16 May 2013

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

Dear Mr. Pattas

NSW DNSP Submission on the Shared Asset Guidelines – Issues Paper

The NSW Distribution Network Service Providers; Ausgrid, Endeavour Energy and Essential Energy (the NSW DNSPs) welcome the opportunity to engage with the Australian Energy Regulator (AER) in developing this Shared Asset guideline (the guideline). The NSW DNSPs support inclusive, ongoing consultation with all stakeholders to deliver an appropriate outcome.

In accordance with the new National Electricity Rules (Rules), the NSW DNSPs understand that in instances where an asset is used to provide both standard control and unregulated services, the AER will seek to reduce the annual revenue requirement to reasonably reflect the part of the shared asset costs attributable to the unregulated service[1].

We expect that the development of this guideline will formalise and clarify the principles and functioning of this guideline. In particular the NSW DNSPs seek clarity regarding the unregulated services to which the guideline will apply and the applicable materiality threshold. A clear understanding of the circumstances in which a sharing mechanism will apply and the process to be followed is of importance to the NSW DNSPs given the proximity of their upcoming determinations.

High level response to the AER's issues paper on Shared Asset Guidelines

The NSW DNSPs support the key issues raised in the Energy Networks Association (ENA) submission to the AER. The principle issue is to develop a simple and transparent mechanism that provides NSPs with an incentive to pursue commercial opportunities whilst ensuring that customers are not disadvantaged and adequately compensated for the existence of these other services.

The AER's initial position focuses on revenues and presumed 'benefits' as opposed to costs. However, we submit that costs would provide a more objective basis for adjustment as set out in the Rules' requirements.[2] The guideline would also benefit from development of the materiality threshold and greater certainty around the guideline's application.

The NSW DNSPs support the ENA's proposal that the AER clarify the type(s) of unregulated services that would be covered by this guideline and the process whereby an adjustment would be made. The ENA submission establishes a 'strawman' methodology to examining the various considerations that should be satisfied before any cost sharing mechanism is applied to any specific service. This methodology is set out below:

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[1] 'Attributable has a meaning in terms of CAMs, It would be advisable that in ascribing costs the Shared Asset Principles align with those of the CAM.

[2] NER 6.4.4(a)

Stage 1: Does the guideline apply to the service?
Identify an unregulated service that satisfies NER clause 6.4.4 (a): Note: If the Cost Allocation Methodology (CAM) has been applied the service is excluded – the assets are not deemed to be 'shared'. **Identify unregulated revenue that is generated from using shared assets for provision of unregulated service.**
Stage 2: Unregulated Revenue (Materiality) Test
Is the use of the asset other than for standard control services material: Is the revenue greater than 1% of Annual Revenue Requirement (**ARR**)? If No: No further action required
Stage 3: Determine the costs to be shared
NSP must submit a 'shared assets cost adjustment proposal' as part of their regulatory proposal that: Demonstrates the non-materiality of the shared asset use for unregulated services; and/or Proposes a cost reduction method. In Step 4, the NSP has the option of demonstrating to the AER that based on some methodology e.g. physical asset use, rival/non-rival etc. - that there is no material use The cost reduction method will also be up to the NSP and does not need to be prescribed in the guideline. **AER considers 'shared assets cost adjustment proposal' for that unregulated service and makes a decision whether to accept or reject in accordance with the guideline.** In a case in which the application of a mechanism results in a cost reduction, the AER is to reduce regulated revenues earned by shared assets.

The objective of this process is for the AER to identify and utilise a sharing mechanism to compensate regulated service customers for capital costs already provided by the regulated service customer that the NSP also receives as part of the unregulated revenues.

Joint NSW DNSP submission on AER's Shared Asset Guideline

The NSW DNSPs support the AER's objective to reduce electricity prices for customers where possible. However, the AER's proposed approach requires further clarification of the types of unregulated services to be covered by the guideline, the materiality assessment and application of the sharing mechanism.

The priority is to ensure regulated service customers are compensated on a fair and reasonable basis for the shared use of assets whilst maintaining commercial and innovation incentives for NSPs to explore and provide unregulated services in the appropriate circumstances.

Responses to the questions contained in the AER's issues paper can be found in Attachment B.

Guiding Principles

The AER's issues paper focuses on sharing revenue or 'benefits' with customers. The NSW DNSPs believe the Rules only permit a reasonable sharing of costs. The fundamental principle that should guide the AER is that a reduction in a DNSP's Annual Revenue Requirement (ARR) should only be for such part of the costs of the assets (used in the provision of Standard Control Services (SCS) and other services) that the DNSP is recovering through charges for the provision of the unregulated services. This is the requirement of the Rules, specifically clause

6.4.4(a) which refers to a reduction in the ARR to reflect such part of the costs of the shared assets the DNSP is recovering through charging for the unregulated services.

