



**AER Shared Asset Guidelines for  
Electricity Distribution and  
Transmission  
Response to Issues Paper**

**May 2013**

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## Part A: Response to the Issues Paper

### 1. Introduction

The Energy Networks Association (ENA) welcomes the opportunity to respond to the Australian Energy Regulator's (AER) Issues Paper - Shared asset guidelines for electricity distribution and transmission. The ENA appreciates the open and interactive approach the AER has adopted in this consultation.

The Australian Energy Market Commission's (AEMC) Rule Determination in respect to Economic Regulation of Network Service Providers, published in November 2012, introduced a requirement on the AER to develop and consult on shared asset guidelines for electricity transmission and distribution businesses. The Shared Asset Guidelines (the Guidelines) will be non-binding on the Network Service Providers (NSP) and the AER. Following the completion of this consultation process, the AER may review, amend or replace the Guidelines in accordance with distribution and transmission consultation procedures under the National Electricity Rules.

The ENA would like to emphasise that there are societal benefits associated with the advancement of unregulated services<sup>1</sup> that share regulated assets, and network businesses should be encouraged to efficiently grow unregulated activities. It follows that the Guidelines must strike an appropriate balance between the costs and benefits of the shared asset mechanism. That is the additional benefits from unregulated activities should be shared with consumers to the extent that these benefits exceed the additional costs of providing the unregulated activities and implementing and administering the shared asset mechanism.

This submission proposes an approach that, in the ENA's view, would result in the effective operation of the Guidelines.

### 2. Key considerations

The National Electricity Rules (Rules) provide a high-level framework for a shared asset mechanism. The ENA considers that there is benefit in outlining a list of considerations that are relevant to the development of a detailed shared asset mechanism. The ENA further considers that these considerations should be included in the Guidelines in order to provide up-front certainty for NSPs and other stakeholders in terms of the scope of application of the Guidelines, as well as the inter-relationship of the Guidelines with the Rules. Specifically:

- The Guidelines must be developed to give effect to the shared asset principles contained in clauses 6.4.4(c) and 6A.5.5(c) of the Rules. In particular, the Guidelines must give effect to the primacy of the first shared asset principle. That is, the Guidelines should encourage, rather than discourage, NSPs to grow existing and offer new shared asset unregulated services;
- The Guidelines must take into account the fact that some existing agreements for the provision of unregulated activities may not have been entered into in their current form if the Guidelines had existed at the time the decision to proceed was made;
- The Guidelines and their application should be forward looking. That is the Guidelines should not be applied retrospectively to revenue already earned;
- There should be no true-up for actuals, i.e. cost reduction should be set at the time of making the distribution or transmission determination;

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<sup>1</sup> Shared asset provisions of the National Electricity Rules relate to distribution standard control services and prescribed transmission services. These services are referred to as regulated services throughout this submission. All other services are referred to as unregulated services. Shared asset provisions do not apply to distribution alternative control services and negotiated transmission services. These services are referred to as unregulated services throughout this submission.

- The Guidelines and their application should be compatible with the cost allocation principles and the operation of the Cost Allocation Methodology;
- The process should be administratively simple and not place any excessive or unnecessary regulatory or administrative burden on NSPs or the AER;
- Given that there are no decision points within a regulatory period, reporting should be done as part of the distribution and transmission determination process (i.e. once every 5 years). This is to decrease administrative burdens and compliance costs, given that the cost reduction can only be applied at the time of regulatory determination;
- Assessment should be done on a per service basis, which may at times correlate with a 'per contract' basis. Where there are multiple contracts for the same 'service' these should be considered on an aggregated basis;
- Cost reduction method (and proportion) should be considered on a business by business basis and service by service; and
- The Guidelines should apply to access based services only. That is, to services where a third party is seeking access to regulated infrastructure, particularly fixed assets such as poles, conduits, buildings, communication networks, etc.

