Better Regulation

Explanatory statement
Draft Shared Asset Guidelines

July 2013

AUSTRALIAN ENERGY REGULATOR

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Glossary

This explanatory statement uses the following definitions:

Term	Definition
annual revenue requirement	an amount representing revenue for a distributor, for each regulatory year of a regulatory control period, calculated in accordance with Part C of Chapter 6 of the NER. For a transmission network service provider, the equivalent is the maximum allowed revenue calculated for a regulatory year of a regulatory control period in accordance with rule 6A.3
cost reduction	shared asset cost reduction a reduction in the regulated annual revenue, as established by clauses 6.4.4 and 6A.5.5 of the NER
cost reduction method	as set out in section 6 of these guidelines
guidelines	Draft shared asset guidelines
material	for the purposes of the application of these guidelines, 'material' is as set out by section 3.2 of these guidelines
NER	National Electricity Rules as defined in the National Electricity Law.
RAB	regulatory asset base
relevant regulatory control period	an upcoming regulatory control period comprising one or more relevant regulatory years
relevant regulatory year	a regulatory year of an upcoming regulatory control period in which total shared asset unregulated revenues are material
return of capital	depreciation calculated in accordance with the relevant distribution or transmission determination
return on capital	the return on capital calculated in accordance with the relevant distribution or transmission determination
RIN	regulatory information notice
service provider	distribution network service provider and/or transmission network service provider as defined by the NER
shared asset standard control revenues	return on and return of capital, as determined under chapter 6 of the NER
shared asset unregulated revenues	revenues paid to a distributor for unregulated services provided using the distributor's shared assets
standard control services	electricity supply services classified by us as standard control services under Chapter 6 (distribution) of the NER

Request for submissions

This explanatory statement is part of the Australian Energy Regulator's (AER) Better Regulation program of work, which follows from changes to the National Electricity and Gas Rules announced in November 2012 by the Australian Energy Market Commission (AEMC). The AER's approach to regulation under the new framework will be set out in a series of guidelines to be published by the end of November 2013.[1]

Interested parties are invited to make written submissions to the AER regarding this issues paper by close of business, 13 September 2013.

Submissions should be sent electronically to: sharedassets@aer.gov.au. The AER prefers that all submissions sent in an electronic format are in Microsoft Word or other text readable document form.

Alternatively, submissions can be sent to:

Mr Chris Pattas
General Manager, Network Operations and Development
Australian Energy Regulator
GPO Box 520
MELBOURNE VIC 3001

The AER prefers that all submissions be publicly available to facilitate an informed and transparent consultative process. Submissions will be treated as public documents unless otherwise requested. Parties wishing to submit confidential information are requested to:

- clearly identify the information that is the subject of the confidentiality claim
- provide a non-confidential version of the submission in a form suitable for publication.

All non-confidential submissions will be placed on the AER's website at www.aer.gov.au. For further information regarding the AER's use and disclosure of information provided to it, see the ACCC/AER Information Policy, October 2008 available on the AER website.

Enquires about this paper, or about lodging submissions, should be directed to the AER's Network Operations and Development Branch on (03) 9290 1444.

[1] Further details on the consultation processes and other guidelines are available at http://www.aer.gov.au/node/18824.

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Executive Summary

This explanatory statement accompanies the Australian Energy Regulator's (AER) Draft Shared Asset Guidelines (draft guidelines). The draft guidelines set out if and how electricity consumers might share in the benefits of using assets paid for by electricity consumers to also provide other unregulated services. The explanatory statement outlines the issues we considered in developing the draft guidelines and the reasoning for our proposed approach.

We are Australia's independent national energy market regulator. Our role is to promote the national electricity and gas objectives. Enshrined in the Electricity and Gas Laws, these objectives focus us on promoting the long term interests of consumers.

A major part of our work is regulating the energy networks that transport energy to consumers (electricity poles and wires, and gas pipelines). In 2012, the Australian Energy Market Commission (AEMC) announced important changes to the electricity and gas rules, affecting our role in regulation. Our role is also changed by the energy market reforms that the Prime Minister announced on 7 December 2012.

National electricity and gas objectives

The objective of the Electricity and Gas Laws is to promote efficient investment in, and efficient operation and use of, energy services for the long term interests of consumers of energy with respect to—

(a) price, quality, safety, reliability and security of supply of energy; and

(b) the reliability, safety and security of the national

We initiated the Better Regulation program to draw together these important reforms and our work in developing our regulatory processes and systems. The Better Regulation program involves us:

- extensively consulting on seven new guidelines that outline our approach to receiving and assessing network businesses' expenditure proposals and determining electricity network revenues and prices
- establishing a consumer reference group specially for our guideline development work, to help consumers engage across the broad spectrum of issues that we are considering
- forming an ongoing Consumer Challenge Panel (appointed 1 July 2013) to ensure our network regulatory determinations properly incorporate consumers' interests
- improving our internal technical expertise and systems, and our engagement and communication with all our stakeholders.

The November 2012 changes to the National Electricity Rules (NER) recognised that distribution and transmission electricity network service providers (service providers) sometimes use regulated assets to earn unregulated revenue streams. The NER now define assets used in this way as 'shared assets'. Specifically, a shared asset is any asset used to provide both unregulated services and either regulated standard control (distribution) or regulated prescribed transmission (transmission) services.[2]

An example is a power pole, paid for by electricity consumers, supporting both power lines and fibre optic cable for internet services. Electricity supply at low voltages is a standard control service which

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[2] Electricity supply services are either transmission (higher voltage) or distribution (lower voltage) services. Transmission and distribution are different segments of the electricity market. Within those segments, services are further classified into groups and regulated in different ways depending on their classification. Shared asset NER relate to distribution standard control services and prescribed transmission services, comprising most distribution and transmission services respectively.

we regulate, but we do not regulate internet services. In this case, the power pole is a shared asset. By charging a third party to use the pole to provide internet services, a service provider earns additional, unregulated, revenues. Through these unregulated revenues, service providers could potentially recover the cost of the poles more than once as the poles are already being paid for in full by electricity consumers.

Under the proposed shared asset mechanism, electricity consumers who funded shared assets through their electricity bills can now share the benefits of unregulated activities (that is, the additional revenues). Consumer benefits will come in the form of lower regulatory asset costs, with cost reductions determined by us under a mechanism principally established in the NER. Electricity prices reflect the cost of assets used to supply electricity. Reducing the cost of shared assets will help contain or reduce electricity prices. By reducing shared asset costs, we aim to ensure electricity consumers will pay less for regulated assets where these assets are also used to provide unregulated services.

The revised NER establish only a high level framework for a mechanism to make shared asset cost reductions. We must publish shared asset guidelines (guidelines) on our intended approach—that is, our proposed steps for making cost reductions. The guidelines may or may not include a detailed method we propose to use to determine cost reductions. For transparency, we have chosen to include a detailed method in the guidelines. However, there is flexibility in the way the mechanism will operate under the NER.

This explanatory statement should be read in conjunction with our draft guidelines for stakeholder review and comment. The draft guidelines set out how we propose to reduce consumer costs for shared assets. This explanatory statement sets out our reasons for the approach to cost reductions detailed in the draft guidelines.

The draft guidelines set out that, for each service provider we regulate, we will:

- at the time of a regulatory determination, make shared asset cost reductions in advance for each year unregulated revenues earned from shared assets are expected to exceed 1 per cent of regulated revenues from standard control (or prescribed transmission) services
- determine cost reductions using the method set out in the guidelines
- reduce standard control (or prescribed transmission) service revenues by an amount equal to the cost reductions we determine
- encourage service providers to submit proposed cost reductions calculated in accordance with the guidelines
- consider proposed cost reductions calculated using alternative methods only if the result leaves consumers no worse off than under the method set out in the guidelines
- require minimum annual reporting and more comprehensive reporting with regulatory proposals.

In determining cost reductions, we will take into account evidence of consumers benefitting from assets upgraded or replaced by third parties. We will accept as the upper limit on potential cost reductions a service provider's reasonable estimate of the regulated returns it earns from its shared assets.

1 Introduction

The Australian Energy Regulator (AER) is responsible for the economic regulation of electricity transmission and distribution services in eastern and southern Australia under chapters 6 and 6A of the National Electricity Rules (NER). We also monitor the wholesale electricity market and are responsible for compliance with and enforcement of the NER. We have similar roles for gas distribution and transmission under the National Gas Rules (NGR).

