Multi-function asset guideline

Consultation paper

6 July 2021

Economic Regulation Authority
WESTERN AUSTRALIA

D235084

Economic Regulation Authority

Level 4, Albert Facey House

469 Wellington Street, Perth WA 6000

Telephone 08 6557 7900

Email info@erawa.com.au

Website www.erawa.com.au

This document can also be made available in alternative formats on request.

National Relay Service TTY: 13 36 77

Invitation to make submissions

Submissions are due by 4:00 pm WST, Friday 13 August 2021.

The ERA is required to develop a guideline setting out the approach it proposes to take in applying the multi-function asset principles included in the *Electricity Networks Access Code 2004*.

The ERA invites comment on this consultation paper and encourages all interested parties to provide comment on the matters discussed in this paper and any other issues or concerns not already raised in this paper.

We would prefer to receive your comments via our online submission form https://www.erawa.com.au/consultation

You can also send comments through:

Email: publicsubmissions@erawa.com.au
Post: Level 4, Albert Facey House, 269 Wellington St, Perth WA 6000

Please note that submissions provided electronically do not need to be provided separately in hard copy.

All submissions will be made available on our website unless arrangements are made in advance between the author and the ERA. This is because it is preferable that all submissions be publicly available to facilitate an informed and transparent consultative process. Parties wishing to submit confidential information are requested to contact us at info@erawa.com.au.

For further information please contact

General Enquiries

Elizabeth Walters
Ph: 08 6557 7958
info@erawa.com.au

Media Enquiries

Natalie Warnock
Ph: 08 6557 7933 | Mob: 0428 859 826
media@erawa.com.au

Contents

1. Introduction

On 18 September 2020, the *Electricity Networks Access Code 2004* was amended to support the delivery of the State Government's Energy Transformation Strategy.[1]

A new asset category, multi-function assets, has been introduced for network assets that provide regulated and unregulated services.

The Access Code amendments include a requirement that an access arrangement must contain a multi-function asset policy, and that target revenue for an access arrangement period should be reduced by 30 per cent of the net incremental revenue earned by multi-function assets during that period.

The ERA must publish guidelines setting out the approach it proposes to take to apply the multi-function asset principles.

1.1 Regulatory requirements

Section 6.84 of the Access Code defines "multi-function asset" and sets out the requirement to reduce target revenue:

> 6.84 If a *network asset* is used to provide *services* other than *covered services* (a "**multi-function asset**"), the *Authority* must, in accordance with the *multi-function asset principles*, in an *access arrangement* for an *access arrangement period*, reduce the *target revenue* for the *service provider* for a *pricing year* within that *access arrangement period* by an amount equal to 30% of the *net incremental revenue*.

The multi-function asset principles are set out in section 6.86 of the Access Code:

> 6.86 The *multi-function asset principles* are as follows:
>
> (a) the *service provider* should be encouraged to use assets that provide *covered services* for the provision of other kinds of *services* where that use is efficient and does not materially prejudice the provision of *covered services*;
>
> (b) a *multi-function asset* revenue reduction should not be dependent on the *service provider* deriving a positive commercial outcome from the use of the asset other than for *covered services*;
>
> (c) a *multi-function asset* revenue reduction should be applied where the use of the asset other than for *covered services* is material;
>
> (d) regard should be had to the manner in which costs of *multi-function assets* have been recovered or revenue of *multi-function assets* have been reduced in respect of the relevant asset in the past and the *reasons* for adopting that manner of reduction; and
>
> (e) any reduction effected under section 6.84 should be compatible with other incentives provided under this Code.

[1] On 6 March 2019, the Minister for Energy announced the Energy Transformation Strategy, which is the State Government's plan to respond to the technological change and evolving consumer preferences that are rapidly transforming the energy sector and to plan for the future of the power system. The delivery of the Strategy is being overseen by the Energy Transformation Taskforce, which is supported by the Energy Transformation Implementation Unit, a dedicated unit within Energy Policy WA.

The definition of net incremental revenue is contained in section 1.3 of the Access Code:

> "**Net incremental revenue**" means, in relation to a *multi-function asset*, the revenue from all payments received by a *service provider* in excess of the revenue it would receive if the asset only provided *covered services*, for a *pricing year*.

The Access Code includes a definition of "material" for the purposes of deciding when a multi-function asset reduction should be applied:

> 6.87 For the purpose of section 6.86(c), the use of a *multi-function asset* other than for *covered services* is material if the *net incremental revenue* derived from the use of all *multi-function assets* in a *pricing year* is greater than $1 million (*CPI adjusted*).

Section 5.1(m) of the Access Code requires the service provider to include a multi-function asset policy in its access arrangement.