### **3. Shared asset approach**

The Rules require that the Shared Asset Guidelines set out the approach the AER proposes to take in applying the shared asset principles. This may include a methodology that the AER proposes to use to determine reductions in the annual revenue requirement to making shared asset cost reductions. The ENA is broadly supportive of the approach that the AER has set out in section 3.4 of its Issues Paper. However, members of the ENA consider that a number of enhancements to the AER's proposal can be made. This section discusses areas of concern with the AER's initial approach and provides a Straw Man proposal for the AER's consideration.

#### **3.1. Simplifying the application of the Shared Asset Guidelines**

An important aspect of encouraging NSPs to be innovative in their use of regulated assets is to minimise the complexity of implementing and administering the cost sharing regime. The AEMC made their intention in this regard very clear in the final rule change determination where they state "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".<sup>2</sup> The AEMC was confirming that a shared asset cost adjustment should be applied only where the use of the asset other than for regulated 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 ENA believes that the benefit would need to significantly outweigh the costs for the incentive to provide such services to be effective.

There is a risk that even the best intentioned Guidelines, whether the cost sharing mechanisms are triggered by arbitrary/rule of thumb materiality thresholds or more involved calculations of the proportional use of shared assets, may entail significant work for the NSP 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 scheme may exceed or erode much of the service's net revenue and ultimately discourage (rather than encourage) the use of regulated assets to provide unregulated services.

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<sup>2</sup> AEMC, *Final Rule Determination: Draft National Electricity Amendment (Economic Regulation of Network Service Providers) Rule*, p196.

For example, where a NSP provides a service from a dedicated depot or office in a different state to where it provides regulated services, this office may use a very small (immaterial) amount of regulated services' assets, such as accounting and billing for the unregulated service it provides. The unregulated service may be material in terms of the revenue it earns, but determining the unregulated service's use of shared assets could be administratively complex and time-consuming for both the AER and NSP. It would not be in anyone's interests for such a service to be captured by the Guideline. Limiting the application of the Guidelines to services where the NSP is providing third party access to regulated assets would avoid unnecessary administrative cost.

The ENA believes that one way to ensure that the encouragement principle is achieved is to exclude from the scope of the shared asset costs adjustments, those 'assets' or 'costs' that have a marginal cost impact. Rather, the ENA believes that the shared asset costs adjustment mechanism should focus on those costs and assets which can be easily identified, quantified and allocated between regulated and unregulated services. That is, 'access based' costs and assets that can be easily identified and characterised as providing third party access type services (for example, poles, conduits, buildings and communication networks). Such arrangements will capture the key costs and services that appear to be the main focus of the rule change, but will offer significant benefits in terms of simplifying implementation, administration and reporting. NSPs and the AER will be able to focus on services that clearly share regulated assets and these assets and costs are likely to be those items that involve the least 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 NSPs in their assessment and implementation of the Guidelines is likely to be significantly simplified. Further, this exercise of the AER's discretion would directly support the principle of encouraging the innovative and efficient provision of other unregulated services.

### ***3.2. Shared asset principles***

In the ENA's view, it is critical that the Guidelines properly reflect the intentions set out in the shared asset principles.

In particular, the ENA believes that the first shared asset principle (cl. 6.4.4(c)(1) and cl. 6A.5.5(c)(1)) is of paramount importance and should significantly inform the development of the Guidelines, the interpretation and application of all the other shared asset principles because:

- It clearly states the main objective that the AER is to have regard to in developing and applying the Guidelines and exercising its powers under clauses 6.4.4(a) and 6A.5.5(a);
- It reflects, and is consistent with, the National Electricity Objective; and
- The other shared asset principles are clearly intended to be read by reference to it. That is, if the shared asset mechanism reflected in the Guidelines does not achieve the first shared asset principle of encouraging the use of regulated assets to provide unregulated service where that use is efficient and does not materially prejudice the provision of regulated, then implementing the other shared asset principle will have no practical effect.

The use of the word 'encourage' in the first shared asset principle is critical to the interpretation and application of that principle. As the AER has noted in its Issues Paper, there is currently no obligation on NSPs to provide unregulated services using shared assets. Creating appropriate economic incentives for NSPs to use regulated assets to provide unregulated services should, therefore, be the AER's primary goal in developing the Guidelines and exercising its powers under clauses 6.4.4(a) and 6A.5.5(a) of the Rules.