This explanatory statement is the second part of our consultation on development of shared asset guidelines for service providers. It forms part of our Better Regulation program of work following the Australian Energy Market Commission's (AEMC) changes to the NER on 29 November 2012. The aim of these reforms is to deliver an improved regulatory framework focused on the long-term interests of energy consumers.

1.1 What is the problem these guidelines are trying to fix?

In some limited circumstances, it is possible for an electricity network service provider to invest in an asset and require electricity consumers to pay for the asset in full and also use that asset to earn revenues from other consumers. This creates the problem of potential cost over recovery.

There are already measures in place to help prevent this problem. These measures include regulatory instruments called Cost Allocation Methods and audit requirements around regulatory reporting statements. We discuss these sorts of measures later in this document. It seems, however, that existing measures do not go far enough.

It is unlikely the circumstances that lead to cost over recovery have occurred in a significant way in the past. However, it is apparent that there may be more opportunities in the future to use assets for purposes not originally envisaged when the assets where first acquired. These include using power poles to hold high speed internet cables or locating electric car recharging stations on or near to electricity distribution transformers.

In light of these issues, the NER has been revised to better accommodate the existence of what are referred to as 'shared assets'.

1.2 Shared assets

The revised NER describe shared assets as those used by distribution and transmission electricity supply businesses (service providers) to provide both regulated and unregulated services. By charging for unregulated services, service providers may recover asset costs more than once.

The NER define shared assets as providing both unregulated services and particular categories of regulated electricity supply services:[3]

- for distribution—standard control services[4]
- for transmission—prescribed transmission services.[5]

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[3] Standard control and prescribed services represent core electricity supply activities. These form the majority of distribution and transmission services respectively, and earn the bulk of revenues accruing to network owners. Appendix A discusses service classifications.

[4] NER, clause 6.4.4(a).

So, any asset used to provide unregulated services and standard control or prescribed transmission services is a shared asset. It need not be fixed (such as power poles), and it may be mobile (such as vehicles), or non-physical (such as radio frequency spectrum). But this definition of a shared asset is not complete without an understanding of its relationship to cost allocation.

When a service provider establishes (builds or buys) an asset it determines the proportion of the asset use for regulated purposes and that for other purposes and allocates the costs accordingly. Done correctly, cost allocation means the price of regulated services properly reflects the cost of assets providing these services. However, it generally is done only once, when an asset is first established.[6]

A shared asset arises when the use of a regulated asset changes after its initial cost allocation. While the asset may still provide all the services that it provided when installed, it may now also provide unregulated services. Alternatively, unregulated revenues may vary compared with the asset's initial cost allocation.

1.3 Rule change

The revised NER now permit us to reduce regulated revenues where electricity supply businesses earn unregulated revenues with the same shared assets. The NER refer to this as a 'cost reduction', because we will reduce asset costs for electricity consumers. The draft guidelines set out our proposed approach to making cost reductions, within the framework established by the NER. We propose to include in the guidelines a detailed method we intend to use to determine cost reductions.[7]

1.4 Limits to the draft shared asset guidelines

As set out in these draft guidelines, our approach to determining cost reductions is constrained in a number of ways. Under the NER, cost reductions must:

- reasonably reflect asset costs that service providers recover by charging for unregulated services
- consider only unregulated revenues earned from use of the shared assets, not other unregulated revenues
- be no greater than the depreciated regulatory value of the shared assets
- be undertaken only as part of our distribution and transmission regulatory determinations, usually every five years.

On the above issues, our approach set out in the draft guidelines is already determined. We may not, for example, make cost reductions worth more than the depreciated regulatory value of the shared assets in question. And we cannot determine cost reductions within a regulatory period. For these constraints to change, the NER would have to change first.

1.5 Treatment of submissions

Appendix C summarises the submissions that we received in response to our shared assets issues paper. We also reference submissions throughout this explanatory statement when relevant to the

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[5] NER, clause 6A.5.5.

[6] Appendix B describes cost allocation in more detail.

[7] Under the NER, the guidelines must set out our proposed approach, or high level steps, to determine cost reductions. We may or may not include in the guidelines a detailed method for determining cost reductions.

text. When several submissions made a similar point, we do not reference every relevant submission. Rather, we note a representative sample.

In addition to the 13 submissions received on our issues paper, we received a further four submissions in response to our bilateral discussions. All submissions are available on our website.[8]

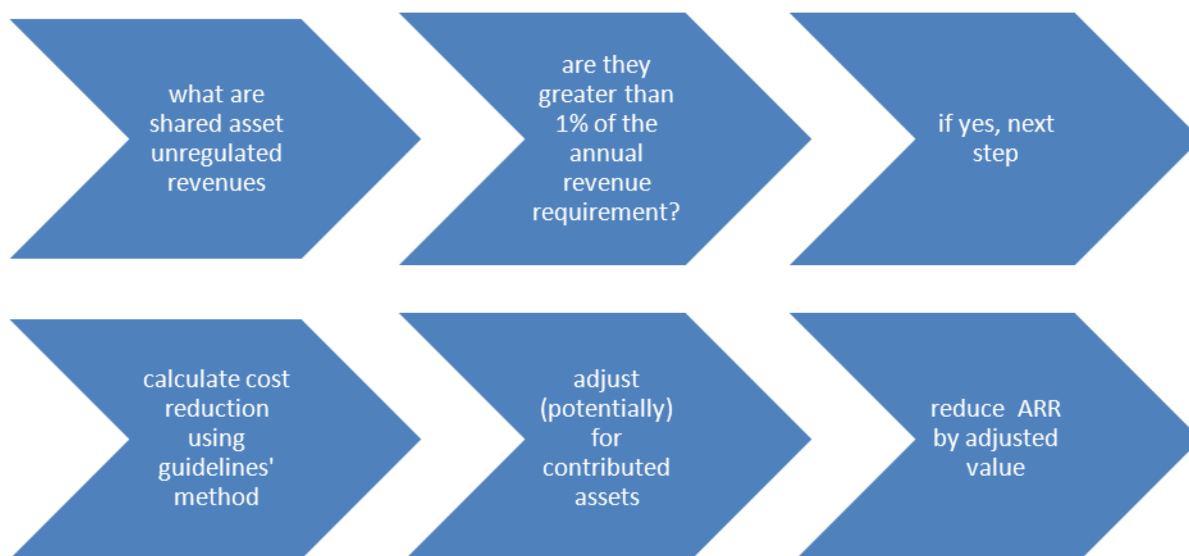
1.6 Structure of this explanatory statement

This explanatory statement takes the following structure:

- Chapter 2 explains our approach to cost reductions.
- Chapter 3 explains our method for determining cost reductions.
- Chapter 4 describes why cost reductions will not account for the incremental costs that service providers incur from using shared assets to provide unregulated services.
- Chapter 5 explains our proposed service providers' information reporting.
- Appendix A details the NER's service classification framework.
- Appendix B describes the relationship between shared assets and the NER's cost allocation framework.
- Appendix C lists submissions on our issues paper.

Figure 1 illustrates our steps to making a cost reduction, as set out in our draft guidelines.

Figure 1: Cost reduction process



If a service provider earns from its shared assets unregulated revenues equal to less than one per cent of its annual revenue requirement, no further action is required.[9] In this scenario, there will be no cost reduction for this service provider for the relevant regulatory year.

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[8] www.aer.gov.au/node/18878

By reducing a service provider's annual revenue requirement, tariffs paid by consumers for standard control (or prescribed transmission) services will be lower than otherwise. Because standard control (or prescribed transmission) services are used by most electricity consumers, lower tariffs for these services mean lower electricity prices for most consumers.

[9] A service provider's annual revenue requirement is the revenue it earns from standard control or prescribed transmission services in a given year. This generally equates to around 80 per cent of a service provider's total annual revenue.

2 Our approach to making cost reductions

This chapter sets out reasons for the approach to making cost reductions set out in our draft guidelines.