This principle is not clear in the AER's issues paper or the benefits the AER are referring to. The guideline should address unregulated revenue that recovers the cost, or a portion thereof, of the shared assets and such costs are being paid for by network customers through distribution use of system (DUOS) charges, so that the DNSP is recovering the cost twice, once from the network customers, once from the third party.

For example, the unregulated revenue may only cover the incremental costs of using the assets to provide services other than SCS. In this instance, there should be no reduction in the DNSP's ARR as these incremental costs would not have been incurred by the DNSP if there were no arrangement with the third party and there is no double benefit being received by the NSP.

In some instances provision of access by a third party to the network may be a statutory obligation imposed on the NSP. In the instance where a third party Telecommunications carrier exercises its statutory rights to access a DNSP's network, a DNSP is only entitled to recover demonstrable loss and damage incurred. As these agreements are generally not negotiated on a commercial basis, the compensation that the DNSP receives would, at best, recover short run marginal costs. It is therefore unlikely that any capital costs would be recovered and available to share with customers.

In assessing these arrangements, the AER should also consider the multiplier effect on overall economic development, which either directly or indirectly benefits every customer of electricity network services. This is the policy principle underpinning this approach to mandate access given the broader economic benefits.

The above example highlights the imperative of ensuring that the reduction to the DNSP's ARR should only occur to the extent that the costs of a shared asset are already recovered through the pricing of unregulated services and that those costs, which are being recovered from the third party, are also being recovered from network customers.

Services

In order to come to a practical set of rules for a cost sharing mechanism, a clear understanding of the various types of shared assets currently employed within the industry must be appreciated. This will be of particular importance in determining the scope of the scheme (i.e. which services to exclude) and how the materiality threshold(s) should be defined and applied.

It becomes apparent when analysing the variety of shared assets currently employed and their historical background that no one single approach would be appropriate. Instead, the guideline should specify a flexible process and approach. Specifically, at the time of a determination the AER should make an assessment of which services pass the materiality considerations and then determine how the sharing mechanism would apply (i.e. percentage to be shared and reduction method) to the relevant service(s).

To assist the AER, Attachment A contains a summarised view of some of the current shared asset arrangements in place in NSW by generalized category. It should be noted that this listing is not comprehensive, but merely provides illustrative examples of some of the arrangements currently in place. It is recommended that the AER consult with DNSPs to develop their understanding of the services and any potential categorisations.

Materiality

The AER has suggested a materiality threshold of 1% of the ARR to apply a sharing mechanism and 0.5% of the ARR as an annual reporting threshold. The priority should be to ensure that the appropriate services are captured without imposing an administrative burden or creating any perverse incentives.

The NSW DNSP's support the ENA's view that a separate reporting threshold is an unnecessary complication to the process. As the mechanism is forward looking there is little benefit in collecting detailed information within a period. It is noted however, that the AER would have some visibility of when total unregulated revenues reach 1% of the ARR during the regulatory period via the annual RIN processes.

In regards to the application of the guideline, the NSW DNSPs support the AER's view that a simple, transparent approach is used. The aforementioned ENA approach seeks to achieve this outcome. This approach involves a materiality assessment utilising revenues as a proxy for cost and then applies a further assessment of the physical use of the asset if required. This approach should ensure that the appropriate and material services are captured and provide a figure to which a sharing mechanism can be applied.

Application

The AER's current position requires clarification of what it refers to as 'revenue', 'reduction' and what costs or revenues will be subject to sharing. It is important that AER's approach is flexible and maintains incentives for DNSPs to provide unregulated services using shared assets where appropriate.

It is the NSW DNSPs view that once the materiality threshold is met, a mechanism would determine the revenue adjustment amount by applying an as yet undetermined percentage to the relevant costs. As per the Rules and process outlined by the ENA, any sharing should apply only to costs. It would, therefore, not be reasonable for DNSPs to make a reduction to revenues in the instance a DNSP is not charging for the service, creating any additional costs to SCS customers or duplicating the recovery of any costs.

A flexible approach to how this reduction is passed on to consumers should be adopted, provided the approaches are net present value (NPV) neutral and in accordance with the Rule requirements. The NSW DNSPs also expect that this guideline will be forward looking and not apply retrospectively.

If you would like to discuss this matter further, please contact Mr Mike Martinson, Group Manager Regulation at Networks NSW on (02) 9249-3120 or via email at michael.martinson@endeavourenergy.com.au.

Yours sincerely,

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