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

By email: costallocations@aer.gov.au

Dear Mr Pattas

Shared asset guidelines for electricity distribution and transmission - Issues Paper, March 2013

Jemena Electricity Networks (Vic) Ltd (**JEN**) is pleased to make this submission in response to the Australian Energy Regulator's (**AER**'s) issues paper for shared asset guidelines for electricity distribution and transmission. JEN's submission relates to shared asset arrangements as they apply to electricity distribution.

JEN has contributed to and supports the submission that the Energy Networks Association (**ENA**) has made in response to the issues paper.

JEN's key messages are:

- the guidelines must be developed in accordance with the shared asset clause 6.4.4 (a) of the Rules – i.e. the annual revenue requirement (**ARR**) may only be reduced to reflect such part of the *costs* of the shared asset that is recovered by a Distribution Network Service Providers (**DNSPs**)
- the guidelines should be forward looking – i.e. the guideline's must not be applied retrospectively to revenue already earned
- cost reduction should be set at the time of making regulatory determinations – i.e. there should be no true-ups for actuals
- the guideline and their application should be compatible with the cost allocation principles and the operation of the AER-approved Cost Allocation Methodology (**CAM**), with the CAM being the default means of cost sharing, where feasible
- the materiality and cost reduction assessments should be done on a per service basis

- the guidelines should include a range of cost reduction methodologies for application on a service to service and business to business basis. In this regard, an important consideration should be whether the use of an asset for unregulated services is rivalrous or non-rivalrous before AER gives consideration to any shared asset cost adjustment in the CAM or to the ARR. We believe there are societal benefits associated with the advancement of unregulated services through shared regulated assets
- the guidelines must be developed to encourage DNSPs to efficiently grow existing and new shared asset unregulated services
- the guideline requirements should be simple to apply and not place any excessive administrative burden on DNSPs or the AER
- the reporting should be done as part of the regulatory determination process, given that cost reduction can only be applied at the time of regulatory determination

JEN's detailed responses to the questions posed in the issues paper are set out in Annexure 1.

If you wish to discuss this submission, please contact Siva Moorthy, Manager Network Regulation and Strategy, on 03 8544 9442 or myself on 03 8544 9053.

Yours sincerely

Robert McMillan
General Manager Regulation

Annexure – 1

Jemena Electricity Networks (Vic) response to the National Electricity Amendment (Recovery of Network Support Payments) Rule 2013

Jemena's answers to the questions posed in the consultation paper are set out below:

Questions 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?

Response:

JEN considers the shared asset guidelines should incorporate a materiality threshold of 1 per cent of the annual revenue requirement (ARR). The one per cent threshold should apply only to unregulated service revenues that use shared assets. Only when the threshold is exceeded, should shared assets cost reductions be considered.

Establishing a threshold would provide a certain level of certainty to NSPs. It provides a simple decision point, as to whether the AER needs to proceed with the shared assets cost reduction mechanism in the guidelines.

It also allows for new and innovative shared asset service offerings to prove their commercial viability at scale prior to adjustment in the CAM or AAR.

Questions 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.

Response:

JEN supports the AER's initial position in section 3.2 of the issues paper – that is, cost reductions should be forward looking. In this regard, the AER would make shared cost reductions at the beginning of the distribution determinations, and there will be no adjustment to future costs recovery for unregulated service costs shared in a previous 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.

Questions 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.

Response:

JEN does not support the AER's proposal for more detailed reporting of shared assets that produce revenues exceeding 0.5 per cent of the ARR. AER has not identified any clear benefit or provided any reason why it wants such comprehensive information on unregulated activities within a regulatory period. Given that there are no decision points within a regulatory period, reporting should be done as part of the distribution determination process (i.e. once every 5 years). This would avoid significant administrative burden and compliance costs, given that the cost reduction can only be applied at the time of a regulatory determination.

JEN currently reports unregulated revenues through the regulatory information notice (**RIN**) in a single line item. To provide visibility of unregulated revenues earned from shared standard control assets and those that are unrelated to shared assets, we propose the revenues be reported as two separate items in the RIN. We believe it would be more appropriate to provide the necessary detailed information at the time of the regulatory proposal to verify the shared cost asset reduction.

Questions 4
In light of our proposed approach to shared asset reductions, what other improvements could be made? Please provide your reasons.

Response:

JEN has contributed to and supports the submission ENA has made in response to the issues paper. ENA's submission contains a Straw Man which shows a step by step approach to determining shared cost reduction. We urge the AER to consider the proposed improvements.

Questions 5
Should shared asset guidelines detail a method for cost adjustment?

Response:

The AER notes in section 4 of the issues paper that under the Rules, the guidelines may or may not detail a shared asset cost adjustment method to apply in a given circumstance.

JEN considers the scope of unregulated activities utilising assets used to provide standard control services vary significantly between NSPs. Consequently it may not be possible to develop a single method of cost adjustment, but rather the guidelines may specify a range of acceptable methodologies that can be applied depending on the circumstances.