### ***3.3. Extent of shared asset cost reductions***

The ENA is concerned with the AER's proposed approach outlined in its Issues Paper that suggests that (in theory) the revenues accruing from the use of shared assets to provide unregulated services may be shared with consumers up to 100 per cent of the relevant asset value. The ENA considers that this approach:

- Would dilute the incentives of a business to provide unregulated services which ultimately benefit consumers and society more broadly;
- Is inconsistent with the shared asset principle that 'unregulated services' use of regulated assets should be encouraged when it does not affect regulated services; and
- Fails to recognise that NSPs often do not recover the full cost of providing an unregulated service, such as where a NSP does not charge for an immaterial regulated service or does not have a right to refuse provision of the unregulated service or access to/use of assets. More specifically, telecommunications carriers have access rights over NSP assets and where those rights are exercised NSPs are compensated for the demonstrable loss and damage incurred post installation, therefore leaving very little scope for sharing any revenues or benefits with consumers.

Consequently the ENA suggests that the focus of the Guidelines should be in accordance with Rules, specifically cl. 6.4.4(a) (cl. 6A.5.5(a) for transmission) which states:

*[T]he AER may, in a distribution determination for a regulatory control period, reduce the annual revenue requirement for that Distribution Network Service Provider (DNSP) for a regulatory year in that regulatory control period by such amount as it considers reasonable to reflect such part of the costs of that asset as the DNSP is recovering through charging for the provision of a service.*

The Guidelines should therefore only apply a sharing mechanism where it can be demonstrated that the unregulated revenue includes a portion of the costs of the shared assets. This provides a more objective basis for reducing revenues and compensating consumers reasonably in accordance with the Rules.

### **3.4. Reporting**

The ENA is also concerned with some of the AER's proposals with regard to the reporting of detailed information about unregulated services.

Firstly, the ENA notes that the AER's proposed reporting threshold that would trigger a requirement for NSPs to provide detailed information about its unregulated services is set at 0.5 per cent of the ARR. This reporting threshold is not linked the basic 1 per cent 'materiality' threshold or any other materiality measure outlined in the section 3.1 of the AER's Issues Paper.

If, for example, the Guidelines were to set the materiality threshold at 1 per cent of ARR, then setting the reporting threshold at 0.5 per cent may create situations in which NSPs would have to incur significant administrative burdens and compliance costs even though a reduction in shared asset costs was not possible as the 1 per cent 'materiality' threshold triggering a reduction was not reached.

Accordingly, the ENA proposes that the thresholds for shared asset cost reductions and provision of detailed information should be aligned in order to avoid a situation whereby significant compliance costs are incurred for no reason.<sup>3</sup>

Secondly, the ENA is concerned with the potential administrative burdens and compliance costs that would be imposed by the AER's indicated approach of requiring NSPs to report detailed information in relation to their unregulated activities on an annual basis. The ENA notes that NSPs already provide the AER with information in relation to their unregulated revenues as part of regulatory financial statements. In the ENA's view, the AER's suggested reporting requirements would introduce an additional administrative burden on the NSPs, without having identified a clear benefit and may in fact be outside the scope of the AER's powers under the Rules in that the AER does not have the power

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<sup>3</sup> Note that the ENA is proposing an *Unregulated Revenue Test* at 1 per cent of the annual revenue requirement (ARR) in the latter of the submission.

to 'regulate' 'unregulated' activities. Furthermore, the ENA is concerned that the AER's suggested reporting requirements are related to an activity not regulated by the AER under the Rules, nor are they linked to any action under the shared asset mechanism. The ENA also notes that the shared asset cost adjustment can only be applied at the beginning of the regulatory period. The ENA therefore considers that reporting on unregulated services should only occur at the time of the regulatory determination process. Under this approach, the NSPs would be required to identify, in their regulatory proposals, the unregulated revenue that is generated from using shared assets for the provision of the unregulated service.

### 3.5. Unregulated Revenue Test

The ENA considers that the Guidelines should include an *Unregulated Revenue Test* at 1 per cent of the annual revenue requirement (ARR), beyond which an assessment of a NSP's unregulated revenue would be required. The *Unregulated Revenue Test* would provide a simple way of identifying unregulated service to which sharing mechanism may potentially be applied.

