Multi-function asset guideline

Decision

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Economic Regulation Authority
WESTERN AUSTRALIA

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Contents

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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 both regulated and unregulated services (also referred to as covered and uncovered 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.[2]

The ERA must publish guidelines setting out the approach it proposes to take to apply the multi-function asset principles and may include the method that the ERA proposes to use to determine the reduction to target revenue.

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

[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 was overseen by the Energy Transformation Taskforce, supported by the Energy Transformation Implementation Unit, a dedicated unit within Energy Policy WA.

[2] "Net incremental revenue" in relation to a multi-function asset is defined 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.

(e) any reduction effected under section 6.84 should be compatible with other incentives provided under this Code.

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 Decision

On 6 July 2021, the ERA published a proposed guideline. Submissions were received from:

- the Australian Energy Council
- Perth Energy
- Synergy
- Western Australian Local Government Association (WALGA)
- Western Power.

The ERA has taken account of matters raised in these submissions to make a decision on the proposed guideline. The decision is structured in line with the 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*.[3]

"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*.[4]

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.

Under the Access Code, capital expenditure for providing covered/regulated services is added to the service provider's regulated capital asset base and recovered through regulated network charges.

As has always been the case, Western Power can undertake unregulated activities, including using its network assets that provide covered services to also provide unregulated services, providing 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.

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3 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.

4 "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 multi-function asset provisions reduce regulated target revenue by a proportion of the revenue received for unregulated services that use regulated assets.

2.1 Proposed guideline

The first section of the proposed guideline deals with the identification of multi-function assets and the payments received for providing services other than covered services.

Section 6.84 of the Access Code refers to a multi-function asset providing a service other than a covered service. However, it is most likely that such a service would use more than one asset, whether that be multiple assets of the same category or a collection of different asset categories. Consequently, the only practicable method to identify the information required on multi-function assets is to start with identifying unregulated services and then identifying whether those services use regulated assets.

The consultation paper included the following proposal:

> **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.

In its submission on the consultation paper, WALGA considered that the guideline should include and make clear that a wide range of assets, including existing assets such as streetlight columns (or poles), fall within the definition of multi-function assets.[5]

The ERA agrees that there is a wide range of network assets that may be able to provide unregulated services. The draft guideline does not restrict the types of asset that will be captured by the multi-function asset provisions. The regulated asset base includes all assets that provide covered services that have been, or are being, paid for by customers. This includes assets that were funded by capital contributions or assets that were gifted to Western Power. The draft guideline requires Western Power to set out how it will identify any unregulated services that use assets included in the regulated asset base.

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[5] WALGA noted that lighting columns can be, and in other jurisdictions are already, used to deliver numerous services that are not about providing light, including:

- Charging electric vehicles and electric bicycles.
- Public Wi-Fi
- CCTV to improve public safety.
- Telecommunications, particularly 5G that requires large numbers of small antennae.
- Mesh communications networks to enable Internet of Things applications, remote meter reading and other services.
- Pedestrian and vehicle traffic monitoring.
- Noise and air quality monitoring.

The Australian Energy Council and Perth Energy suggested that the guideline should include a section on how a multi-function asset should be managed. Perth Energy suggested that if operation of the asset significantly affected the operations of other market participants, there may be a case for separate rules to cover the operation of the assets, including ringfencing them from other Western Power activities.

Although the first multi-function asset principle is that the service provider should be encouraged to use assets that provide covered services for the provision of other kinds of services, this is restricted to circumstances where that use is efficient and does not materially prejudice the provision of covered services. The proposed guideline included a requirement that Western Power must set out how it will ensure this in its multi-function asset policy.

As discussed below, the ERA does not regulate unregulated services. It is for the service provider to decide whether to offer unregulated services and the prices it will offer. However, the ERA would be concerned if an unregulated service adversely affected the provision of covered services. The guideline has been amended to make this clearer.

The ERA will assess this as part of its assessment of Western Power's proposed revised access arrangement, due to commence in February 2022.

The Australian Energy Council suggested that the guideline should include additional information requirements on the types of multi-function assets that will be operating and the services that will be provided including the eligibility criteria and indicative charges.

Unregulated services, by definition, are not regulated under the Access Code. Consequently, the ERA cannot require Western Power to provide information on unregulated services that will be provided including the eligibility criteria and indicative charges. Subject to ensuring that the use is efficient and does not materially prejudice the provision of covered services, Western Power is free to choose whether to offer unregulated services and the prices it will seek. Potential customers are free to choose whether to take up the services offered.

Western Power queried whether the supply to third parties of suitable equipment (for example, poles and cable supplied to developers) for installations to connect to the Western Power network would be captured under the multi-function asset provisions as these sales were carried out as an adjunct to the activity within some Western Power depots, which are network assets.

Materials are a good rather than a service. The materials sold are not network assets and are not paid for by network users. On that basis, the ERA considers that material sales would not be captured under the multi-function asset provisions.

2.2 Decision

The ERA's decision is to modify the proposed guideline set out in the consultation paper as discussed above. The amendments are marked in red.

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 provisions in section 6.84 of the Access Code require the multi-function asset target revenue reduction to 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.

3.1 Proposed guideline

The consultation paper included the following proposal:

> **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 between 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.

Submissions from WALGA and Western Power raised queries about the calculation of net incremental revenue.

WALGA noted that the Access Code provisions were clear that revenue was to be considered but sought clarification about the calculation of net incremental revenue in cases where additional assets were required to provide the service.

Western Power was concerned about additional costs required to provide unregulated services and noted that the consultation paper on the amendments to the Access Code referred to Western Power being required to share a proportion of “net profit” with customers:

> Western Power believes that the definition of net incremental revenue should be read that the costs incurred in providing these services are to be converted to a notional revenue ‘it would receive if the asset provided only covered services’. That is, the incremental revenue portion is revenue above the revenue derived from costs determined on a similar basis to regulated services (i.e. using a building block approach). This reading appears more closely aligned with EPWA’s seeming policy intent.

