# Directlink Interconnector Cost Allocation Methodology

EII Submission to the Australian Energy Regulator

April 2010

## Amendment Record

| Version | Date | Pages |
|---|---|---|
| 01 | 18 April 2008 | 14 |
| 02 | 28 May 2008 | |
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| 06 | 5 April 2010 | 15 |

## Contents

# 1 Introduction

The Directlink asset is owned by the Directlink Joint Venture. The Directlink Joint Venture's ABN is 16 779 340 889. The Directlink Joint Venture is beneficially owned by Energy Infrastructure Investments Pty Limited (EII).

EII is an energy infrastructure investment company which owns electricity interconnectors (including Murraylink), gas fired power generation, coal seam gas processing plants and gas pipelines. EII is owned by:

- Marubeni Corporation (49.9%) – a Japanese Company with businesses across a wide range of industrial sectors internationally. Marubeni has interests in approximately 6,300 MW of generation capacity around the world, including 1,000 MW in Australia, through interests in the Milmerran Power Station in Queensland and the Smithfield Cogeneration Plant in New South Wales;
- Osaka Gas (30.2%) – has energy investments in over 56,000 km of gas transmission and distribution pipelines in Japan and an interest in approximately 5,200 MW of power generation in Japan, USA and Europe; and
- APA Group (19.9%) - APA is a major owner and operator of energy infrastructure in Australia owning over 12,000km of gas transmission pipelines and over 2,500 km of gas distribution networks.

The Directlink asset is operated and maintained by the APA Group under contractual arrangements. The primary contract is the Management, Operations and Maintenance and Commercial Services Agreement (MOMCSA)[1]. Under the MOMCSA, APA provides the following services to EII, at a margin on all relevant costs, in respect of its asset portfolio (refer to Appendix B):

- management, operating and maintenance;
- liaison with third parties;
- administration;
- procurement;
- project work; and

1 The MOMSCA is a seven year contract with the option to extend for a further ten years in the form of two five year increments.

- litigation.

APA also provides commercial services (financial management and reporting, legal and regulatory and project management services) which are provided on a fixed fee basis.

EII is an investment vehicle and as such has no employees.

Directlink is an 180MW capacity High Voltage Direct Current transmission link which interconnects the Queensland and New South Wales AC power grids. Directlink is a bi-directional facility. The link was commissioned in 2000.

Clause 6A 19.4 (a) *National Electricity Rules* (NER) requires the Directlink Joint Venture (the Transmission Network Service Provider) to submit to the Australian Energy Regulator (AER) for its approval a document setting out its proposed cost allocation method to manage the allocation of direct and shared costs to its transmission service.

Directlink's proposed cost allocation methodology has been developed in accordance with the AER's *Electricity Transmission Network Service Providers Cost Allocation Guidelines* (the Guidelines)[2].

## 1.1 Scope of Methodology

Directlink's proposed cost allocation methodology covers the allocation of direct and shared costs to its transmission service, as required by clause 6A.19.2 of the NER. The electricity transmission service provided by Directlink, the costs associated with this service and the method for allocating the costs is set out in sections 2 and 3 below.

The proposed cost allocation methodology also covers the allocation of management and commercial services charges which are charged to EII by the APA Group in accordance with the MOMCSA Agreement and then allocated to Directlink as one of the EII assets.

The broad structure of EII, the nature of the services provided to Directlink under the MOMCSA Agreement and the basis for allocating the costs associated with those services are outlined in the Appendices B and C.

[2] AER (2007). Electricity Transmission Network Service Providers Cost Allocation Guidelines – Final. September.

## 1.2 Overview of Approach

The proposed approach is the cost allocation methodology which will be used to prepare Directlink's regulatory accounts, which will be submitted annually to the AER on the basis of a financial year ending on 31 December. This method essentially involves:

- costs directly associated with the operation and maintenance of Directlink which are directly attributed to the Directlink Joint Venture; and
- costs associated with the provision of other commercial services under MOMCSA which are allocated by EII to the Directlink Joint Venture using the allocation rules outlined in Appendix C.

Section 3 provides information on the nature of each shared cost item and where and how it is allocated, in sufficient detail to enable the cost allocation to be replicated by the AER or an independent third party.

