CitiPower, Powercor Australia and

SA Power Networks

JOINT RESPONSE TO AER ISSUES PAPER ON SHARED ASSET GUIDELINES FOR ELECTRICITY DISTRIBUTION AND TRANSMISSION

17 May 2013

Introduction

CitiPower, Powercor Australia and SA Power Networks (**the Businesses**) welcome the opportunity to make this submission on the AER Issues Paper *Shared asset guidelines for electricity distribution and transmission* (**the Issues Paper**) dated March 2013.

The Businesses are fully supportive of the ENA submission on the Issues Paper, and in particular endorse the straw man shared asset approach put forward in the ENA submission.

The Businesses wish to highlight the importance of the first of the shared asset principles, which states that the NSP should be encouraged to use standard control services assets to provide unregulated services where that use is efficient and does not materially prejudice the provision of the standard control services. The value in this principle is very clear – where a NSP provides unregulated services that can share costs with standard control services, all stakeholders benefit.

The Businesses believe that this is the key principle and should be given significant emphasis, because the meaning and value of all of the other principles depends upon it. If the shared asset guidelines (**the Guidelines**) are inconsistent with this principle, there may be little or no benefit to share with customers.

Using standard control services assets to provide unregulated services can be achieved by either growing existing shared asset unregulated services or by being innovative in finding ways to provide new unregulated shared asset services. Encouraging such behaviour has important consequences for the Guidelines, as discussed below.

Materiality

An important consideration for encouraging shared asset unregulated services is administrative cost and complexity. The AEMC made it clear in the final determination of the economic regulation of network service providers rule change proposal (at p196) where it states "the benefit of sharing the cost of the asset based on use should outweigh the administrative costs of implementing the shared asset cost adjustment mechanism". The AEMC was confirming that a shared assets cost adjustment should be applied only where the use of the asset other than for standard control services is material, effectively setting a lower threshold of materiality at the point where the benefit of sharing outweighs the administrative costs of implementing the shared asset cost adjustment. The Businesses believe that the benefit would need to significantly outweigh the costs for the incentive to provide such services to be effective.

A materiality threshold of 1 per cent of the annual revenue requirement would be appropriate since it is consistent with the materiality threshold for cost pass through applications as set out in the National Electricity Rules. Since cost pass-throughs are considered on a case by case basis, it is equally appropriate that each shared asset service is considered on a case by case basis. In the absence of considering shared asset services on a case by case basis, there is the potential for the shared asset cost reduction to be imposed in relation to an unregulated service where the use of the asset is immaterial.

For example, a NSP's annual revenue requirement may be $500m per annum. Service A shared asset revenue/use may be $8m per annum. Service B shared asset revenue/use may be $0.1m per annum. If the 1 per cent materiality test was applied to both services on an aggregated basis then a shared asset cost reduction would need to be determined for each service, but with no

discernible customer benefit for service B. If the 1 per cent materiality test was applied to each service individually then a shared asset cost reduction would be appropriately determined for service A, and appropriately not for service B.

Forward looking

The Businesses consider that application of the Guidelines should be forward-looking (that is, the shared asset cost reduction determined ex-ante) with no ex-post true-up because this is consistent with encouraging the growth of unregulated shared asset services, in the same way that forward looking cost forecasts create an incentive to be cost-efficient. To the extent that unregulated shared asset revenues/use changes during the regulatory period, the shared asset cost adjustment should only be reviewed at the beginning of the next regulatory period and then apply to the forecast revenues/use for that regulatory period.

This forward-looking principle is required under clause 6.4.4(a) of the National Electricity Rules and is consistent with the intent of the AEMC as expressed in the final determination of the economic regulation of network service providers rule change proposal.

Relevant services

There is a risk that even the best intentioned Guidelines, irrespective of whether the cost sharing mechanisms are triggered by arbitrary/rule of thumb materiality thresholds or more involved calculations of proportional use of shared assets, may entail significant work for the NSP and AER to determine ultimately that there are no costs to share or that they are immaterial and not worth the effort. The risk is that the administrative costs of implementing the sharing scheme may exceed or erode much of the service's net revenue.

The Businesses believe that an appropriate way to ensure that this regime does not impact on such marginal services is to limit its application to services that can be characterised as the NSP providing third party access to standard control assets. Such a regime will capture the key services that appear to be the main focus of the rule change, but will offer significant benefits in terms of streamlined administration. NSPs will be able to focus on services that clearly share standard control services assets, and these are likely to be services that do not involve a great deal of complexity either in terms of their cost structure or use of the shared assets. The work for both the AER in its development of the Guidelines, and both the AER and NSPs in their assessment of the Guidelines' application are likely to be significantly simplified under this approach.

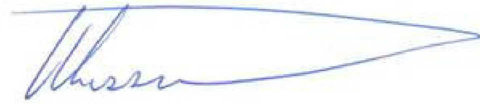
An example of an unregulated service, which does not provide third party access to standard control assets, is a NSP providing maintenance services in a different state to where it provides standard control services. The services are provided from a dedicated office in the different state. The same SAP IT system that is used to provide standard control services is also used to a very small extent to support accounting and billing systems for the unregulated maintenance service. The unregulated service is material in terms of the revenue it earns, but the process for determining the unregulated service's use of shared assets could be administratively complex and time-consuming for both the AER and NSP and ultimately identify immaterial use of shared assets for unregulated services. It would not be in anyone's interests for focus on such services to be required by the Guideline. Limiting the application of the Guidelines to services where the NSP is providing third party access to standard control assets would avoid unnecessary administrative cost.

Continuous incentive

It is important that the Guidelines create a continuous incentive and do not create the perverse incentive for NSPs to grow unregulated shared asset services to the materiality threshold, and no further. For instance, a NSP might have grown unregulated shared asset revenue/use to $1.9m per annum where the materiality threshold might equate to $2m per annum of unregulated shared asset revenue/use. In the absence of a continuous incentive, if the DNSP were to grow the unregulated shared asset revenue/use to $2.1m per annum it might then at the next determination be subject to a shared asset cost reduction over the next regulatory period. The DNSP may be better off keeping unregulated shared asset revenue/use below the materiality threshold. There are different ways for the Guidelines to avoid this perverse outcome, for instance the shared asset cost reduction could be applied only to revenue/use incremental to the materiality threshold.

If you have any queries regarding this request please do not hesitate to contact either Mark de Villiers on 03 9683-4907 or mdevilliers@powercor.com.au or Tom Walker on 08 8404-9649 or tom.walker@sapowernetworks.com.au.

Yours sincerely



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