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Via online lodgement

Tara D'Souza
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Dear Ms D'Souza

Rule change proposal – Changes to cost allocation method

Jemena Limited (**Jemena**) welcomes the opportunity to respond to the Australian Energy Market Commission's (**AEMC**'s) consultation paper on the changes to cost allocation method (**CAM**) rule change proposal.

Jemena is the owner of Jemena Electricity Networks (Vic) Limited (**JEN**) in Victoria. Jemena also has ownership interests in the United Energy electricity distribution business in Victoria (34%) and the ActewAGL electricity distribution partnership in the ACT (50%). Accordingly, Jemena has a strong interest in the outcome of this consultation.

Jemena considers that allowing for consultation on the CAM would, providing this resulted in no delays to the Australian Energy Regulator's (**AER**) approval process, be consistent with the national electricity objective. We would welcome and value the input of stakeholders. However, Jemena highlights that it is not workable to require numeric quantities of chosen allocators to be included in the CAM. Jemena also believes and that it would not be appropriate to require network service providers (**NSPs**) to base negotiated distribution service charges purely on the costs incurred in providing those services, as this would effectively turn negotiated services into direct control. To the extent that the AER believes that prices for particular services need to be based purely on the costs of provision, the AER could classify those services as direct control.

Jemena expands on these key points below. Responses to individual questions are contained in **Attachment 1**.

Transparency of cost allocation method

Jemena believes that the current process is robust and transparent. Jemena does not believe that requiring CAMs to include numeric allocators is practicable, as this would require annual CAM updates and approvals. In considering the publication of the value of allocators, the AEMC should consider the practicality of annual CAM updates and the checks and balances already provided by the AER RIN process.

The underlying approach in the JEN CAM is to assign direct costs based mainly on activity based costing, cost centre and general ledger account balances and the allocation of shared costs via the use of a *causal based allocator*. The shared costs applicable to JEN are allocated to standard control, alternative control, negotiated distribution services and unregulated services based on the proportion of direct costs for each service category to total direct costs. These direct costs necessarily vary annually.

The rule change proposal suggests that the published CAM should include the value of allocators to facilitate effective negotiation of prices under Part D of the NER. Jemena does not oppose disclosing the value of the allocators at the time the CAM is approved. However, by their nature allocators will change annually due to changes in the proportion of direct costs to each service category. For example, connection of embedded generation is a direct cost, which can be attributed to negotiated services. Regulatory years in which relatively high volumes of embedded generation are connected would, all else equal, lead to a higher allocator percentage for negotiated services.

Due to the changing make up of direct costs, it is not possible or preferable to keep allocators fixed for five years. Further, it would be impractical to alter the CAM annually to update the allocators and seek new approval from the AER each time.

Instead, the AER has served a regulatory information notice (RIN) upon NSPs that requires the annual disclosure of the information (direct costs) from which allocators are derived, as well as a full break down of all costs by service classification. The NSP annual RIN responses are audited for compliance with the CAM, and to ensure they allocate costs in accordance with the CAM. This provides the necessary checks and balances to ensure NSPs only allocate costs to negotiated services where this is appropriate and to ensure costs are not allocated more than once. If a customer suspects that costs are not being allocated appropriately, it could raise this with the AER as a potential non-compliance with a NSP's negotiating framework and/or CAM.

Principles to establish negotiated prices

Jemena does not consider it appropriate to mandate that NSPs must base negotiated distribution service charges purely on the costs incurred in providing those services. Services that warrant 'cost plus' pricing, should be appropriately classified as direct control services. That is, as either alternative control services or standard control services.

The concept of a negotiated service is that, by its nature, the service is beyond the scope of an 'essential service' and is being provided in an environment where the purchaser has material countervailing power. The NSP needs an incentive to provide this value-added service and it is up to the NSP to figure out what is the level of a sufficient incentive. The AER approves the negotiation process and, provided the parties negotiate in good faith, no inefficiencies should arise. Given such services are not an 'essential service', there is no requirement that parties must agree.

In JEN's case, only two types of services were classified by the AER as being negotiated services:

- Alteration and relocation of DNSP public lighting assets
- New public lighting assets (that is, new lighting types not subject to a regulated charge and new public lighting at Greenfield sites).

The first service deals with a very rare scenario where a third party would prefer for a DNSP to relocate its existing assets elsewhere for the convenience of that third party. This is not an essential service and, given that this service involves a DNSP's property rights, it is entirely appropriate that the DNSP determine what compensation it requires.

The second service, which is much more substantial by volume, is fully contestable in Victoria. A developer or local council can engage any appropriately qualified and accredited party to install new public lighting assets. Potential installers include the local DNSP, any other DNSP and electrical contractors. Competitive forces ensure that charges for this service are set at efficient levels.

This is in contrast to legacy public lighting assets, which the AER classified as direct control services, establishing prices by lighting type. This made sense, as it would not be economic or efficient for a local council to duplicate existing public lighting infrastructure if it was unhappy with prices charged by the local DNSP.

