or tests, it must publish: (1) the proposed guideline, methodology, model, scheme, test or amendment;"

Energex interprets the intent of the above clause to mean any documents, schemes, tests, etc prepared and produced by the AER are subject to public consultation. Documents and methodologies of the DNSP do not fall within the scope of the clause. Accordingly, as the CAM is produced by the DNSP, Energex does not consider this to be subject to public consultation.

Further clarification is required from the AEMC in regards to the intent of NER 6.16 as it appears Trans Tasman Energy Group interprets a DNSP's CAM to be a methodology subject to the distribution consultation procedures.

Energex does not consider the Distribution Consultation Procedures to be an appropriate framework for cost allocation methods specifically in regards to the timing of processes.

Under the current framework, the AER is required to notify the DNSP of the outcome (approve or refuse to approve) of its cost allocation method within 6 months of submission. Requiring consultation would add at least 30 days to the submission process. In addition after the period for submission has ended, further time would be required for the AER to consider views from stakeholders. Consequently, the deadline of 6 months will likely need to be extended to allow for full public consultation with all the associated processes.

Question 6 Will the inclusion of numeric quantities require more frequent updating of cost allocation methods? Does the proposed solution to include numeric quantities achieve the aim of including sufficient information to replicate costs to be recovered?

The value (e.g. historic, forecast) of allocators (e.g. direct spend) changes regularly as actuals are realised. Updating the actual values attributed by the allocator on an ongoing basis achieves greater precision and more reliable outcomes. Having the requirement that numeric quantities be published in the CAM will result in more frequent updates and therefore an increase in costs with the associated process for CAM approval.

Energex believes the publishing of such values may jeopardise the commercial viability of its non regulated services. As such Energex believes it is inappropriate for stakeholders other than the regulator being able to replicate the cost structures of the DNSP.

Question 7 To what extent do the existing principles influence the negotiation criteria? Is imposing a pricing requirement consistent with the level regulation appropriate for negotiated services?

NER 6.7.4(b) states that:

"The Negotiated Distribution Service Criteria must give effect to and be consistent with the Negotiated Distribution Service Principles set out in clause 6.7.1."

Energex is not in a position to comment on this as Energex currently does not have any negotiated services.

Question 8 If the cost allocation principles are amended are the existing arrangements sufficient to enable compliance? Should transitional arrangements be considered to allow any rule changes to have effect as soon as possible?

Energex is of the view that any changes made to the cost allocation principles will require the AER to consult on a new CAM guideline. Energex believes that new guidelines, models, schemes or tests would not take effect until the next regulatory control period. If this is the case no transitional arrangements would be required.

If a DNSP is required to immediately reflect changes to the CAM guidelines in their own CAM transitional arrangements may result in a change in the revenue requirement set for the current period. The impact on revenue (and consequentially network pricing) may be positive or negative. As such Energex does not believe this uncertainty would be in the best interest of customers.

