



Proposed Cost Allocation Methodology

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Version 1.2



ElectraNet Corporate Headquarters

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Revision Table

| Version No. | Date of Revision | Authorised By | Details of Amendment |
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| 1.0 | 28 March 2008 | | Proposed Version 1.0 |
| 1.1 | 8 August 2008 | | Amended Proposed Version 1.1 |
| 1.2 | 15 August 2008 | | Minor clarification of amended Proposed Version 1.1 |
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Amendments to each version of this document will be tracked through ElectraNet's Document Management System.

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1. Purpose, Nature and Scope of this Document

The National Electricity Rules (NER) require each Transmission Network Service Provider (TNSP) to submit to the Australian Energy Regulator (AER) for approval a document setting out its proposed Cost Allocation Methodology by no later than 28 March 2008. The NER also require that the Cost Allocation Methodology proposed by a TNSP must give effect to and be consistent with the AER's Cost Allocation Guidelines¹.

Each TNSP is responsible for developing the detailed principles and policies for attributing costs to, or allocating costs between or within, the categories of transmission services that it provides. These detailed principles and policies must be included in the proposed cost allocation methodology that the TNSP submits to the AER for approval.

This document is ElectraNet's Cost Allocation Methodology, and has been prepared in accordance with the requirements of the NER and the AER's Cost Allocation Guidelines. The NER requires that each TNSP must comply with the Cost Allocation Methodology that has been approved by the AER in respect of that provider from time to time.

The Cost Allocation Methodology will be used by ElectraNet for the preparation of capital and operating expenditure forecasts included in Revenue Proposals submitted to the AER, prices for negotiated transmission services, and certified annual statements (regulatory reporting) in accordance with the NER. All staff are required to apply the principles included in this methodology to their roles within ElectraNet.

2. Commencement Date and Publication

This Cost Allocation Methodology will commence from the date of the AER's approval or deemed approval in accordance with the NER. The NER provides for the amendment of this methodology from time to time, and requires that the history and date of issue of the document will be updated accordingly. ElectraNet will also maintain a current copy of the Cost Allocation Methodology on its website in accordance with clause 6A.19.4(h) of the NER.

The proposed methodology is consistent with the principles that ElectraNet has used in managing and reporting costs throughout the regulatory period from 1 January 2003 to 30 June 2008 and is consistent with current practice.

3. Responsibilities for Implementation and Compliance

Clause 3.2(3) of the AER's Cost Allocation Guidelines requires the Cost Allocation Methodology to provide details of accountabilities within the TNSP to set out clearly:

- the TNSP's commitment to implementing the cost allocation methodology; and
- responsibilities within the TNSP for updating, maintaining and applying the cost allocation methodology and for internally monitoring and reporting on its application.

¹ Australian Energy Regulator, Electricity Transmission Network Service Providers, Cost allocation guidelines, September 2007.

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To address this requirement, the table below sets out the relevant responsibilities within ElectraNet.

| Role | Responsibility |
|------------------|--|
| ElectraNet Board | <ul style="list-style-type: none">• Approval of the Cost Allocation Methodology• Certify that Revenue Proposals and Regulatory Financial Statements have been prepared in accordance with the cost allocation methodology |
| Internal Audit | <ul style="list-style-type: none">• Monitor and report to Management and the Board on the application of the Cost Allocation Methodology. |
| Finance Team | <ul style="list-style-type: none">• Ensure compliance with the Cost Allocation Methodology• Prepare financial reports to the AER and develop supporting working papers |
| Regulatory Team | <ul style="list-style-type: none">• Advise of changes to NER and/or AER guidelines regarding the Cost Allocation Methodology |
| All Staff | <ul style="list-style-type: none">• Attribute direct costs to transmission service categories either via timesheet (labour) or invoice. |

To monitor and ensure compliance with this methodology, ElectraNet will:

- Audit the annual financial statements of the business in accordance with the requirements of the AER's information guidelines; and
- Ensure that Internal Audit reviews the application of the Cost Allocation Methodology on a triennial basis.
- Where the AER requests an audit in accordance with clause 5.3 of the Guidelines, ElectraNet will:
 - employ an auditor to report on the required information; and
 - ensure that the AER receives the auditor's assurance that the information can be relied upon for regulatory purposes.

4. Records Management

In accordance with clause 3.2(7) of the Cost Allocation Guidelines, ElectraNet will maintain records including supporting work papers to ensure that its application of the Cost Allocation Methodology can be:

- Demonstrated to the AER, in accordance with clause 5.2 of the Cost Allocation Guidelines; and
- Audited or otherwise verified by a third party, including the AER, as required.
- ElectraNet records its costs in accordance with accounting standards and the Corporations Law.

