Attachment B: Response to AER Issues Paper Questions		
	AER's questions	**Comments**
Q1	***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***	One of the shared asset principles is that a shared asset cost reduction should be applied where the use of the asset other than for standard control service is material. The focus is on use; hence assessing materiality based on physical asset appears most consistent with this principle. Whilst this may be the case, physical use may not be the most practical measure or the most appropriate to indicate the materiality of use. This is because (a) it can be difficult to define physical use and/or can be contentious and (b) physical use does not indicate the extent of the impact of that use on the operations – hence costs – of a DNSP. For example, the physical use may be minor and therefore appears to be not material but it nevertheless has a significant impact on the operation of the DNSPs which would result in additional significant costs for the DNSP. Therefore, we consider that the proportion of revenue may be the more practical proxy to indicate the use of the asset to provide services other than standard control services. The 1% materiality threshold suggested by the AER would be an appropriate test. Revenue, to some extent, reflects the costs to the DNSP, and consequently provides some indication of the impact on the operations of the DNSP through the use of the asset. Unregulated revenue here refers to the revenue earned from the use of the shared assets (i.e. assets that are in the regulated asset base and are now being used to provide both standard control services and unregulated services). Whilst revenue may be used as a measure of materiality, it does not mean that unregulated revenue can be used as a method to reduce the DNSP's ARR. As stated before, the reduction must be for the amount of costs that have been recovered through charging of the unregulated services. Irrespective of the measure and threshold adopted to indicate material use of the shared assets, the AER needs to ensure that the materiality threshold is to act only as a hurdle that must be satisfied before a cost reduction to ARR can be considered.
Q2	***We propose to forecast shared asset cost reductions and not require any adjustment***	Yes, agree with approach: • Consistent with the AEMC's approach.

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	once actual outcomes are known. Do you agree with this approach? Please provide your reasons	• Consistent with the setting of annual revenue requirement because the reduction is to the annual revenue requirement. No other components of the annual revenue requirement are adjusted for actual outcomes. • SCS is subject to revenue cap, to have adjustments for actual outcomes for shared assets may result in double counting. • Cost of reconciling forecast to actual outcomes may outweigh the benefits. The variance may not make any difference.
Q3	***We propose that when shared assets produce revenue 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 NSW DNSPs agree with the AER that it should only require comprehensive reporting on shared assets once a specified threshold is met. The critical issue is defining this threshold. In this context, we consider that the threshold for reporting should align to the material threshold. This is because the reduction in ARR should only be applied when the use of the asset other than for SCS is material. There are no benefits in mandating a comprehensive reporting regime when the threshold for the application of shared asset cost reduction has not been met. This would only result in costs to the DNSP and the AER. Further, the AER considers that shared asset cost reductions can only be made at the start of the regulatory period, as part of the making of a distribution determination, and not within the period. Given this, we do not consider it necessary for the AER to require reporting on an annual basis. It is sufficient for the DNSP to provide this information as part of regulatory proposal submission process.
Q4	***In light of our proposed approach to shared asset reductions, what other improvements could be made? Please provide your reasons***	We consider that the AER should address the following questions in formulating an approach to shared asset cost reduction: 1. Does the DNSP use existing assets (the values for which are reflected in the RAB) to provide SCS and other unregulated services? 2. If yes, is the use of the assets to provide services other than SCS material? 3. If yes, what is the pricing arrangement for the unregulated services? Does that pricing arrangement recover the costs of the shared assets that already have been recovered from network customers? 4. If yes, How much are these costs so that they can be reduced from the annual

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		revenue requirement?
Q5	***Should shared asset guidelines detail a method for cost adjustment?***	Whether to prescribe a method in the guideline requires the balancing of certainty and flexibility. Whilst it is often beneficial for the DNSP to have certainty of the AER's method, we consider that in this instance it would be more beneficial and productive to have flexibility so that individual circumstances of each DNSP and the factors underpinning the commercial arrangement that a DNSP has with a third party can be appropriately taken into account in determining the amount the ARR should be reduced by. As such, instead of prescribing a method, we consider that the AER outlines the factors that it would take into account in determining amount to be reduced. These factors obviously would need to give effect to and be consistent with the shared asset principles set out in the NER. It is then up to the DNSP to propose a method that is consistent with the shared asset principles, taking into account the factors in the AER's guideline.
Q6	***How could cost reductions best share unregulated service benefits with customers while retaining incentives for asset owners?***	We consider that clarification is required on what exactly is meant by 'unregulated service benefits'. It is the cost of providing unregulated service and the extent to which such costs have been recovered from network customers that should be the focus of the reduction to the ARR. Whether the DNSP is earning a commercial return on its unregulated services and the quantum of such return is not a relevant consideration Further, as stated above, we consider the fundamental principle is that reduction to a DNSP's ARR can only be made to reflect the portion of costs of shared assets that have been recovered through the charging for unregulated services (and these costs are also being recovered from network customers). In this way, network customers will benefit from the leveraging of network assets for other unregulated uses through the reduction in the revenue that the DSNP is allowed to recover from network users. Whilst the focus rightly is on ensuring that network customers do not pay more than the cost of providing SCS, it is equally applicable that the DNSP should not be deprived of the reasonable opportunity to recover its efficient costs, as espoused in the National Electricity Law
Q7	***Should profit from unregulated services be used to make shared asset cost adjustments?***	We consider that profit from unregulated services cannot be used to make shared asset cost adjustments. This is contrary to clause 6.4.4(a) of the NER which state that a DNSP'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 DNSP is recovering through charging for the provision

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		of the unregulated service. Such approach: • Would be against the shared asset principles of encouraging the DNSP to use assets that provide SCS for the provision of other services where that use is efficient and does not materially prejudice the provision of those services. • Would also be inconsistent with the AEMC's position that unregulated revenue or profit should not be used as a basis for shared asset cost reduction. [AEMC final paper, Nov 2012 p192]
Q8	***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?***	We are unable to indicate a preferred approach as it is not clear, nor is yet demonstrated, as to how either physical asset use or proportional revenues are appropriate measure of the costs of shared assets that is being recovered by the DNSPs through charging of unregulated services. The critical issue is the determination of the portion of the charging for unregulated services that is for the recovery of costs of the shared assets that are being recovered from network users. This determination is dependent upon the particulars of each case/commercial arrangement. There may be instances where the charge for unregulated services is to recover the incremental costs only; hence neither physical asset uses nor proportional revenues would be appropriate as the DNSP would be deprived of the revenue that it is appropriately recovering from network customers. The AER should not equate the revenue earned from unregulated services with the costs of providing those services. As stated above, the NER does not permit the AER to automatically offset the unregulated revenues against the ARR.
Q9	***Should the guidelines include a fixed cost reduction proportion? If so, what should the proportion be? Should the guidelines set out another approach?***	Whether the reduction proportion should be fixed or variable is secondary to the determination of the reduction proportion. Once the reduction proportion had been determined, it may be appropriate in the circumstance that this proportion is fixed as the same amount of costs of shared assets is being recovered from unregulated services charges. The converse is equally applicable.