## 1.3 Implementation and Accountabilities

The proposed cost allocation methodology will be used to prepare Directlink's regulatory accounts, which will be submitted annually to the AER on the basis of a financial year ending on 31 December. The proposed cost allocation methodology will apply from the date it is approved by the AER, it will be used to prepare Directlink's regulatory accounts for each reporting period thereafter, until revisions to this methodology are approved.

All direct and shared costs are allocated in accordance with Directlink's approved cost allocation methodology and recorded in EII's financial systems, which are maintained by APA. This information will be used to prepare Directlink's:

- regulatory accounts;
- forecast operating expenditure;
- forecast capital expenditure;
- the certified annual statement (in accordance with clause 6A. 17.1 (a) of the NER); and
- actual or estimated capital expenditure for the purposes of increasing the value of its regulatory asset base.

Directlink's cost allocation methodology will be updated (subject to AER approval) and maintained by the Regulatory Manager, APA Group acting on behalf of EII and will be applied by APA Group officers acting on behalf of EII, who report to the APA Group Chief Financial Officer.

EII, and APA acting on behalf of EII, will allocate costs on a substance over legal form basis, but will not do so in such a way that contravenes any legal requirement.

Internal monitoring and reporting on the application of the cost allocation methodology will be conducted on an ongoing basis by both the Regulatory Manager, APA Group acting on behalf of EII and officers reporting to the APA Group Chief Financial Officer acting on behalf of EII.

Independent verification (audit), on the application of and compliance with the cost allocation methodology, will be conducted on an annual basis, or as otherwise required, as part of Directlink's Regulatory Financial Report. The verification process will include an assessment of the:

- maintenance of financial records on the allocation of direct and shared costs;
- allocation of direct and shared costs in accordance with Directlink's approved cost allocation methodology;
- arithmetic accuracy; and
- reconciliation to statutory financial statements.

This report is prepared in accordance with the AER's *Electricity Transmission Network Service Providers: Information Guidelines*[3].

A signed copy of Directlink's Director's Statement which confirms the accuracy of the proposed approach and Directlink's intention to comply with the cost allocation methodology as approved by the AER is included in Appendix A.

[3] AER (2007). *Electricity Transmission Network Service Providers: Information Guidelines (Final).* September.

# 2 Directlink's Transmission Services and Costs

## 2.1 Transmission Services

Directlink provides one Prescribed Transmission Service which is made available (exclusively) to AEMO for the purposes of dispatch, to ensure the efficient and secure flow of energy.

Directlink does not provide any services that are classified as negotiated services.

The transfer of the Directlink Joint Venture to EII was completed on 12 December 2008.

The cost allocation guidelines therefore provide an explanation of how costs are allocated to the Directlink Joint Venture. Furthermore, regardless of the entity in which costs are incurred they are to be allocated in accordance with the cost allocation methodology. This requirement extends to the MOMCSA Agreement, where APA must comply with the approved cost allocation methodology when performing financial management and reporting on behalf of EII.

In the event that, in the future, Directlink does provide negotiated or non-regulated services any associated costs will be allocated in accordance with the AER's Cost Allocation Guidelines and National Electricity Rule's Cost Allocation Principles.

## 2.2 Transmission Costs

Directlink's electricity transmission costs comprise the following components:

- direct network operations, including operating expenses, communications, energy costs and connection costs;
- direct maintenance costs;
- direct other costs, including insurance, contracted services, taxes, travel costs, utilities expenses, accounting fees and legal fees, and other direct expenses which can be attributed to the asset;
- an allocation of the costs incurred by EII for other commercial services under the MOMCSA;

- additional costs incurred by APA outside of the MOMCSA which may then incur an additional charge on EII. These costs may either be directly attributed to Directlink or may be attributed to EII and then allocated to Directlink.

Each of the direct costs identified above are incurred by Directlink and attributed to the prescribed transmission service.

# 3 Allocation of Costs to Directlink

EII's corporate structure and asset portfolio is represented in Appendix B. The revenue stream earned from each of these assets represents a mix of regulated and negotiated (commercial) returns.