2.1 Cost reductions will be forward looking

2.1.1 Issue

Some stakeholder submissions supported ex post reconciliations for the difference between cost reductions made using forecasts and actual outcomes.[10] However, the NER and the AEMC do not support ex post reconciliations.[11]

2.1.2 Proposed approach

We propose to make cost reductions based on forecasts, within the distribution and transmission regulatory determinations that we undertake at the beginning of regulatory periods. We propose not to make ex post reconciliations.

2.1.3 Reasons for the proposed approach

We propose not to make ex post reconciliations for the following reasons:

- The NER do not specifically allow ex post reconciliations and imply real-time cost reductions.
- The AEMC considers ex post reconciliations should not be necessary.
- Consumer benefits from services begun only in the preceding regulatory period will be limited, because only a short period of operation will have been possible.
- We propose to monitor the accuracy of forecasts compared with actual unregulated service and revenue outcomes, with a view to possibly changing our approach and the NER if necessary.

The NER do not mention reconciliations for the difference between forecasts and actual outcomes. Also, the phrasing of the NER seems to support a real-time approach to determining cost reductions:[12]

> The AER may, in a distribution determination for a regulatory control period, reduce the annual revenue requirement for a [a distributor] to reflect such part of the costs of the asset as the [distributor] is recovering through charging for the provision of [unregulated services].

Our interpretation of the NER is supported by AEMC comments that ex post reconciliations should not be necessary:[13]

> In respect of an ex post adjustment, or 'true-up', once the actual benefits in a period of a sharing arrangement are known, the Commission considered in the draft rule determination that this should not be necessary. First, if the sharing arrangements are set on the basis of a contract the revenue received should be relatively easy to predict. Second, the revenue received will be only one factor to consider in setting the cost reduction for consumers, which must be based on the cost of assets shared. Third, to the extent

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10 Energy Users Association of Australia (EUAA), *Submission on shared assets*, 17 May 2013, p. 1.

11 NER, clause 6.4.4 for distribution and clause 6A.5.5 for transmission. AEMC, *Final position paper—National Electricity Amendment (Economic Regulation of Network Service Providers) Rule 2012, National Gas Amendment (Price and Revenue Regulation of Gas Services) Rule 2012*, November 2012, p. 166.

12 NER, clause 6.4.4(a) for distribution and clause 6A.5.5(a) for transmission.

13 AEMC, *Final position paper, November 2012*, p. 166.

> revenues received through the sharing arrangements change, the cost reduction can be adjusted at the next regulatory determination for the next regulatory period.

Submissions from consumer groups tended to support ex post reconciliations while service providers tended to support use of forecasts only.[14] So, service providers may perceive an advantage in not having ex post reconciliations while consumers may perceive them as a failsafe mechanism to ensure they receive appropriate benefits. We gave significant weight to the AEMC's views that ex post reconciliations should not be necessary, but we retain an open mind about changing our approach.

We propose to carefully monitor actual unregulated services and revenue outcomes compared with the forecasts used to determine cost reductions. If we find a significant difference that would limit benefits to consumers, then we will seek to change our approach. If an unregulated service begins during the regulatory period and preceding our first consideration of that service in a regulatory determination, then we propose no ex post reconciliation would occur. Rather, we will permit service providers to retain their full regulated revenues for the few years that the new unregulated service operated. In the AEMC's view, benefit sharing with consumers should begin from the first full regulatory period in which the unregulated service is operated:[15]

> There would be no reconciliation or 'ex post adjustment' in respect of any sharing arrangement that was put in place during the middle of a regulatory period; the cost reduction would only start from the beginning of the next regulatory period.

This approach received support from at least one consumer group submission. The Major Energy Users noted that we will, by not reducing regulated revenue in response to an unregulated service's first operation, create a strong incentive for service providers to seek unregulated revenue streams.[16] The service providers will thus have an ongoing incentive for benefit sharing with consumers.

However, the NER permit cost reductions to reflect unregulated services that have not yet commenced at the time of our determination. If we have sufficient certainty about related unregulated revenue, we may make cost reductions to account for forecast revenues from services not yet begun. In this case, we will make the cost reduction for the upcoming regulatory period, consistent with our proposed method set out in the draft guidelines.

2.2 Service providers may propose cost reductions

The NER indicates the AER may make a reasonable adjustment to a service provider's annual revenue requirement to account for a shared asset. It does not indicate a service provider should include such an adjustment in its regulatory proposal to the AER.

2.2.1 Issue

In general, the prices that service providers may charge are determined through a propose-respond approach. Under this approach, service providers propose regulatory arrangements and we either approve or substitute with our own arrangements as we consider necessary.[17] We think this approach should be reflected in arriving at particular shared asset mechanism for a given service provider.

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[14] Energy Users Association of Australia (EUAA), *Submission on shared assets*, 17 May 2013, p. 1. Energy Networks Association (ENA), *AER shared asset guidelines for electricity distribution and transmission - response to issues paper*, May 2013, p.10.

[15] AEMC, *Final position paper*, p. 165.

[16] Major Energy Users (MEU), *MEU response to shared asset guidelines for electricity distribution and transmission*, May 2013, p. 15.

[17] NER, clauses. 6.8.2 and 6.12 for distribution; clauses 6A.10.1 and 6A.12 for transmission.

2.2.2 Proposed approach

In our draft guidelines, we propose to accept as our own determination any reasonable proposed cost reduction a service provider submits with its regulatory proposal. Proposed cost reductions should be calculated using the method set out in the draft guidelines (our method), or leave consumers no worse off if calculated under another method.

2.2.3 Reasons for the proposed approach

We consider the propose—response model is appropriate for shared asset cost reductions for the following reasons:

- It is consistent with the approach established by the NER more generally.
- It is likely to minimise costs for service providers and us, with benefits for electricity consumers and taxpayers.
- We will accept proposed cost reductions only if we consider they are reasonable.
- If we consider a proposed cost reduction is not reasonable, or a service provider does not propose a cost reduction for a year for which we think one should be proposed, we will substitute our own cost reduction.

The NER propose—response model is no less appropriate for shared asset cost reductions than for other elements of a regulatory determination. While the shared asset provisions make no mention of service providers proposing cost reductions, we consider it unlikely that the AEMC would wish to rule out this option. The draft guidelines set out our expectations around proposed cost reductions, to clarify and formalise what is already possible under the NER.

Service providers are more familiar than we are with their asset management practices. As such, they may be better able to efficiently estimate some costs and revenues. We consider consumer value arises from us using service provider insights, while retaining our authority to determine whether proposed cost reductions are reasonable.

We consider our proposed method leads to reasonable cost reductions and thus meets the NER requirements and appropriately shares benefits with consumers. But we cannot assert that we would not consider proposed cost reductions calculated using an alternative method. The shared asset guidelines are not binding on us or anyone else.[18] And, under the NER, we are obliged to consider proposed cost reductions prepared using an alternative method.

However, we have broad authority to make cost reductions that we consider reasonable. Service providers have an incentive to minimise the value of cost reductions to consumers. If they use an alternative method to calculate a proposed cost reduction, then we will assess the reasonableness of that reduction against our own method. We will not consider reasonable the proposed cost reduction if it leaves consumers worse off than under our method.

So, when proposing a cost reduction calculated using an alternative method, service providers must demonstrate to us that it leaves consumers no worse off than under our method. We expect a service provider to set out for us both the alternative method used and an equivalent cost reduction calculated using our method. Service providers should present outcomes under both methods to demonstrate

[18] NER, clause 6.2.8(c).

the relative benefits for consumers. Otherwise, we may not be able to accept the proposed cost reduction prepared using an alternative method.

In our shared assets issues paper, we did not discuss the possibility of allowing service providers to submit cost reduction proposals. For that reason, stakeholder responses to the draft guidelines will be the first opportunity for service providers and consumers to respond to our proposal. We welcome submissions on this issue.

2.3 Defining material unregulated use of shared assets

2.3.1 Issue

Under the NER, we may make cost reductions only if use of shared assets for unregulated services is material. However, the NER do not define materiality in this context.