The NER clause 6.4.4 provides for the AER to reduce the ARR where an asset that is used to provide standard control services is also used to provide unregulated services. Specifically, clause 6.4.4(a) (2) (ii) states:

> "… the *AER* may, in a distribution determination for a *regulatory control period*, reduce the *annual revenue requirement* for that *Distribution Network Service Provider* for a *regulatory year* in that *regulatory control period* by such amount as it considers reasonable to reflect <u>such part of the costs of that asset as the *Distribution Network Service Provider* is recovering</u> through charging for the provision of a service referred to in subparagraph (1) or (2)." [Emphasis added]

JEN considers where a DNSP is not recovering any costs of the shared asset through charging for the provision of an unregulated service, then there can be no adjustment to the DNSP's ARR.

For example, JEN has recently reached agreement with a telecommunication company to attach its cables to our power poles. The annual charge per pole recovers only the incremental costs of the communication cables on our power poles. These costs include the additional time it would take JEN when carrying out routine maintenance on power poles where communication cables are attached; the impact on control centre operations and unplanned or emergency actions. Because the attachment of these cables are non-rivalrous, JEN did not seek to recover the return on and return of the power pole. The agreement requires the telecommunication company to bear the full costs of all 'make ready' works which may include replacement of some existing poles where necessary. Replacement of some poles are necessary by the telecommunication company because the poles are either not in the required position or they have do not have sufficient capacity to meet the statutory height/separation clearances. Where poles are replaced, they are gifted to JEN and they go into the regulatory asset base at zero value. Under this arrangement, electricity customers stand to benefit from lower electricity prices because JEN will use these gifted poles to provide electricity distribution services over the 40-year service life of these poles at no capital cost to our electricity customers.

A rivalrous use is when the use by one service on an asset prevents simultaneous use by other services. For example, JEN has communication cables for supervisory control and data acquisition (SCADA). A number of fibres are used by a telecommunication company to provide data services to a group of hospitals. This is a rivalrous use because the fibre capacity to run SCADA data is diminished by the extent of fibre capacity being used to provide communication services to the hospitals. Such use may therefore qualify for shared asset cost adjustment.

JEN believes the AER should consider whether the use of an asset for unregulated services is rivalrous or non- rivalrous before it determines the shared asset cost adjustment in the CAM or to the ARR. We believe there are societal benefits associated with the advancement of unregulated services through shared regulated assets, and network businesses should be encouraged to efficiently grow unregulated activities.

Maximising non-rivalrous uses of energy assets will support productive, allocative and dynamic efficiency in the Australian economy by lowering the cost of goods and services provided within the economy.

The above examples show that there needs to be different methodologies to cover different circumstances. In this regard, the ENA has suggested in its submission that further work is required to fully understand the implications and feasibility of prescribing methodologies in the guidelines. It proposes to develop suggestions for drafting potential methodologies and submit it to the AER outside of the formal consultation process. JEN looks forward to this, should it be acceptable to the AER.

Questions 6

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

Response:

Cost sharing for unregulated services with customers can best retain incentives for asset owners and thereby maximise benefits to electricity customers over time by:

- applying a materiality threshold
- allocation based on cost sharing not revenues, as required by the NER
- allowing new and innovative service offerings to get established in practice and at scale prior to adjusting the regulated cost base. This would avoid placing undue risk in this emerging sector that could stymie its growth. An example of a sharing mechanism is one that incorporates a one regulatory period exclusion equivalent to the 5 year benefit sharing achieved through the current efficiency benefit sharing scheme and the AER's contemplated capex sharing scheme.

To retain incentives for regulated service use of standard control assets, DNSPs should be allowed to retain all of the revenues related to new unregulated services it may negotiate with a third party in the initial regulatory period. After that, the DNSP should be allowed to retain a reasonable portion of unregulated revenues.

JEN considers that when deciding how much of the revenues should be allowed to be retained whilst encouraging DNSPs to grow the unregulated revenue, assessment should be done on a per service basis. If the unregulated revenues are aggregated for the purposes of determining revenue adjustment, it may unintentionally stifle initiatives in unregulated services. Where there are multiple contracts for the same 'service' these should be considered on an aggregated basis.

Questions 7 Should the profit from unregulated services be used to make shared asset cost adjustments?

Response:

JEN 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). Below is an extract from the AEMC Final Rule Determination[1] that clarifies this matter.

> "*In the draft rule determination, the Commission did not consider it possible for a shared assets cost adjustment mechanism to share a portion of the profit or revenue from unregulated services. By transferring a portion of this profit or revenue to customers of regulated services, the mechanism would be limiting the revenue that the NSP could earn from the unregulated service. <u>This would have the same effect as regulating the unregulated service, which does not appear to be permitted under the NEL and NER.</u>*
>
> ***Shared assets cost adjustment mechanism – cost reduction***

[1] AEMC, *Final Rule Determination: Draft National Electricity Amendment (Economic Regulation of Network Service Providers) Rule,* p192.

> *It was decided in the draft rule determination 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. The best way it was considered that this could work was if the sharing was implemented through a reduction in the costs of the shared asset that are recovered from consumers of the regulated service.* " [Emphasis added]

Questions 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?

Response:

The allocation should not be by reference to revenues or revenue proportionality because this would contradict the rule requirement and AEMC intent as discussed in our response to question 7.

JEN considers it may not be possible to develop a single method for cost adjustment, but rather the guidelines may specify a range of acceptable principles or methodologies that may be applied to cater for a range of circumstances.

Questions 9
Should the guidelines include a fixed cost reduction proportion? If so, what should the proportion be? Should the guidelines set out another approach?

Response:

JEN does not support a fixed cost reduction proposition. Please refer to our responses to questions 5 and 6.