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ElectraNet will maintain source documents for a period of five years. General ledger trial balances and transaction listings as well as cost allocation working papers will also be retained for a minimum period of five years.

ElectraNet will maintain records within its integrated financial and asset management business system SAP.

5. Operational Structure

Clause 3.2(4) of the Cost Allocation Guidelines requires ElectraNet to provide a description of its corporate and operational structure in order to enable the AER to understand how the TNSP is organised to provide its transmission services. To address this requirement, it should be noted that ElectraNet is structured as three major complementary Divisions:

- Assets and Operations - responsible for network and asset management strategy, and network maintenance and operation.
- Development and Projects - responsible for managing the provision of services for the planning, development, engineering and construction of transmission assets.
- Finance and Corporate Development – responsible for strategic and business planning, business development, regulatory management, financial and management accounting, payroll, treasury and taxation, and information, procurement and corporate support services.

Each division has multiple business units which code their operating costs using a cost centre structure. The cost centre structure provides for segregation of costs by cost item (as described in section 7.2), account code and business area.

ElectraNet's business areas are directly aligned to the categories of transmission services provided by ElectraNet.

6. Categories of Transmission Services

Clause 3.2(5) of the Cost Allocation Guidelines requires ElectraNet to specify the categories of transmission services that it provides to which costs are to be attributed or allocated and the types of persons to whom those services are provided. In accordance with this requirement, ElectraNet notes that its Cost Allocation Methodology applies to the categories of transmission services which are defined in Chapter 10 of the National Electricity Rules. For the purpose of this Cost Allocation Methodology, these categories of transmission services and the types of persons to whom those services are provided are:

- Prescribed transmission services – these services are subject to revenue regulation by the AER and are shared transmission network services, connection services provided to distribution networks, and grandfathered connection services² provided to generators and high voltage customers.

² Clause 11.6.11 of the NER grandfathers connection services in operation or committed to be constructed as at 9 February 2006 as prescribed transmission services. Post this date all connection services other than those providing network to network connections are treated as negotiated transmission services.

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- Negotiated transmission services – these are connection services provided to a generator or transmission customer, or a group of generators or transmission customers, and shared transmission services provided to customers where the service exceeds standard network performance requirements. Negotiation of these services is subject to ElectraNet's negotiating framework and Negotiated Transmission Service Criteria approved by the AER³ on the basis that the services can only be provided by ElectraNet.
- Non-regulated (contestable) transmission services – these are services that ElectraNet is not obliged to provide and which are capable of being provided on a contestable basis by a range of suppliers. Commercial terms and conditions are negotiated between the parties.

The above categories of transmission services are directly linked to ElectraNet's individual cost item types (as defined in section 7.2).

7. Cost Allocation Principles and Policies

7.1 Overview

Clause 3.2(6) of the Cost Allocation Guidelines requires ElectraNet to provide details of its principles and policies to be used for attributing costs directly to, or allocating costs between, categories of transmission services that meet the requirements of clause 2.2 of the Cost Allocation Guidelines. The Guidelines also note that these principles and policies should also address the attribution or allocation of costs relating to any related party transactions. The remainder of this section of the Cost Allocation Methodology addresses the requirements of Clause 3.2(6) of the Cost Allocation Guidelines

As a first step, where possible ElectraNet will directly allocate costs. If direct allocation is not possible, a causal basis of allocation will be determined. ElectraNet's framework for cost allocation is explained in section 7.5 below. The application of the cost allocation framework will result in different allocation percentages each year depending on changes in inputs to the allocation base. Outcomes of applying the cost allocation framework will be described in working papers supporting annual regulatory information reporting and will be consistent with the transmission ring-fencing guidelines.

In accordance with clause 2.2.5 of the Cost Allocation Guideline ElectraNet will not allocate the same cost more than once, which means that:

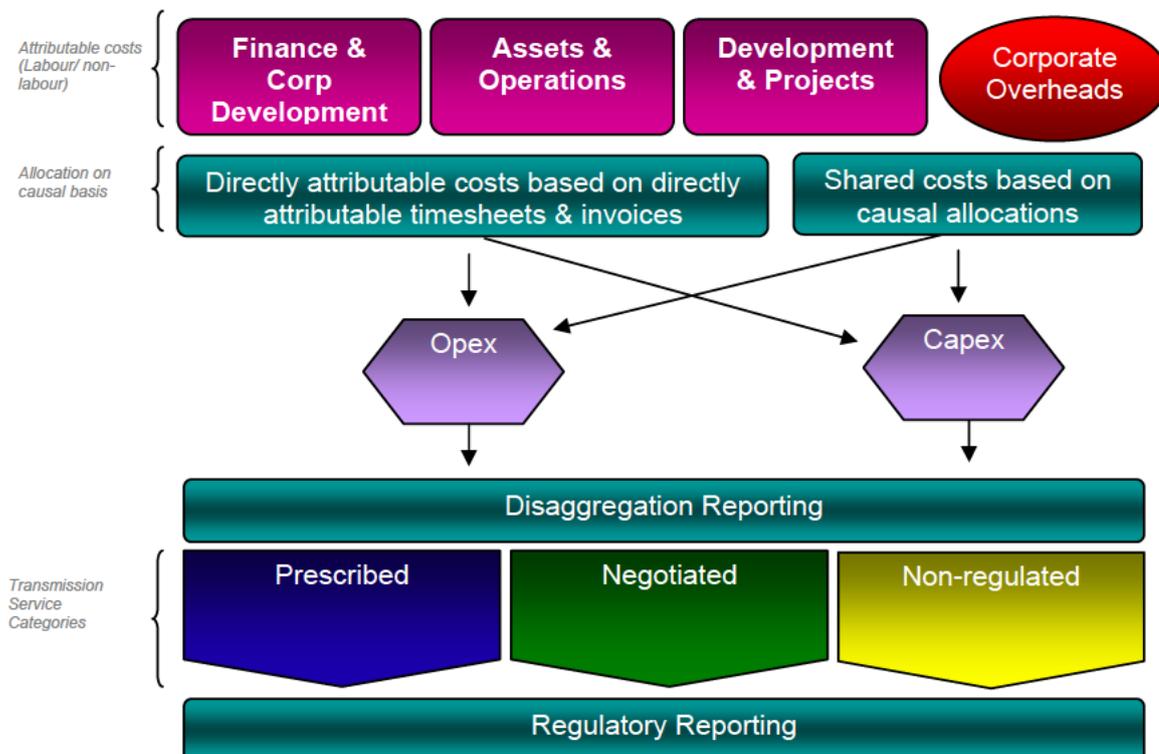
- The same cost will not be treated as both a direct cost and a shared cost;
- A direct cost will only be attributed once to a single category of transmission services;
- A shared cost will only be allocated once between or within categories of transmission services; and

³ ElectraNet's approved negotiating framework is published on its website at www.electranet.com.au and the Negotiated Transmission Service Criteria are published by the AER in its ElectraNet transmission determination for the 2008-09 to 2012-13 regulatory control period.

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- ElectraNet will recover the same cost only once through the charges that it levies for its transmission services.

The figure below illustrates at a high-level the process that ElectraNet uses to allocate costs. A more detailed description is provided in the sections below.



Costs incurred either by direct attribution or by causal allocation to prescribed transmission services, will be allocated between different types of prescribed transmission services in accordance with ElectraNet's approved pricing methodology⁴.

In accordance with clause 2.2.6 of the Cost Allocation Guidelines, ElectraNet's Cost Allocation Methodology complies with and is consistent with the transmission ring-fencing guidelines.

7.2 Nature of Cost Items

The nature of cost items for which costs can be either directly attributable or shared are:

- Network maintenance includes all transmission network maintenance, including routine, condition based, and corrective maintenance, maintenance projects and field support activities;
- Operations activities are those associated with the operation of the transmission network and include system control monitoring and switching as well as fault investigation and network performance monitoring and planning;

⁴ ElectraNet's approved pricing methodology for prescribed transmission services is published on its website at www.electranet.com.au.

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- Asset manager support activities are those that support the strategic development and ongoing asset management of the network life-cycle cost management including standards development overall asset risk profile management. It also includes the costs of running processes and systems that support the asset management function such as regulatory costs, IT, network planning and project support;
- Corporate support activities are required by ElectraNet in order to ensure adequate and effective corporate governance; and
- Network support relates to payments made to a generator or other person for providing network support services that is an alternative to network augmentation.

Cost allocation principles outlined in section 7.1 above and described in more detail in sections 7.3, 7.4 and 7.5 below are applied to all these cost items to determine the final cost allocation outcome.

7.3 Asset Allocation

Assets are assigned to transmission service categories. This allows direct attribution of asset related costs and a causal allocation basis for shared assets.

When an asset or group of assets cannot be directly attributed or allocated to a transmission service category, the allocation of the individual asset will be determined using an appropriate causal allocation. For example: :

- (1) Generation or reactive plant nameplate rating capacity or agreed maximum demand (AMD) supplied by the specified transmission category as a percentage of the total capacity and demand of all transmission categories at that location: Costs are attributable based on the capacity or AMD agreed upon by the customer(s); or
- (2) Unit of plant method: Costs are allocated based on the number of units of plant installed (typically circuit breakers) where these units of plant can be attributed to a particular category of transmission service.