2.3.2 Proposed approach

In our draft guidelines, we propose a materiality definition based on unregulated revenue relative to regulated revenue. A service provider's expected annual unregulated revenue earned with shared assets must be at least one per cent of its expected revenue from standard control (or prescribed transmission) services.[19]

2.3.3 Reasons for the proposed approach

We include a proposed materiality definition in our draft guidelines for the following reasons:

- The NER require us to apply a materiality definition before we make cost reductions.
- It will help to protect electricity consumers and taxpayers from higher costs.
- It will provide certainty for service providers and electricity consumers.
- We propose the approach to determining materiality set out in our draft guidelines for the following reasons:
- Using relative revenues as a benchmark for asset use is simple, transparent and directly related to cost reductions.
- Assessing materiality in aggregate, rather than by service, is fair to electricity consumers and avoids the complexities of defining individual services.
- The one per cent threshold is consistent with the NER materiality definition for cost pass through applications. [20]

Why include a materiality definition in the guidelines

Under the NER, cost reductions apply only when shared asset use for unregulated services is material. For this reason, we consider cost reductions do not apply when unregulated services are not material. The normal meaning of material is 'significant or important'. However, this definition presents challenges in a regulatory context. Most obviously, interpretations of importance may vary greatly

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[19] A service provider's annual revenue from standard control or prescribed transmission revenue is otherwise referred to as its annual revenue requirement.

[20] NER, chapter 10—glossary, definition of 'materially'.

among different parties to a single event. Electricity consumers may consider any potential change that could lower or constrain electricity prices to be important. Alternatively, service providers may consider any existing unregulated revenue streams to be important to them but insignificant to electricity consumers.

We consider that establishing a materiality definition and incorporating it in our guidelines will provide service providers and consumers with certainty. This will help business planning and investment, with flow-on benefits for consumers. We also consider that there are likely to be cost advantages for consumers and service providers from establishing a materiality threshold. This is because very small cost reductions could result in consumers paying more for electricity rather than less. That is, consumers pay for the costs incurred by service providers in submitting regulator proposals. This is because service providers recover their administrative costs from their consumers.

Submissions generally supported establishing a materiality definition to mitigate risk of undue administrative costs for limited consumer benefits. Only one submission supported having no materiality threshold at all.[21] As discussed above, we consider publishing a materiality threshold that we intend to apply will benefit all parties.

Why use relative revenues

Using revenue as a benchmark for material use of shared assets for unregulated services has several advantages over other approaches. First, revenue is easily measurable and therefore transparent. Second, revenues are readily aggregated across multiple services. And finally, revenue relates directly to the cost reduction method and therefore to reducing asset costs for electricity consumers. The NER state that:[22]

> ..the AER may, in a distribution determination for a regulatory control period, reduce the annual revenue requirement … by such amount as it considers reasonable to reflect such part of the costs of that asset as the [service provider] is recovering through charging for [unregulated services].

That is, our cost reductions must reflect asset costs recovered via unregulated revenues. We consider this supports use of relative revenues to assess the materiality of shared asset use for unregulated services. Unregulated revenues are the best indication of the extent of asset cost recovery achieved by service providers through charging for unregulated services. We acknowledge that revenue is not a perfect measure of asset use. However, we consider the weaknesses of revenue as a benchmark for asset use are less relevant in this case because cost reductions must reflect asset costs recovered from regulated and unregulated services respectively. We consider the relative size of the two revenue streams is the best indication of relative asset cost recovery.

We propose to measure materiality in aggregate, across all of a service provider's unregulated services provided using shared assets. We think this is reasonable. Applying a materiality definition separately to individual services would have the effect of diluting its impact. Such an approach would be equivalent to applying a higher materiality threshold in aggregate. Therefore, it would erode the possibility of benefit sharing with consumers in proportion to the number of individual services to which a threshold would apply.

An aggregated materiality threshold is also the simplest approach. Per service assessment would give rise to difficulties in defining specific services. For example, were telecommunications services to

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[21] Southern Sydney Regional Organisation of Councils (SSROC), *Better Regulation - Shared Assets Guideline Submission*, 17 May, p.4.

[22] NER, clause 6.4.4(a) for distribution and clause. 6A.5.5 for transmission.

be provided in several different discrete parts of an electricity supply network, would that be a single service or several? Similarly, were multiple telecommunications providers to use a single network, would that be a single service or several? Aggregating unregulated revenues earned by shared assets across all unregulated services provided with shared assets avoids such definitional difficulties.

Consumer submissions favoured materiality assessment in aggregate, as we propose.[23] Service provider submissions, however, tended to favour a per service approach to assessing materiality.[24] It was not clear from service provider submissions how to address definitional issues, or how such an approach would be in the interests of consumers. For both reasons, we consider our proposed approach is more reasonable than that proposed by service providers.

Why one per cent

Our proposed materiality threshold, one per cent of a service provider's annual standard control (or prescribed transmission) revenues, is equivalent to the only materiality definition already established in the NER—for cost pass throughs. This provides a degree of reciprocity within the regulatory framework. To recover an additional cost, so to gain a benefit, service providers must show that a cost meets the one per cent threshold. And to share unregulated service benefits with electricity consumers, so to lose something, relevant revenues must meet the same threshold.

Of the consumer submissions which favoured a materiality definition, these suggested lower thresholds than our proposed one per cent threshold.[25] We consider, however, that one per cent is reasonable in the context of consumer benefits to be realised under the NER. That is, cost reductions will pass through to consumers in the form of averaged tariff reductions across all of a service provider's regulated standard control or prescribed transmission services. The per consumer and per unit price reduction will be equivalently small. Where cost reductions themselves are small compared to a service provider's regulated revenues, benefits per consumer will be negligible.

We consider assessing materiality based on the physical use of an asset for both regulated and unregulated services has significant weaknesses. It would raise questions like: on what basis will we measure physical use? Time used for different types of service? Physical space? Should unregulated service use of an asset be compared to regulated service use, or to the asset's total potential capacity? And finally, how would such measures be aggregated across a number of different asset types and services? In this context, the weaknesses of revenue as a materiality measure are less significant than the apparent weaknesses of physical asset use as an alternative.

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[23] EUAA, 17 May 2013, p. 1. Major Energy Users (MEU), *Response to shared asset guidelines for electricity distribution and transmission*, May 2013, p. 7.

[24] Energy Networks Association (ENA), *AER shared asset guidelines for electricity distribution and transmission - response to issues paper*, May 2013, p.10.

[25] EUAA, 17 May 2013, p. 1. MEU, May 2013, p. 7.

3 Cost reduction method

3.1 Issue

The NER require us to publish guidelines setting out our approach to making cost reductions. The guidelines may or may not detail a method we intend to use to determine cost reductions.[26]

3.2 Proposed approach

Our draft guidelines include our proposed method to determine cost reductions. Our proposed method is a relatively straightforward set of calculations. It incorporates a primary set of calculations and a secondary control step, which is designed to ensure the shared asset cost reduction does not exceed the value of the shared assts.

3.3 Reasons for proposed approach

Our draft guidelines include our proposed method because we consider it will:

- further enhance transparency and certainty
- minimise administrative costs.
- We consider that our proposed method has a number of advantages over other possible approaches, in that it will:
- reduce electricity consumer costs when unregulated use of shared assets is material
- minimise administrative costs.

Why include a method in the guidelines

Setting out our proposed method in the guidelines provides certainty, improves investment confidence and may lower administrative costs. Establishing a single method consolidates these advantages. Were we to establish a range of methods applicable in different circumstances, or at the choice of service providers, the additional uncertainty may undermine any associated benefits.

We consider the benefits of including a method in the guidelines outweigh the potential benefits from retaining greater flexibility to apply different methods in different circumstances. Service providers can be confident that we will approve reasonable cost reductions prepared under the method set out in the guidelines. It may also reduce service provider perceived need to provide additional material in support of their proposal, such as consultant reports and other input from independent experts. And having a ready-made method available may avoid the costs of service providers developing their own methods.

Submissions from both consumer groups and service providers generally favoured including in the guidelines at least one method to determine cost reductions. Some service provider submissions suggested establishing a range of methods for them to select from in particular circumstances.[27] Or, even less prescriptively, other service providers preferred to see the guidelines set out only factors we would consider when making cost reductions and service providers would be able to propose their

[26] NER, clause 6.4.4(d) for distribution and clause 6A.5.5(d) for transmission.
[27] ENA, May 2013, p. 11; AGL, 17 May, p.2.

own methods.[28] Where service providers supported methods to be set out in the guidelines, they were silent on what methods should apply in specific circumstances. Rather, service providers sought to discuss with us the details of one or more cost reduction methods which would be applicable.[29]

Why use relative revenues to determine cost reductions

The method set out in our draft guidelines bases cost reductions on the unregulated revenues a service provider earns from use of shared assets compared to its regulated standard control (or prescribed transmission) revenues. This is consistent with our proposed materiality definition. It is also consistent with the nature of the NER, which establishes our authority to reduce regulated revenues in terms of asset costs recovered through charging for unregulated services.