The requirements for a multi-function asset policy are set out in section 5.37 of the Access Code:

> 5.37 A *multi-function asset policy* must:
>
> (a) to the extent reasonably practicable, accommodate the interests of the *service provider* and of *users* and *applicants*; and
>
> (b) be sufficiently detailed to enable *users* and *applicants* to understand in advance how the *multi-function asset policy* will operate; and
>
> (c) set out the method for determining *net incremental revenue*; and
>
> (d) be consistent with the *multi-function asset guidelines*.

The requirement for the ERA to publish guidelines is set out in section 6.88 of the Access Code:

> 6.88 The Authority must make and publish guidelines setting out the approach the Authority proposes to take in applying the multi-function asset principles (which may include a methodology that the Authority proposes to use to determine reductions for the purposes of section 6.84) …

1.2 Consultation paper

The ERA is seeking views on its proposed guideline setting out the approach it will take to apply the multi-function asset principles and the method it will use to determine any reduction to target revenue for multi-function asset net incremental revenue.

To develop this consultation paper, the ERA has considered the questions raised by the Australian Energy Council in its submission on the framework and approach issues paper:

- What assets will be used as multi-function assets? Are network connected batteries that satisfy the New Facilities Investment Test (the "NFIT") multi-function assets?
- What network services will be provided by multi-function assets?
- In what circumstances will multi-function assets be permitted to create a new line of business in competition with third parties?
- What assessment will be conducted, and what information is required, to determine if the network operator multi-function asset is the least cost solution?

- What information will the ERA require the network operator to disclose and publish? For example, will this include a list of unregulated services a network operator provides and the total unregulated revenue from shared assets.

The consultation paper is structured in line with the proposed guideline as follows:

- multi-function asset policy
- net incremental revenue
- reduction to target revenue.

2. Multi-function asset policy

Section 5.1(m) of the Access Code requires the service provider to include a multi-function asset policy in its access arrangement.

As set out in section 6.84 of the Access Code, a multi-function asset is a network asset used to provide services other than covered services.

As defined in section 1.3 of the Access Code, "network assets" are used to provide, or connected with providing, covered services on the network.

> "**Network assets**" in relation to a *network*, means the apparatus, equipment, plant and buildings used to provide or in connection with providing *covered services* on the *network*, which assets are either *connection assets* or *shared assets*.[2]

"Covered service" is defined in section 1.3 of the Access Code:

> "**covered service**" means a *service* provided by means of a *covered network*, including:
>
> (a) a *connection service*; or
>
> (b) an *entry service* or *exit service*; or
>
> (c) a network use of system service; or
>
> (d) a *common* service; or
>
> (e) a *service* ancillary to a *service* listed in paragraphs (a) to (d) above,
>
> but does not include an *excluded service*.[3]

Taking account of the Access Code requirements, the first condition for an asset to be considered a multi-function asset is that it is an asset used to provide covered services. The second condition is that it also provides services that are not covered.

The Access Code definition of multi-function assets is the same as "shared assets" in the National Electricity Market (NEM). In the NEM, shared assets are defined as any electricity supply asset providing both standard regulated electricity supply services and unregulated services.

Under the Access Code, and in the NEM, the costs of assets providing covered/regulated services are added to the service provider's capital asset base and are recovered through regulated network charges.

---

2 As set out in section 1.3 of the Access Code, "connection assets" for a connection point means all of the network assets that are used only in order to provide covered services at the connection point and "shared assets" means those network assets which are not connection assets.

3 "excluded service" means a service provided by means of a covered network, including:

(a) a connection service; or

(b) an entry service or exit service; or

(c) a network use of system service; or

(d) a common service; or

(e) a service ancillary to the services listed in paragraphs (a) to (d) above,

which meets the following criteria:

(f) the supply of the service is subject to effective competition; and

(g) the cost of the service is able to be excluded from consideration for price control purposes without departing from the Code objective.

The new facilities investment test, set out in section 6.52 of the Access Code, determines the capital expenditure that can be added to the capital asset base and recovered through network charges. The test is comprised of two limbs. Both limbs must be met. The first limb of the test is that the expenditure must not exceed the amount that would be invested by a service provider acting efficiently, in accordance with good electricity industry practice seeking to achieve the lowest sustainable cost of delivering covered services.[4]

Capital expenditure that is required for the provision of services that are not covered does not meet the requirements of the first limb of the new facilities investment test and, therefore, cannot be included in the capital asset base or regulated network charges.

For capital expenditure on assets that are acquired or built to provide both covered services and services that are not covered (for example, a battery that provides network support services, which are covered services, and storage services that are not covered services) there may be no straightforward method to identify the costs that meet the first limb of the new facilities investment test. For such assets, it may be preferable to not include any portion of the capital expenditure in the regulated capital asset base and instead charge the regulated business based on actual use of the asset for the provision of covered services during the year.

Historically, Western Power's fleet assets have not been included in the regulated asset base. Instead, unit rates that include capital and operating costs are charged, based on usage, to the relevant business activity (for example, a specific capital project, regulated operational activities or unregulated activities).