Section.2.2.6 of the Guidelines requires the cost allocation methodology to be consistent with the *Transmission Network Ring-fencing Guidelines*[4]. As shown in Appendix B, EII owns/performs a related business (as defined in the ring-fencing guidelines) as it owns generation assets.

In accordance with clause 7.4 of the Ring-fencing Guidelines, shared costs between ring-fenced services will be allocated in accordance with Directlink's approved cost allocation methodology.

Section 3.1 below explains the basis of the allocation of shared costs, notably the MOMCSA cost, between Directlink and other EII's related businesses. This allocation approach is used consistently across all assets owned by EII.

## 3.1 EII Shared Costs

The shared corporate services provided by the APA Group to EII under the MOMCSA include the following functions:

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

A monthly cost allocation is undertaken for all shared costs, the bulk of which are incurred under the MOMCSA. These costs are allocated to an individual asset as a

[4] AER (2005) *Compendium of Electricity Transmission Regulatory Guidelines.* August. Pp 71 -82.

percentage (%) of the revenue the asset contributes to EII's total revenue. This should result in the fees only being allocated once, that is the fees are not over – recovered. .

That is, MOMCSA costs are allocated, on a percentage basis, to individual EII assets. This should result in these costs only being allocated once and EII has no intention to allocate costs more than once.

In accordance with clause 2.2.5 of the AER cost allocation guidelines Directlink will not allocate any costs more than once.

Based on historical performance, Directlink believes revenue is an appropriate driver for allocating shared corporate costs as the services provided by means of the shared cost are necessary for the generation of revenue. That is, a causal relationship exists between revenue generation and corporate overheads. The ACCC and AER have previously accepted revenue as an appropriate allocator for shared corporate costs in relation to the Directlink asset.

It should be noted that in instances where a service can be directly attributed to the asset, such as a legal cost relating solely to the asset, then this is attributed as a direct other cost as outlined in section 2.2.

## 3.2 EII's Asset Categories

EII has the following asset categories (as shown in Appendix B):

- Murraylink;
- Directlink;
- Daandine power station;
- X41 power station;
- Tipton West;
- Kogan North;
- Telfer/Nifty Gas Pipeline;
- Bonaparte Gas Pipeline; and
- Wickham Point Pipeline;

# A Directors’ Statement

## Directors’ Statement Regarding Cost Allocation Methodology

In the opinion of the Directors of the partners of Directlink Joint Venture the information contained in the Directlink cost allocation methodology is accurate and the Directors of Directlink Joint Venture confirm Directlink’s intention to comply with the cost allocation methodology as approved by the AER.