Under our proposed method, we will reduce a service provider's regulated revenues from assets providing standard control (or prescribed transmission) services by around 10 per cent of the value of unregulated revenues earned with shared assets.[30] We consider that a fixed cost reduction proportion further enhances transparency and certainty for both service providers and consumers.[31] Alternative approaches, such as making cost reductions of varying proportions depending on the circumstances, would provide less certainty than our proposed approach.

Our proposed method provides transparency and certainty but is consistent with our limitations as an economic regulator. That is, we are not regulating the revenues of unregulated services. This is because, under the NER, consumer benefits are capped at the standard control (or prescribed transmission) revenues earned by a service provider from its shared assets. Under the control step of our proposed cost reduction method, we have also capped fixed proportional benefit sharing at this value. This means that shared asset unregulated revenues in addition to a service provider's regulated returns from the same assets would not be relevant to our cost reductions. For clarity, we note that the AEMC stated in its final position paper on the revised NER:[32]

> With respect to determining the appropriate portion of costs for the purposes of a shared assets cost adjustment, the Commission considered in the draft rule determination the most obvious approach is for the AER to base this on the relative use of the asset for the provision of the different kind of services such as the technical use or physical use. Another possible way could include using the ratio between the proportion of revenue from the asset for standard control services and the proportion of revenue from the asset for other than for standard control services over the current regulatory period. However, this should not be taken as precluding the AER from considering other possible bases for sharing the costs of the asset.

We consider our proposed cost reduction method is equivalent to basing cost reductions on the ratio of unregulated to regulated revenues, as proposed by the AEMC. We note also that the AEMC does not rule out other possible bases for cost reductions. In the context of the nature of the shared asset mechanism established by the NER, we consider our proposed method is within our authority.

The AEMC's proposal that cost reductions could be based on physical asset use incurs the same problems as physical use to determine materiality. How would relative use be measured? How would such measures be aggregated across services and asset types? Relative revenues, however, are transparent and readily aggregated across services and assets.

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[28] Networks NSW, 16 May 2013, attachment B.

[29] ENA, May 2013, p.11.

[30] Asset related regulated revenues equal a service provider's return on and of capital for its regulatory asset base (RAB). That is, revenues earned through charging for regulated services to compensate service providers for asset depreciation (return of capital) and to provide a rate of return on capital.

[31] We discuss our proposed benefit sharing proportion in detail in chapter 6 of this paper.

[32] AEMC, *Final position paper*, November 2012, p. 168

Precision versus administrative costs

Our proposed cost reduction method uses straightforward calculations to keep administrative costs to a minimum. Under our proposed method, service providers need not track individual asset use for regulated and unregulated services. This is intentional. We recognise though that this simplicity is only achieved at the cost of some degree of precision. Our proposed method is less precise than methods in use under other parts of the NER. We consider this is consistent with the nature of the shared asset provisions and the scale of potential benefit sharing with consumers. The cost of establishing a more precise, but more onerous, method may outweigh the potential benefits for consumers.

A more detailed method may cause service providers to incur higher staffing and information technology costs to track individual asset use and to estimate the unregulated revenue earned by each shared asset. Service providers would pass on those costs to electricity consumers. In the context of very large asset bases, we consider such detailed asset management may not be practicable. And where consumer benefit sharing per shared asset may be limited, the costs of a more detailed method would likely undermine the potential benefits.

The control step

Our proposed control step allows service providers to estimate the standard control (or prescribed transmission) revenues they earn from shared assets. By allowing service providers flexibility to estimate this value, we aim to avoid administrative costs that may be incurred under a more interventionist approach. That is, we recognise that service providers are more familiar with their own asset management practices than we are. As such, they will be more aware of the most efficient ways to estimate regulated returns from specific assets while avoiding undue administrative costs.

We have strict expectations for the information service providers should submit in support of their proposed upper limit for cost reductions. Service providers must set out how they have estimated regulated returns under the control step and justify that approach. We propose to reserve the right to not accept a proposed calculation under the control step and substitute our own estimate using average asset lives and revenues for relevant asset classes.

3.3.1 Services which use shared assets only marginally

Service provider proposals that the guidelines should include a range of methods in part reflected the different degrees of shared asset use across different unregulated services.[33] For example, unregulated telecommunications services using distribution power poles rely heavily on shared assets. That is, we consider all unregulated revenues earned by a service provider from that unregulated service are for use of shared assets. However, an unregulated maintenance service run by a service provider may primarily use unregulated assets and use shared assets in a very limited way.

We consider the best way to address this issue is by focussing on the unregulated revenue stream derived from an unregulated service. Service providers should apportion their unregulated revenues to reflect the extent to which unregulated services rely on shared assets. When reporting to us, service providers should set out their reasons for apportioning revenues and the basis on which they have done so. Where we consider such a proposed apportionment reasonably reflects shared asset use, we would accept it as an element of our own cost reduction determination.

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[33] ENA, May 2013, p. 5; Citipower, Powercor, SA Power Networks, 17 May 2013, p. 2.

3.3.2 Contributed assets

The draft guidelines allow service providers to present evidence of electricity consumers benefitting from assets contributed by third parties, such as telecommunications providers. We propose to take such evidence into account when determining cost reductions. A third party, for example, may replace distribution power poles, because the original poles were too short or too weak to support additional telecommunications cables. If service providers demonstrate consumer benefits accruing from contributed assets, we may reduce the size of a cost reduction. Any such reductions will be in proportion to the scale of the demonstrated consumer benefits from asset upgrades or replacements.

Service providers should note that because of the NER approach to contributed assets, related consumer benefits in an upcoming regulatory period may be relatively small. This is because, under the NER, an asset replaced by a third party remains part of the service provider's future earnings until its regulatory value depreciates to zero. The service provider records the new asset in its regulatory asset base at zero value, so this has no impact on electricity prices. The consumer benefit is therefore the avoided cost of replacing the asset at the end of its regulatory life. In many cases, this means that consumers will experience the avoided asset replacement costs in the future. We will discount these benefits to account for inflation experienced between now and then.

4 Incremental costs will not be accounted for

4.1 Issue

Service providers and consumer groups proposed that cost reductions account for the additional, or incremental, costs of providing unregulated services.[34] That is, service providers should share with consumers only their profits from unregulated services provided with shared assets. However, such an approach would directly contradict the NER.

4.2 Proposed approach

Through a balanced approach to cost reductions, we propose to retain incentives for unregulated services provided with regulated assets. We propose to reduce service provider standard control (or prescribed transmission) revenues by around 10 per cent of the value of unregulated revenues earned with shared assets.

4.3 Reasons for the proposed approach

The draft guidelines do not account for service provider incremental costs because:

- such an approach is not supported by the NER
- An incremental cost approach would see commercial risk move to consumers.

We consider our proposed approach is consistent with all of the elements of the shared asset provisions of the NER for the following reasons:

- It retains reasonable incentives for shared assets to be used for unregulated services.
- It shares with consumers the benefits of unregulated revenues earned with shared assets.
- It is not based on service provider profit from unregulated services provided with shared assets.

We set out below our detailed reasoning behind each of the above points. Most importantly, the NER shared asset principles state:[35]

> a shared asset cost reduction should not be dependent on the [service provider] deriving a positive commercial outcome from the use of the asset other than for [standard control or prescribed transmission services]

This principle is clear. The profitability (positive economic returns) of an unregulated service for a service provider should not be the basis for cost reductions. Rather than focussing on profit, we should make cost reductions if use of assets for unregulated services is material. In this way, a cost reduction is an acknowledgement that assets are being used, in a material way, for purposes other than standard control (or prescribed transmission) services, for which additional revenue is earned by the service provider.