Further assessment of NSP's unregulated revenue (after application of *Unregulated Revenue Test* described above) should be based on minimum agreed information necessary to verify the shared asset cost reduction, as these are not regulated services and are commercially confidential. It is important that the information requirements strike an appropriate balance between information disclosure in relation to the services that are not regulated by the Rules and the application of the shared asset mechanism.

Consequently, the ENA proposes the following process that is aimed at ensuring the Guidelines provide for a simple, transparent and cost effective application of the shared asset mechanism.

**Table 1 Straw Man Proposal – Shared Asset Approach**

<b>Step 1</b>	Identify the unregulated service that uses shared assets.  (Note: if the CAM has been applied, the service is excluded – the assets are not deemed to be 'shared assets')
<b>Step 2</b>	Identify <u>unregulated</u> revenue that is generated from using shared assets for provision of that unregulated service.  Exclude all other unregulated revenue.
<b>Step 3</b>	Unregulated Revenue Test: Is the unregulated revenue that is generated from using shared assets for provision of that unregulated service > 1% of ARR?  If Yes: Go to Step 4  If No: No further action required.  (Note: This is not a test of 'material use' of the shared asset as required in the Rules)
<b>Step 4</b>	NSP must submit a 'shared asset cost adjustment proposal' as part of their regulatory proposal that either; <ul style="list-style-type: none"> <li>• Demonstrates the non-materiality of the shared asset use for that unregulated service; or</li> <li>• Proposes a cost reduction method.</li> </ul> <p><i>At this stage, the NSP has the option of demonstrating to the AER that based on some methodology e.g. physical asset use, rivalrous/non-rivalrous etc. - that there is no material use.</i></p> <p><i>The Guidelines may specify a range of acceptable methods.</i></p>

<b>Step 5</b>	<p>The AER considers the ‘shared assets cost adjustment proposal’ for that unregulated service and makes a decision whether to accept or reject the proposal. In a case in which the AER decides to reject the proposal, the AER should determine a shared assets cost reduction in consideration of the Rules and the Shared Asset Guidelines.</p> <p>In a case in which application of shared asset mechanism results in the cost reduction, the AER is to reduce regulated revenues to be earned by shared assets.</p>
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## 4. Cost reduction method

In accordance with clauses 6.4.4(d) and 6A.5.5(d) of the Rules, the Guidelines may include a methodology that the AER proposes to use to determine a reduction to the ARR, as a consequence of the shared use of an asset. Further, by virtue of clauses 6.4.4(b) and 6A.5.5(b) of the Rules, in deciding to whether to reduce a NSPs ARR under the shared asset mechanism, the AER must have regard to the shared asset principles in clauses 6.4.4(c) and 6A.5.5(c) of the Rules.

The ENA considers that it is desirable for a range of acceptable methodologies to be outlined in the Guidelines. This is because the NSPs should apply the most appropriate method for a particular service. Members of the ENA consider that this would be a sensible approach given that different NSPs provide different unregulated services, and the risks and costs of providing these services may vary substantially. Also, this flexibility is required to recognise jurisdictional differences that currently exist due to the fact that shared assets have historically been treated differently by the NSPs and their State and Territory Regulators. Another possible approach is to not specify the potential methods in the Guidelines and leave it up to the NSPs to propose the most appropriate method for a particular service.

At this stage the ENA has not provided drafting of the potential methodologies for cost reduction to be included in the Guidelines. The ENA proposes to develop suggestions for drafting of potential methodologies for the AER’s consideration and suggests that a further workshop should be held with the AER to discuss drafting options. As explained above, members of the ENA consider that no single method will suit all circumstances of the NSPs. In light of this, it is important the AER holds a workshop on the specific drafting of cost reduction methods.