__________________________________ __________________________________

Ross Gersbach Dated

Director

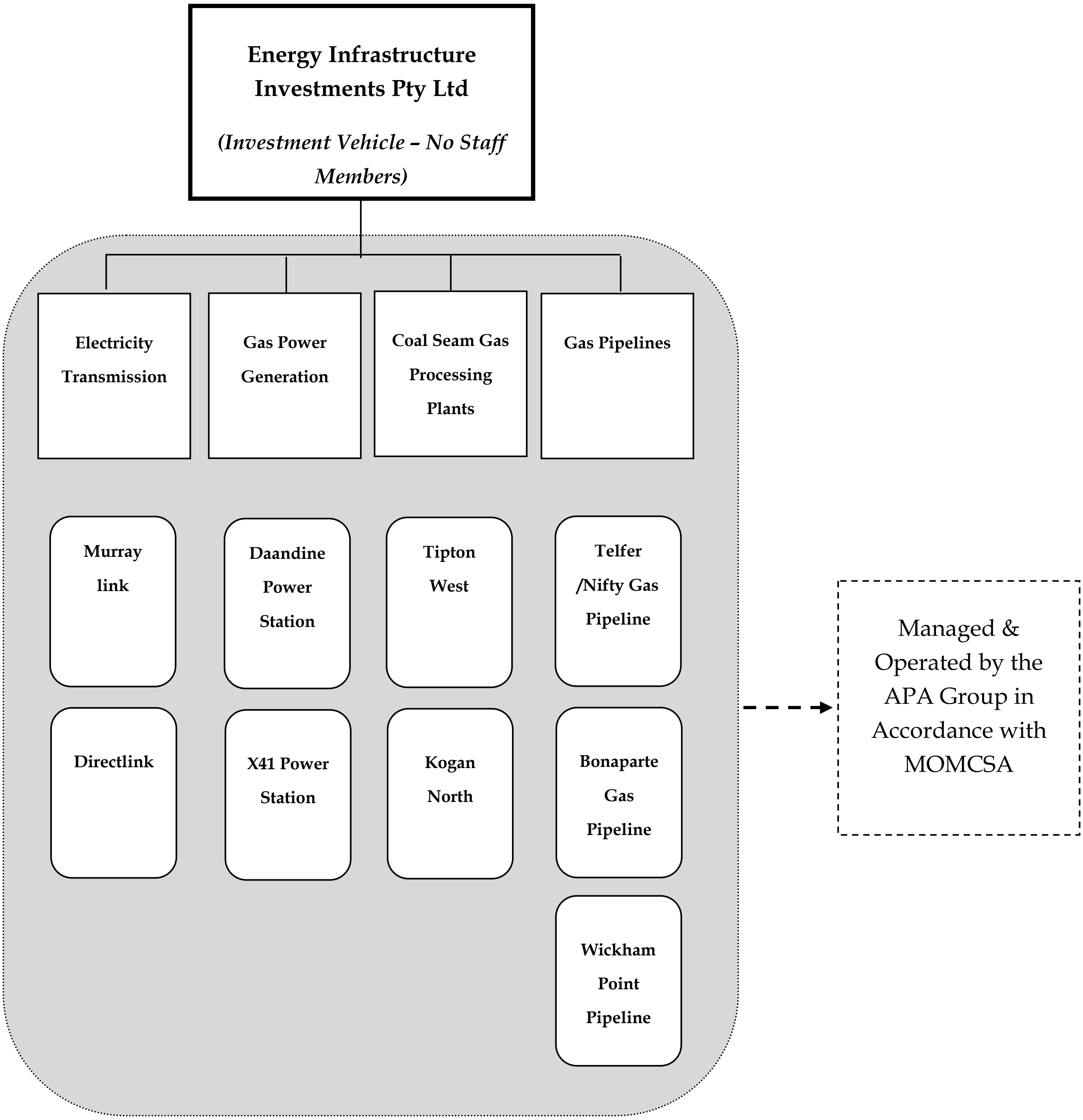
__________________________________ __________________________________

Peter Fredricson Dated

Director

## B EII Assets and Asset Categories

The EII structure below is broadly indicative of how EII assets are categorised and managed. It does not represent the actual detailed corporate structure of EII.



## C Cost Allocation Summary Tables

Where a cost cannot be directly attributed to an asset, it is allocated based on a revenue driver. The revenue driver is based on the overall revenue contribution of the asset as a percentage of EII's total revenue.

**Table 1 Allocation of Shared Costs to Directlink**

| Cost Category | Description | Costs Shared Between | Basis of Allocation (Driver) |
|---|---|---|---|
| Finance | Costs include:<br>• Business advisory services<br>• Treasury functions<br>• Accounting services<br>• Taxation | Each of EII's assets | Proportional to the contribution to group revenue |
| Operations Management | Costs of the office of high level management of operations | Each of EII's assets | Proportional to the contribution to group revenue |
| Commercial Management | Costs of commercial functions | Each of EII's assets | Proportional to the contribution to group revenue |
| Engineering Management | Costs include:<br>• Engineering advisory services<br>• Operational Planning<br>• | Each of EII's assets | Proportional to the contribution to group revenue |
| Strategic Planning | Costs include:<br>• Business advisory services<br>• Business Planning/Business Strategy | Each of EII's assets | Proportional to the contribution to group revenue |
| Legal and Regulatory | Costs include:<br>• Legal advice and compliance<br>• Regulatory services | Each of EII's assets | Proportional to the contribution to group revenue |
| Company Secretariat | Costs include:<br>• Secretariat<br>• Corporate governance | Each of EII's assets | Proportional to the contribution to group revenue |