If you wish to discuss the submission please contact Anton Murashev, Manager Asset Regulation and Strategy on (03) 8544 9036 or at anton.murashev@jemena.com.au

Yours sincerely



Robert McMillan
General Manager Regulation
Jemena Limited

Attachment 1. Jemena response to AEMC questions.

AEMC question	Jemena response
Assessment framework	
1. Is the assessment framework presented in this consultation paper appropriate for assessing this rule change request??	<ul style="list-style-type: none"> • Jemena considers that there should be one important change to the assessment framework: <ul style="list-style-type: none"> ○ Rather than simply considering how the rule change will lead to more efficient prices for negotiated services, the AEMC should also consider whether the proposed change would, in the long-term, lead to more efficient provision of network services. This would enable a better assessment of the rule change against the national electricity objective.
Significance and scope of the problem	
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?	<ul style="list-style-type: none"> • The CAM is unlikely to change frequently over a regulatory period. However, the value of the allocators changes every year due to changes in the underlying drivers of those allocators. • For JEN, allocators change due to changes in the level of direct costs allocated to each of the service categories (i.e. standard control, alternative control, negotiated distribution services and unregulated services).

AEMC question	Jemena response
<p>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?</p>	<p>JEN's CAM includes:</p> <ul style="list-style-type: none"> • A description of how the services are classified; • The organisation and operational structure; • An explanation of the cost allocation principles and policies; • A description of directly attributable costs including a table of cost items, their description, the basis of allocation and the services the direct costs are allocated to. There is also an example of how 'on-costs' are added; • A shared cost summary provides how these are broken down by cost items and the cost relationship with a description of the costs and the services the cost item is allocated to; • A description of the shared costs allocation mechanism explained with an example; • A description of record maintenance and compliance monitoring. <p>JEN has not undertaken a detailed review of other DNSPs' CAMs, however, JEN expects that there is material variability between DNSPs' at the detail level, though the high level principles are likely similar. The variability is reasonable, given the differences in how various DNSPs are structured and how they conduct their business. This is why the NER provide for individual CAMs, rather than mandating a single CAM.</p> <p>JEN does not see how comparability of cost allocation methods is relevant to the negotiation framework. The cost of providing more detailed information on allocators in the CAM is that it would create the need for an annual CAM update and approval process between each distributor and the AER. More importantly, no incremental benefit would be gained, as the current RIN process already ensures compliance with the CAM and proper cost allocation through audits and certifications from company officers to the AER.</p>
<p>4. Are the problems that the proponent identified also present in the transmission frameworks for cost allocation method and negotiated services?</p>	<ul style="list-style-type: none"> • JEN is not involved in providing transmission services.

AEMC question	Jemena response
Assessment of proposed solutions	
<p>5. Is additional consultation required? Are the Distribution Consultation Procedures an appropriate framework for consultation in this 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?</p>	<ul style="list-style-type: none"> JEN does not believe that additional consultation is required. However, JEN does not oppose additional consultation provided it does not slow down or delay the AER approval process for the CAM.
<p>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?</p>	<ul style="list-style-type: none"> See our response in the main body of the letter above. The causal allocator values change annually with none being fixed for the five year regulatory period. This means that, if CAMs had to list numeric allocators, annual CAM updates would be required. A CAM, even with the most up-to-date numeric values, does not provide enough information to replicate the costing calculation. The statutory and regulatory accounts of the business at a detailed level are involved. However, much of this information is commercially sensitive and remains confidential between the DNSP and the AER.

AEMC question	Jemena response
<p>7. To what extent do the existing principles influence the negotiation criteria? Is imposing a pricing requirement consistent with the level of regulation appropriate for negotiated services?</p>	<ul style="list-style-type: none"> • The existing principles are fundamental to the negotiation criteria. JEN's negotiating framework outlines that it will comply with all the Negotiated Distribution Service Principles set out in clause 6.7.1 of the national electricity rules. • In Jemena's view, it is not appropriate to impose a pricing requirement. To consider whether imposing a price requirement is appropriate for negotiated services, it is important to be clear of the difference between negotiated distribution services and direct control services. <ul style="list-style-type: none"> ○ Negotiated distribution services cover services performed directly for customers. For example, in relation to public lighting, JEN deals directly with Councils. The cost of providing negotiated distribution services are recovered by cost negotiation and agreement with the end-user. ○ For JEN, the AER classified the following services as negotiated distribution services: <ul style="list-style-type: none"> ▪ Alteration and relocation of DNSP public lighting assets ▪ New public lighting assets (that is, new lighting types not subject to a regulated charge and new public lighting at Greenfield sites) ○ Direct control services are divided into standard control services and alternative control services. They are undertaken for end-use electricity customers within the geographical boundaries of the network. These end users are themselves customers of various electricity retailers. JEN therefore invoices relevant retailers for the various distribution services provided to these end-users. • Imposing a pricing requirement on negotiated services would be inconsistent with the intent of the national electricity law and national electricity rules as it would effectively turn negotiated services into direct control services.

AEMC question	Jemena response
Implementation requirements	
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?	<ul style="list-style-type: none"><li data-bbox="787 375 1766 399">• Jemena does not consider that changes are required to the cost allocation principles.