7.4 Direct Attribution

Directly attributable costs are those that are solely related to one particular category of transmission service.

ElectraNet's chart of accounts structure summarises similar transactions into related cost items, which are directly attributable to the appropriate category of transmission services.

Maintenance costs are directly allocated against each asset. Each asset is assigned to a transmission service category as defined by section 7.3. The characteristic of the cost that associates it uniquely with direct attribution to a given transmission service is its relationship to an asset that is solely for providing that transmission service.

Other costs that are directly attributable are directly coded by ElectraNet staff identifying the type of transmission service they are working on.

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As discussed in section 4 , records of the costs and the allocation of assets to specific transmission services are maintained in ElectraNet's integrated financial and asset management business systems.

The allocation of costs which cannot be directly attributed to a category of transmission services are described in section 7.5.

7.5 Shared Costs

Costs that are not directly attributable to the provision of a category of transmission services will be allocated using a causal allocation, to the extent that:

- The shared costs are material; and
- A causal relationship can be established without undue cost and effort.

Where a shared cost is immaterial or a causal allocation cannot be established, ElectraNet will allocate these costs using an AER approved non causal allocation basis. ElectraNet will apply to the AER in writing for approval of any proposed non causal basis of allocation in accordance with clause 2.2.4(c) of the cost allocation guidelines.

ElectraNet allocates the following costs on a causal basis:

- Asset related expenditure; and
- Business unit chargeable costs.

Shared costs are only incurred through these cost categories, therefore no other type of shared costs are incurred.

As discussed in section 3, records of all the causally allocated costs and the attribution of assets to specific transmission services are maintained in ElectraNet's integrated financial and asset management business systems. The causal allocation approach is available in supporting working papers.

7.5.1 *Asset related expenditure*

Asset related expenditure is directly coded against the asset and the assigned transmission service cost allocation determines the cost allocation between transmission service categories.

Costs incurred directly to asset related expenditure includes:

- Network operations and maintenance service contracts; and
- Operational telecommunications contracts.

Where asset related expenditure can be allocated to multiple categories of transmission services an appropriate causal allocation is applied (refer to section 7.3). The allocation basis chosen in section 7.3 appropriately reflects the usage of the asset between transmission service categories.

The cost allocation basis may change from year to year as a result of a change in transmission services provided by the relevant asset.

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7.5.2 Business unit chargeable costs

ElectraNet uses a transfer pricing methodology to allocate costs across business units. Transfer pricing is based on either burdened labour rates or allocation of costs between business units, typically using the following cost allocators:

- head count; and
- forecast working hours.

The burdened labour rates include:

- labour costs and labour related on-costs such as superannuation, novated lease vehicles, fringe benefits tax, payroll tax and recruitment costs;
- professional association subscriptions;
- training costs; and
- internally charged costs (costs transfer priced from other business units).

Internally charged costs transfer priced from other business units may include:

- Meals/catering including employee entertainment;
- Travel and accommodation;
- Computer software and hardware support;
- General business telecommunications;
- Contracted Services;
- Consultants; and
- Legal fees.

The reason for selecting this cost allocation basis is because the actual cost consumption of the resource matches as closely as possible to the underlying activity.

As the allocation basis is determined each year by the headcount of business units, forecast work to be performed or direct allocation of shared costs, the allocation percentage may change from year to year throughout the regulatory control period.

7.5.3 Substance over legal form

ElectraNet will attribute costs to the categories of transmission services based on the substance of the underlying transaction or event. Where substance differs from legal form, the substance rather than legal form of a transaction or event will be used for cost attribution.

In determining the substance of a transaction or event, ElectraNet will assess all the implications, expectations and motivations for the transaction or event. The commercial effect of a series of interrelated transactions or events will be considered in aggregate when determining the substance of a transaction or event.

8. Directors' Statement

On behalf of the board of directors of ElectraNet Pty Ltd, we confirm that:

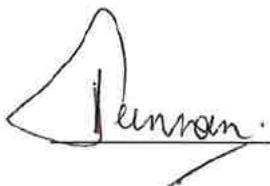
- In the directors' opinion, the information contained in this cost allocation methodology version 1.2 dated 15 August is accurate; and
- It is ElectraNet Pty Ltd intention that this cost allocation methodology once approved by the AER, will be complied with.

Signed in accordance with a resolution of directors:



Name: Gordon Jardine
Director

Dated: 21/8 2008



Name: Maurie Brennan
Director

Dated: 21/8 2008