Service provider submissions and statements on this issue were somewhat inconsistent. They tended to be strongly of the view that profits service providers earn from unregulated services should not be the basis for cost reductions.[36] However, service providers also strongly proposed that cost reductions

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[34] ENA, May 2013, p. 6; Jemena, 17 May 2013, p. 5.
[35] NER, clauses 6.4.4(c)(2) and 6A5.5(c)(2)
[36] ENA, May 2013, p. 12.

should account for their incremental costs associated with unregulated services.[37] We consider these two positions are not jointly sustainable.

We consider that by accounting for the incremental costs of unregulated services, we would establish a profit sharing cost reduction method by default. Under such a method, if a service provider's incremental costs were greater than the unregulated revenue stream derived from shared assets, electricity consumers would receive no benefit. Such an approach would directly contradict the shared asset principles. AEMC comments support our interpretation of the shared asset principles:[38]

> The Commission did not accept … the principle that the [service provider] should only have to pass on the benefit of a shared asset if it receives a net profit as a result, which was proposed by NSPs to recognise the associated risks of the NSP with sharing arrangements. In general, the NSP should bear the risk so it takes this into account when deciding whether to enter a sharing arrangement, as the Commission considered the NSP to be the party best able to assess and manage this risk.

Under the NER, electricity consumers have financed shared assets, so should receive a benefit from their material use to generate other revenues. Whether those other revenues are sufficient to cover the additional costs incurred by service providers is an issue for service providers, not electricity consumers. An equivalent scenario to the incremental cost proposal is a retailer proposing to pay rent to a landlord only if the retailer makes a profit. In such a scenario, the landlord would be taking on commercial risk incurred by the retailer. The landlord, however, would have no capacity to manage that risk.

In light of the NER and the AEMC's supporting statement, we are unable to support the incremental cost approach proposed by consumer groups and service providers. We do, however, have some sympathy for the proposal. It is consistent with the NER approach to regulated revenues more broadly. That is, service providers are able to recover the efficient costs of their regulated services and earn a regulated rate of return. The NER shared asset provisions, however, are different.

Service providers put forward two main arguments in support of their incremental cost proposal:[39]

- First, that retention of incentives for unregulated services should take priority over all other considerations.

  This argument is based on another shared asset principle, that service providers should be encouraged to provide unregulated services with regulated assets. However, the shared asset principles taken as a whole do not support this argument. Nor is it supported by the AEMC comments on allocation of commercial risk, as set out above.

- Second, service providers proposed that our authority to make cost reductions is constrained to considering only unregulated revenues above their incremental costs.

- We disagree. The NER is explicit in asserting that we should not base cost reductions on positive commercial returns. By definition, cost reductions should not depend on asset owners deriving a profit from the other services they choose to provide with assets paid for by electricity consumers.

Consumer groups proposed an incremental cost approach for different reasons to service providers.[40] Consumer groups suggested that allowing service providers to recover their incremental costs means the remaining unregulated revenues can be used to reduce costs for consumers. Again however, the

[37] Records of NSP meetings with AER staff are available on the AER website www.aer.gov.au.
[38] AEMC, *Final Position Paper - National Electricity Amendment Rule 2012*, November 2012, p. 168.
[39] See meeting records, available on the AER website www.aer.gov.au.
[40] EUAA, 17 May 2013, p. 2; MEU, May 2013, p. 13.

NER does not support the proposed approach. We are also mindful that the scale of benefit sharing under an incremental cost approach may not be what consumer groups expect.

We accept that service providers do incur additional costs from providing unregulated services with existing regulated assets. For a service like fibre optic cable fitted to power poles, there are likely to be establishment costs, such as switching on and off the power and moving power cables while the fibre optic cables are installed. There are also likely to be higher ongoing costs, like more frequent inspections and more difficult power line maintenance. While we are unable to comment on the scale of incremental costs compared to unregulated revenues, we accept their existence in many cases, if not all.

4.4 Our proposed benefit sharing proportion

In developing our draft guidelines, we have given equal weight to the shared asset principles. That is, we have balanced the provision of incentives for unregulated services with the requirement that cost reductions not be based on profit. We consider that our proposal to reduce regulated revenues by around 10 per cent of the value of unregulated revenues earned with shared assets strikes a reasonable balance. Indeed, retaining a reasonable incentive for ongoing provision of unregulated services is key to the ongoing sharing of benefits with consumers.

As discussed above, consumer group submissions proposed very high benefit sharing proportions. The EUAA proposed that service provider regulated revenues be reduced by 90 per cent of the value of unregulated revenues earned with shared assets.[41] However, the EUAA also proposed that we permit service providers to retain regulated revenues equal to their incremental costs of the unregulated services. As above, we consider the NER does not support this approach.

The MEU proposed that we establish a sliding scale of benefit sharing proportions. The MEU considered this would mitigate the risk of creating an incentive for service providers to keep unregulated revenues marginally below the cost reduction threshold. We consider this option runs the risk of us appearing to regulate the revenues of services we do not regulate, by treating service providers differently.

Any benefit sharing proportion, or detailed method of determining cost reductions, is to an extent arbitrary. While we consider 10 per cent is a reasonable benefit sharing proportion, we are not able to set out mathematical proof that it will optimise consumer benefits. To extend that arbitrary concept by setting different benefit sharing proportions would establish different impacts for different service providers with little reason or analysis behind it. We consider that such an approach is less defensible than our proposal to establish a single benefit sharing proportion applicable where unregulated use of shared assets is material.

Finally, in proposing our 10 per cent approach, we have taken into account the societal benefits provided by unregulated services using electricity network assets. Services, for example, such as telephony, internet and other telecommunications products have significant value to the community more broadly. Electricity infrastructure is a least cost mode of delivery for many services. We seek to retain reasonable conditions for the ongoing use of network assets to continue to produce these other social benefits.

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[41] EUAA, 17 May 2013, p. 2.

5 Information reporting

5.1 Issue

To inform our shared asset cost reductions, we require information about a service provider's revenue, unregulated services and future expectations. However, there is a cost to service providers arising from any information request. Depending on the information requested, administrative costs may be significant and erode consumer benefits from shared asset cost reductions.

5.2 Proposed approach

The draft guidelines set out minimum annual reporting requirements and more comprehensive requirements for regulatory proposals where cost reductions are in scope. We propose to give effect to these requirements through annual and regulatory proposal regulatory information notices and similar information reporting mechanisms.

5.3 Reasons for proposed approach

We consider our proposed approach balances the administrative costs faced by service providers and the interests of consumers. The nature of the shared asset mechanism, established principally in the NER, is such that a degree of information about unregulated services is necessary. We consider that the information we propose to request is a minimum necessary to reasonably ensure compliance with the NER.

In our shared assets issues paper, we proposed to establish a lower materiality threshold for detailed information reporting to give us visibility on unregulated services and revenues as they approach the cost reduction materiality threshold. Service provider submissions objected to this, and to annual reporting, because we may only make cost reductions at the beginning of regulatory periods.[42] We have taken this feedback into account and have revised our proposal. We now propose to require detailed reporting only when the cost reduction threshold is met. However, we propose to maintain awareness of unregulated services and revenues through limited annual reporting requirements.

We consider that maintaining awareness of actual unregulated services and revenues will prepare us for subsequent distribution and transmission regulatory determinations. Moreover, we intend to monitor the accuracy of the service and revenue forecasts we will rely on to determine cost reductions. Should actual services and revenues considerably diverge from forecasts, we will consider amending our approach to determining cost reductions.

Because regulatory determinations occur only every five years, information reporting only with regulatory determinations implies significant lead times before we would have evidence to support guideline changes. Annual reporting of actual outcomes will allow us to form judgements on guideline changes in more efficient timeframes. We consider the limited regulatory burden associated with our proposed annual reporting requirements is reasonable in the circumstances.

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[42] Ausgrid, 16 May 2013, p. 4; ENA, May 2013, p. 11.

A Service classifications

This appendix summarises the service classification frameworks central to the NER shared asset definitions. We undertake service classification during our five yearly revenue determinations. By classifying services, we group them and apply different forms of economic regulation, or no regulation.[43] The NER provide slightly different classification categories for the distribution and transmission sectors. As a result, the two sectors have slightly different shared asset definitions.