Further, the ENA considers that it would be prudent for the Guidelines to require that NSPs submit a ‘shared asset cost adjustment proposal’ as part of their regulatory proposal (see step 4 in [Table 1](#)). The ‘shared asset cost adjustment proposal’ would need to demonstrate the materiality of the shared asset use for unregulated services, as well as to nominate a cost reduction method for each unregulated service from the methods specified in the Guidelines. The suggested approach would not limit the AER’s ability to reject the NSP’s proposal and determine an alternative amount of shared asset cost reduction, in consideration of the Rules and the Guidelines.

The ENA notes that the AER is required to determine whether the use of the shared assets is material and that materiality is not defined in the Rules. The ENA considers that further work is required in relation to defining ‘material use’ in the Guidelines. It is considered that the definition of materiality will be inherent in identifying the potential methodologies for cost reduction. Based on an appropriate methodology, e.g. physical asset use, rivalrous/non-rivalrous etc. – the NSPs will be required to demonstrate whether the use of shared asset is material or not.

## 5. Conclusion

The ENA considers the approach outlined above would strike an appropriate balance between the costs and benefits of the shared asset mechanism. In the first instance, limiting the application of the Guidelines to third party access to regulated assets will significantly simplify the development and application of the Guidelines and would not materially prejudice cost sharing outcomes. Further, the *Unregulated Revenue Test* will exclude the services that do not generate a material amount of



revenue from further assessment. It is expected that this step will significantly decrease the administrative burden to the NSPs and the AER. In relation to those unregulated services that generate revenue in excess of the *Unregulated Revenue Test* threshold, the opportunity to submit the 'shared asset cost adjustment proposal' will enhance investment certainty, whilst preserving the AER's ability to scrutinise the proposal to ensure that it delivers an outcome that is in the interests of consumers.

## Part B: Responses to the Issues Paper Questions

### Question 1

Should shared asset guidelines incorporate a materiality threshold of 1 per cent of the annual revenue requirement? Please provide your reasons. Alternatively, what approach to materiality might be adopted?

The ENA considers that the Guidelines should include an *Unregulated Revenue Test* at 1 per cent of the ARR. Logically this test should be applied on a per service basis to avoid high administrative cost being incurred in relation to a non-material service. The *Unregulated Revenue Test* would provide a simple way of identifying unregulated service to which sharing mechanism may potentially be applied. The ENA notes that this is not a test of 'material use' of the shared asset as required in the Rules.

The *Unregulated Revenue Test* will aim to exclude the services that do not generate a material amount of revenue from further assessment. It is expected that having this test in place will significantly decrease the administrative burden to the NSPs and the AER.

The ENA considers that further work is required in relation to defining 'material use' in the Guidelines. It is considered that the definition of materiality will be inherent in identifying the potential methodologies for cost reduction. In accordance with the Straw Man proposal provided in [Table 1](#), the ENA considers that NSPs should be required to demonstrate the materiality of the shared asset use for an unregulated service as part of 'shared asset cost adjustment proposal' based on an appropriate methodology.

### Question 2

We propose to forecast shared asset cost reductions and not require any adjustment once actual outcomes are known. Do you agree with this approach? Please provide your reasons.

The ENA considers that application of the Guidelines should be forward-looking. This is consistent with the approach envisaged by the AEMC in the final determination of the economic regulation of network service providers rule change proposal.<sup>4</sup>

There should be no true-up for actual outcomes once they become available. This position aligns with the *ex ante* approach to setting annual revenue requirement under the Rules. To the extent that unregulated revenues generated from shared use of regulated assets change during the regulatory period, the shared asset cost adjustment can only be reviewed at the beginning of the next regulatory period and apply to the forecast revenues for that regulatory period. This will preserve the incentive for NSPs to identify new opportunities for sharing assets that will in turn benefit consumers through lower asset costs in future regulatory periods.

The AER correctly noted that the Rules do not permit making shared asset cost reductions within regulatory period. Cost reduction should be set at the time of making the distribution or transmission determination.

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<sup>4</sup> AEMC, *Final Rule Determination: Draft National Electricity Amendment (Economic Regulation of Network Service Providers) Rule*, p193.

### Question 3

We propose that when shared assets produce revenues exceeding 0.5 per cent of the annual revenue requirement that more detailed reporting of these revenue sources would be required on an annual basis. Do you agree? Please provide your reasons.