The ERA is considering these cost allocation matters further in the development of the new facility investment test and net benefit guidelines.

After the initial allocation of capital costs to the regulated asset base, the use of those assets may change. In particular, the assets may be used to provide services that are not covered services.

As has always been the case, Western Power is free to undertake unregulated activities, providing that it complies with the Access Code ringfencing objectives (which prohibit it from generating or retailing electricity except under certain circumstances) and any other requirements governing the scope of its activities. This includes using assets in the regulated asset base to provide unregulated services,

The introduction of the Access Code multi-function asset provisions, like the shared asset provisions in the NEM, requires Western Power to share a proportion of any non-regulated revenue earned using assets that are included in the regulated asset base with the network users that paid for those assets.

---

4 See section 6.52(a) and the definition of "efficiently minimising costs". The second limb is that one or more of the conditions set out in section 6.52(b) must also be met. These are:

- The anticipated incremental revenue for the new facility is expected to at least recover the new facilities investment.
- The new facility provides a net benefit in the covered network over a reasonable period of time that justifies the approval of higher reference tariffs.
- The new facility is necessary to maintain the safety or reliability of the covered network or its ability to provide contracted covered services.
- The new facility is a priority project.

The multi-function asset principle – that the use of those assets to provide unregulated services must be efficient and not materially prejudice the provision of covered services – ensures there are no adverse consequences for the network users that paid for the assets.

The ERA's proposed guideline for the multi-function asset policy that must be included in the access arrangement is set out in the box below.

Proposed guideline

Multi-function asset policy

A service provider must include a multi-function asset policy in its access arrangement.

The policy must:

- Set out how the service provider will identify any services that are not covered services that use assets included in the regulated asset base over the access arrangement period.
- Set out how the service provider will identify and report all payments received for services that are not covered services that use assets included in the regulated asset base.
- Set out how the service provider will ensure the use of assets included in the regulated asset base to provide services that are not covered services is efficient and does not materially prejudice the provision of covered services.

3. Net incremental revenue

The multi-function asset target revenue reduction must be based on net incremental revenue.

Net incremental revenue is defined in the Access Code as the revenue from all payments received by a service provider in excess of the revenue it would receive if the asset only provided covered services, for a pricing year.

The Access Code refers to revenue rather than profit. The definition of net incremental revenue is <u>revenue</u> from all payments received by a service provider in excess of the <u>revenue</u> it would receive if the asset provided only covered services.

Consequently, any incremental costs incurred for providing services other than covered services are not relevant to the calculation of the multi-function asset target revenue reduction. This is consistent with the multi-function asset principle that a multi-function asset revenue reduction should not be dependent on the service provider deriving a positive commercial outcome from the use of the asset other than for covered services.

The ERA's proposed guideline to address the requirements above is set out in the box below.

Proposed guideline

Net incremental revenue

For each pricing year during the access arrangement period the service provider must record all revenue received for services that are not covered services.

The service provider must provide detailed descriptions of each service that is not a covered service and categorise them as either those that use assets in the regulated asset base and those that do not. Evidence to support these categorisations will be required.

The service provider must document the process and any supporting accounting information it has used to derive revenue received for services that are not covered services. The process must include a reconciliation with total revenue received by the service provider to ensure that all revenue is accounted for as either revenue for covered services or services that are not covered services.

The service provider must include the information above in its next access arrangement proposal to the ERA.

4. Calculation of reduction to target revenue

The parameters required for calculating the reduction to target revenue are specified in the Access Code:

- The reduction to target revenue should be applied if the use of the asset other than for covered services is material.[5] This has been defined as being net incremental revenue derived from the use of all multi-function assets in a pricing year is greater than $1 million (Consumer Price Index-adjusted).[6]
- The reduction to target revenue is specified as 30 per cent of net incremental revenue.[7]

The Access Code does not include specific provisions about the timing of the adjustment.

The ERA proposes:

- The service provider will be required to record details of its multi-function assets and net incremental revenue for each pricing year during the access arrangement period and provide this information in its next access arrangement proposal to the ERA.
- The information will be used to calculate any reduction to target revenue in accordance with the Access Code requirements.
- Target revenue for the following access arrangement period will be reduced by the amount calculated above.

The ERA proposes to include these requirements in the guideline as set out in the box below.

Proposed guideline

Calculation of reduction to target revenue

For each year of the access arrangement, the service provider must calculate the total revenue received for all services that are not covered services that use assets in the regulated asset base.

For any year where the total revenue calculated above is greater than $1 million (Consumer Price Index-adjusted) a reduction to target revenue will be calculated.

The reduction will be calculated as 30 per cent of the total revenue received.

An *ex-post* adjustment will be made to target revenue for the subsequent access arrangement period based on the sum of the reductions for the access arrangement period (adjusted for the time value of money).

5 Section 6.86(c) of the Access Code.

6 Section 6.87 of the Access Code.

7 Section 6.84 of the Access Code.