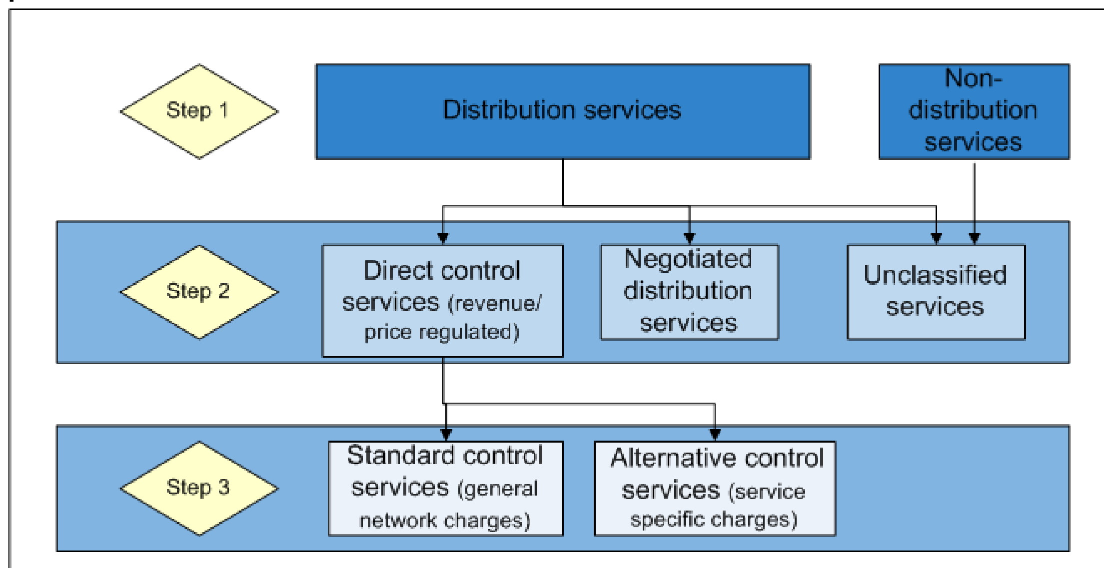
Service classifications—distribution

Distribution service classifications that provide the most prescriptive regulation are standard control and alternative control. Collectively, we call these services direct control services, because we directly determine consumer prices for them. Direct control services tend to be subject to monopolistic power, so may not be provided by others.[44] Within this classification, standard control services are generally provided for a broad customer base and alternative control services are relatively ad hoc (such as a request to move a power pole) or potentially competitive (such as meter reading).

The remaining distribution classification is negotiated services, for which service providers and customers negotiate prices under a framework established by the NER.[45]

Finally, some services provided by electricity distribution network assets are not classified—unregulated services. These may be unregulated distribution services or unrelated to electricity distribution. Figure A1 sets out the NER process for classifying distribution services.[46]

Figure A1: Distribution service classification process



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43 We determine service classifications by the degree of competition for service supply. We classify services to a more strict form of economic regulation when competition to supply those services is less. When greater service supply competition exists, we classify to a less strict form of regulation.

44 Direct control services are frequently restricted to licensed network service providers, so legal barriers prevent effective supply competition.

45 Reflecting a degree of supply competition.

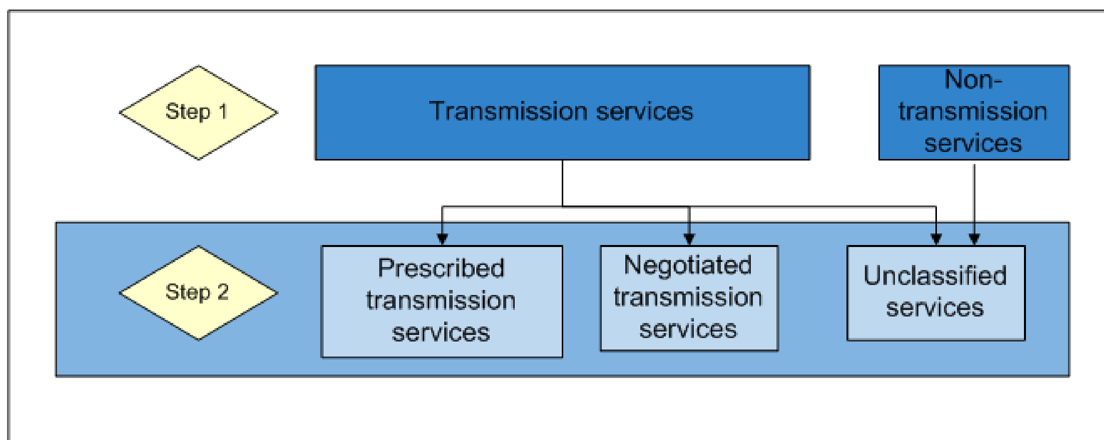
46 Comprising three steps. First, we confirm whether a service is a distribution service. We then determine the appropriate level of regulation: strict, less strict or none. And, finally, when direct control is appropriate, we classify services as either standard control or direct control.

Service classification—transmission

For transmission, a single direct control classification is available—prescribed transmission services. We generally classify transmission services for the broad customer base as prescribed transmission services. These services provide electricity to transmission customers, so are central to a service provider's monopoly power. The only other transmission classification available is negotiated services. Negotiated service prices for transmission, as for distribution, are subject to a negotiation framework established by the NER.

Also as for distribution, electricity transmission assets may provide some services that are not classified at all— unregulated services. These may be unregulated transmission services or unrelated to electricity supply. Figure A2 sets out the NER process for classifying transmission services.

Figure A2: Transmission service classification process



B Cost allocation and shared assets

If the allocation of costs between regulated and unregulated services was correct, why would a shared asset mechanism be required? The answer is that it would not. However, as the intended use of an asset may change, there is a need for a shared asset mechanism.

What is cost allocation?

We determine regulated electricity service prices or revenues based on costs that the service provider incurs to provide services which are classified into service types. We must, therefore, understand which costs relate to specific service classifications. The NER facilitate this understanding by requiring each electricity supply business to establish a cost allocation method (CAM), setting out its approach to cost allocation.[47] The CAM links costs incurred by service providers to service classifications. Appendix A provides further background on service classifications.

Routine power line maintenance, for example, supports core electricity supply services, so CAMs link asset costs such as maintenance trucks to standard control services. This cost allocation allows the electricity supply business to recover its maintenance costs, through regulated prices, from across its customer base. The cost allocation 'driver' in this case—the metric used to allocate truck costs to services—might be time spent on maintaining power lines. The service provider records time spent by each maintenance truck on line maintenance and allocates the truck's costs to standard control services in the same proportion.

The NER require CAMs to reflect the cost allocation principles in the NER.[48] These principles mandate that costs be allocated only once. CAMs should prevent double-dip cost recovery by stopping the same cost from being allocated to multiple service classifications. For customers of regulated electricity supply services, cost allocation should ensure they pay only costs related to service supply. This cost includes asset costs. Cost allocation should exclude assets providing other types of service from the standard control and prescribed transmission service regulatory asset bases.

A fleet of maintenance vehicles, for example, may do both routine line maintenance and ad hoc pole relocation jobs, which is not a standard control service. The service provider may negotiate the price of the latter service with customers who require that service. As above, let's assume the service provider's CAM uses time spent on jobs to allocate truck costs to the standard control and other service classifications respectively. In this way, the standard control asset base should reflect only costs that the service provider incurs in providing standard control services. CAMs also guide cost allocation to any unclassified, or unregulated, services.

When a single asset provides two types of service, the cost allocation framework requires asset owners to apportion values to the relevant service classifications. For a vehicle providing both electricity supply services and unregulated services, the standard control asset base would include some of the vehicle's asset value but exclude a proportion that reflects the unregulated services.

Limitations of cost allocation

Unless service classifications change, cost allocation largely occurs only once. That is, once asset costs/values are allocated to a service classification, they remain part of the asset base for that

[47] The NER require CAMs to be publicly available on network service providers' websites.
[48] NER, clauses 6.15.2 and 6A.19.2.

service classification. Asset cost allocation generally only changes if the services provided by that asset are re-classified. This semi-permanent cost allocation does not reflect new or growing unregulated revenue streams. Standard control assets may earn additional unregulated revenues without distributors removing any asset value from the standard control asset base or changing their cost allocation.