The ENA disagrees that a comprehensive reporting threshold is required. In the ENA's view, compliance with such a threshold would introduce an additional administrative burden on the NSPs, without having identified a clear benefit. Further, the ENA is concerned that the AER's suggested reporting requirements are related to an activity not regulated by the AER under the Rules, nor are they linked to any action under the shared asset mechanism.

However, the ENA would support an approach where an assessment of a NSP's unregulated revenue would be required once the specified threshold is met. Therefore, the ENA has proposed that the Guidelines should include an *Unregulated Revenue Test* at 1 per cent of the ARR that is discussed in section 3 of this submission. Outside of the *Unregulated Revenue Test*, the unregulated revenue earned from the shared use of an asset would be considered irrelevant.

Further assessment of NSP's unregulated revenue (after application of *Unregulated Revenue Test* described above) should be based on minimum agreed information necessary to verify the shared asset cost reduction, as these are not regulated services and are commercially confidential.

### Question 4

In light of our proposed approach to shared asset reductions, what other improvements could be made? Please provide your reasons.

The ENA has provided a Straw Man in [Table 1](#) that proposes a number of enhancements to the AER's approach.

### Question 5

Should shared asset guidelines detail a method for cost adjustment?

The ENA considers that it is desirable for a range of acceptable methodologies to be outlined in the Guidelines. This is because the NSPs should have the option of using a method that takes into account the individual circumstances of the unregulated service in question.

At this stage the ENA has not provided drafting of the potential methodologies for cost reduction to be included in the Guidelines. Further work is required to fully understand implications and feasibility of various approaches. The ENA proposes to develop suggestions for drafting of potential methodologies and submit it to the AER outside of the formal consultation process.

Following the submission of this work to the AER, the ENA proposes that the AER should hold a stakeholder workshop on the specific drafting of cost reduction methods.

**Question 6**

How could cost reductions best share unregulated service benefits with customers while retaining incentives for asset owners?

The ENA considers that the answer to the question is contingent to further work to be undertaken (see response to Question 5).

There is a clear tension between sharing the benefits with consumers and maintaining incentives for NSPs to identify opportunities to share assets. There is risk that if cost reductions are set too high; it will discourage efficient use of regulated assets to provide unregulated services.

**Question 7**

Should the profit from unregulated services be used to make shared asset cost adjustments?

The ENA considers that profit from unregulated services that share regulated assets cannot be used to make shared asset cost adjustments. To do so would be in conflict with clauses 6.4.4(a) and 6A.5.5(a) of the Rules, which state that a NSP's ARR should only be reduced by such amount that the AER considers reasonable to reflect such part of the cost of the shared assets that the NSP is recovering through charging for the provision of the unregulated service.

Furthermore, it was explicitly stated by the AEMC in the final determination of the economic regulation of network service providers rule change proposal, that "the shared assets cost adjustment mechanism should operate in a way that would not be based on the profit or revenue received by the NSP from the unregulated service".<sup>5</sup> The AEMC was mindful that the shared asset arrangements should not attempt to regulate the unregulated service by limiting profits that can be earned from that unregulated service.

**Question 8**

Is a technical/physical asset use approach to a shared asset cost reduction preferable to an approach based on proportional revenues? Please provide your reasons. What other method could the guidelines incorporate?

The ENA considers that the answer to the question is contingent to further work to be undertaken (see response to Question 5).

As discussed in section 4 of this submission, the ENA supports certainty in application of the Guidelines, without limiting flexibility. Therefore, the ENA considers that it is desirable for a range of acceptable methodologies to be outlined in the Guidelines. Another possible approach is to not specify the potential methods in the Guidelines and leave it up to the NSPs to propose the most appropriate method for a particular service.

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<sup>5</sup> AEMC, *Final Rule Determination: Draft National Electricity Amendment (Economic Regulation of Network Service Providers) Rule*, p192.

**Question 9**

Should the guidelines include a fixed cost reduction proportion? If so, what should the proportion be?  
Should the guidelines set out another approach?

The ENA considers that the answer to the question is contingent to further work to be undertaken (see response to Question 5).