For this reason, the cost allocation approach will not affect what standard control service customers pay for that service, even if asset owners earn additional revenues from those assets. Therefore, asset owners may earn two revenue streams from a shared asset: one regulated revenue stream and another unregulated. They thus may recover the cost of standard control (or prescribed transmission) assets more than once.

How shared asset reductions address cost allocation's limitations

The NER shared asset mechanism deals with unregulated revenues in a way that cost allocation does not permit. Cost allocation deals with costs, while shared asset cost reductions can deal with unregulated service revenues. Shared asset cost reductions also mitigate the risk of asset owners recovering the cost of assets more than once, from both customers of regulated electricity supply services and customers of unregulated services. If asset owners earn additional unregulated revenue streams from assets previously allocated to the standard control (or prescribed transmission) asset base, then we can adjust regulated revenues to reflect the new avenue for asset cost recovery.

C Summary of submissions

Issue	Stakeholder[49]	Summary
Materiality	ActewAGL	Unregulated revenues50 of 1% of ARR51, assessed per service.
	Citipower, Powercor, SA Power	Unregulated revenues of 1% of ARR, assessed per service.
	ENA	Assess per service. Unregulated revenues of 1% of ARR triggers AER investigation.
	Energex	Supports establishment an unspecified materiality threshold.
	Ergon	Unregulated revenues of 1% of ARR, assessed per service, but with a further investigation of material asset use.
	EUAA	Unregulated revenues of 0.25% of ARR.
	Jemena	Unregulated revenues of 1% of ARR, assessed per service.
	MEU	Supports a materiality threshold lower than 1% of ARR.
	NBN Co	Guidelines should avoid creating a 'materiality trap' giving NSPs incentive to stop third party access to regulated assets.
	Networks NSW	Assess per service. Unregulated revenues of 1 per cent require NSP to address the issue. NSP may show unregulated use of shared assets is not material; if so, no cost reduction would apply.
	Origin	Supports a materiality threshold without specifying one.
	SSROC	A materiality threshold is not relevant to public lighting assets financed by local government.
Application of the shared asset mechanism	ActewAGL	Should apply only to unregulated services earning revenues.
	Citipower, Powercor, SA Power	Limit application to third party provided services. Apply cost reductions to only services or revenues above the materiality threshold.
	ENA	Apply to third party unregulated services only, excluding unregulated services provided by NSPs themselves. Exclude unregulated services using shared assets only marginally. Apply only to revenues above NSP incremental costs from unregulated services.
	Energex	It should not apply to non-network assets like vehicles, which do not directly earn unregulated revenues. Should apply only to third party use of network assets.
	Ergon	Details require further engagement with the AER. Guidelines should include a list of considerations to give stakeholders certainty on the guidelines' application.
	EUAA	The mechanism should include reconciliations for actual outcomes compared to forecasts used to determine cost reductions.

49 A submission by Citilum did not comment on issues relevant to the shared asset guidelines.
50 Refers to unregulated revenues earned with shared assets.
51 Annual revenue requirement. Total annual regulated revenue earned by service providers from standard control or prescribed transmission revenues.

Issue	Stakeholder[49]	Summary
	Jemena	Application should be determined per service.
	MEU	Should apply to overheads and other opex type costs in addition to assets. NSPs should retain all unregulated revenues earned in the regulatory period in which an unregulated service begins. Benefit sharing should apply from the next regulatory determination.
	NBN Co	Not specified.
	Networks NSW	Should only apply to unregulated services recovering more than NSP incremental costs. Should be flexible.
	Origin	Not specified.
	SSROC	Cost reductions should be based on actual service and revenue outcomes, not forecasts.
Cost reduction method	ActewAGL	Should be flexible to respond to business/service circumstances.
	Citipower, Powercor, SA Power	Not specified.
	ENA	Proposed a range of methods should be established for NSPs to select from in specific circumstances. Seeks further AER engagement to develop methods. Using NSP profit from unregulated services would contradict the Rules.
	Energex	Not specified.
	Ergon	A range of methods should be established. Requires further AER engagement. Should not be profit based.
	EUAA	NSPs should retain unregulated revenues to recover their incremental costs.
	Jemena	A range of methods should be available. They should account for the rivalrous or non-rivalrous nature of unregulated service use of shared assets, compared to regulated service use.
	MEU	Transaction/administration costs will increase the more specific the method is to individual assets. Customers should capture most unregulated revenues. Customers should continue to benefit from unregulated revenue streams even when relevant assets have zero regulatory value.
	NBN Co	While certainty would be beneficial, a prescriptive approach may fail to account for different circumstances. In-kind or make-ready works also benefit electricity customers through delayed asset replacement costs. It is unclear how these benefits could be accounted for. The market value of access to electricity networks may be lower than arbitrary physical use metrics may indicate.
	Networks NSW	Methods should be up to service providers to determine.
	Origin	Not specified.
	SSROC	Cost reductions should be based on unregulated revenues earned by each shared asset. NSPs should retain their incremental costs.
Benefit sharing proportion	ActewAGL	Should be determined by NSPs.

Issue	Stakeholder[49]	Summary
	Citipower, Powercor, SA Power	Not specified.
	ENA	Not specified.
	Energex	Not specified.
	Ergon	Contingent on further AER engagement.
	EUAA	90% of unregulated revenues above NSP incremental costs should benefit customers.
	Jemena	Should not be a single fixed proportion.
	MEU	NSPs should retain unregulated revenues equal to only their incremental costs from unregulated services, perhaps with a small profit margin. Benefit sharing proportions should increase with larger unregulated revenue streams.
	NBN Co	Not specified.
	Networks NSW	Not specified.
	Origin	NSPs should retain some unregulated revenues as incentive for ongoing benefit sharing with customers.
	SSROC	Not specified.
Reporting	ActewAGL	There should be no annual reporting requirement other than as already established by existing RINs52. Details of contracts for unregulated services are commercially sensitive.
	Citipower, Powercor, SA Power	Not specified.
	ENA	Reporting should be required only with regulatory proposals and kept to a minimum.
	Energex	Not specified.
	Ergon	Reporting should be required only with regulatory proposals.
	EUAA	Adequate reporting should be mandated when cost reductions are triggered.
	Jemena	Annual reporting should not be required. Regulatory proposal reporting should be through a separate line item in regulatory RINs.
	MEU	Supports detailed reporting when unregulated revenues reach 0.5% of ARR.
	NBN Co	Contractual arrangements are commercially sensitive.
	Networks NSW	Annual reporting should be limited. Regulatory proposal reporting should be required when the cost reduction materiality threshold is met.
	Origin	Supports detailed reporting when unregulated revenues reach 0.5% of ARR.
	SSROC	Local government should have access to data on the use of public lighting assets for other purposes.
Other emphasis	ActewAGL	Unregulated service use of regulated assets should be encouraged.

[52] Regulatory Information Notices.

Issue	Stakeholder[49]	Summary
	Citipower, Powercor, SA Power	The provision of incentives for unregulated services to be provided is the key shared asset principle. Assessing minor unregulated service use of regulated assets will increase administration costs.
	ENA	Primary focus should be to retain incentives for unregulated services to be provided.
	Energex	Administration costs should be minimised.
	Ergon	NSPs are not always able to recover their incremental costs from unregulated services.
	EUAA	While electricity customers may benefit from unregulated services provided with regulated assets, NSPs should focus on providing electricity supply services.
	Jemena	Cost reductions should relate to costs, not revenues.
	MEU	Without annual adjustments within regulatory periods, NSPs will game the process by postponing unregulated revenues to after AER regulatory determinations. The AER should consider proposing a Rule change to the AEMC if it considers the Rules constrain it inappropriately.
	NBN Co	NBN Co pays reasonable costs incurred in accessing distribution power poles. Contributions to overheads/profits depend on commercial negotiations. NBN Co is concerned that the shared asset mechanism may erode incentives for NSPs to provide access to electricity network infrastructure.
	Networks NSW	The AER should account for the broader economic benefits of allowing unregulated services to be provided with electricity network assets.
	Origin	Due the nature of the shared asset Rules, there could be considerable delay before customers see benefits. The market for competitive metering and energy management services is evolving, so forecasting with confidence at the next round of regulatory determinations is unlikely.
	SSROC	Local governments have paid the full cost of public lighting assets, or made capital contributions. NSPs have not sought permission from local governments to provide other, unregulated, services with public lighting assets.