Although the consultation paper on the Access Code amendments in some instances referred to net profit, the amended Access Code refers to revenue rather than profit.[6] In addition, one of the multi-function asset principles is 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.

However, as "net incremental revenue" is defined 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 reason for a payment determines whether it is revenue or something else. A payment for the performance of a service is generally classified as revenue. A payment for an asset would generally be classified as a capital contribution. On that basis, the ERA considers that payments received that are to recover capital expenditure (for example additional assets required to provide the unregulated service) or for the supply of materials should be excluded from the calculation of net incremental revenue. The guideline has been amended to reflect this.

Western Power also queried whether the reporting requirements for net incremental revenue included in the guideline were necessary, as the multi-function asset policy would set out the rationale for Western Power's classification process for services that were not covered services. It considered:

> Detailed descriptions, accounting information and reconciliations may be avoided if the policy is clear in its application, in which case the regulatory financial statements Western Power provides to the ERA could address these issues in a simpler way.

The ERA agrees that Western Power's multi-function asset policy will need to deal with the process to identify services that are not covered services and that the required information could be included in the regulatory financial statements. The guideline sets out the ERA's expectations on what should be included in the policy and the information required for the reduction to target revenue. The ERA will assess Western Power's proposed policy against these expectations as part of the access arrangement review.

3.2 Decision

The ERA's decision is to modify the proposed guideline set out in the consultation paper as discussed above. The amendments are marked in red.

Guideline
Net incremental revenue

For each pricing year during the access arrangement period the service provider must record all ~~revenue~~ payments 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 between 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~~ payments received for services that are not covered services. The process must include a reconciliation with total ~~revenue~~ payments received by the service provider to ensure that all ~~revenue~~ payments received are accounted for as either ~~revenue~~ payments for covered services or services that are not covered services.

Net incremental revenue for each unregulated service is calculated by identifying total payments received and deducting any payments that relate to recovery of the cost of additional assets, or modifications to existing assets, required to provide the unregulated service or for materials supplied.

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.[7] 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).[8]
- The reduction to target revenue is specified as 30 per cent of net incremental revenue.[9]

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

4.1 Proposed guideline

The consultation paper included the following proposal:

> **Calculation of reduction to target revenue**
>
> For any year where the total revenue from all payments received by a service provider greater than the revenue it would receive if the asset provided only covered services 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 from all payments received by a service provider greater than the revenue it would receive if the asset provided only covered services.
>
> An *ex post* adjustment will be made to target revenue for the subsequent access arrangement period based on the sum of the reductions (adjusted for the time value of money).

In its submission on the consultation paper, WALGA queried whether the materiality threshold applied to each multi-function asset or to all multi-function assets in total.

Some of the Access Code provisions refer to “multi-function asset” in the singular. Section 6.84 requires a reduction to target revenue to be applied in accordance with the multi-function asset principles if “a network asset is used to provide services other than covered services”. The relevant multi-function asset principle also refers to a single asset and requires that a revenue reduction should be applied “where the use of the asset other than for covered services is material”.

However, the materiality threshold set out in section 6.87 is based on net incremental revenue derived from the use of <u>all multi-function assets</u> in a pricing year being greater than $1 million (Consumer Price Index-adjusted).

As discussed in section 2, it is most likely that an unregulated service would use more than one asset, whether that be multiple assets of the same category or a collection of different asset categories. Consequently, it is not practicable to identify or attribute revenue from unregulated services to individual assets. In any case, the materiality threshold has been specified based on the use of all multi-function assets in a pricing year. On that basis, the guidelines require that the service provider report net incremental revenue received for each

7 Section 6.86(c) of the Access Code.

8 Section 6.87 of the Access Code.

9 Section 6.84 of the Access Code.

unregulated service that uses regulated assets and that the target revenue reduction applies if the total net incremental revenue from all unregulated services using regulated assets is greater than $1 million. The wording in the guideline has been amended to make this clearer.

WALGA considered that any revenue adjustment for unregulated services provided by assets used by a specific group of customers (for example streetlight poles) should be applied to the prices paid by those customers. It also queried the treatment of internal services, such as remote meter reading and system control functions, provided by assets paid for and reflected in the tariff paid by a particular class of customer, such as local government authorities.

The multi-function asset policy is required to deal with the total reduction to target revenue. The allocation of costs and target revenue to specific tariffs is dealt with in the pricing methods set out in Chapter 7 of the Access Code. Western Power will submit its proposed pricing methods and tariffs to the ERA as part of its access arrangement proposal on 1 February 2022.

As noted above, it is likely that an unregulated service would use a range of regulated assets that provide many different services and the cost of those assets is recovered across multiple tariff classes. In such cases, the multi-function target revenue reduction would also need to be applied across multiple tariff classes.

However, in the case of streetlight assets there is a dedicated tariff that applies only to streetlight assets, including gifted streetlight assets. Consequently, if an unregulated service used only streetlight assets, then the element of the multi-function target revenue reduction attributable to that unregulated service could be applied to reduce streetlight tariffs. Western Power is also required to demonstrate that streetlight tariffs reflect only the efficient costs of providing streetlight services. The ERA will assess these matters as part of its review of the access arrangement.

WALGA considered that the revenue reduction should be applied each year in the annual price list.

The ERA considers it is more cost effective to review and calculate the total revenue reduction for each year of an access arrangement period at the subsequent access arrangement review. Undertaking a review and adjustment each year would add complexity and cost to the regulatory process. The target revenue reduction at each access arrangement review will include an adjustment for the time value of money to ensure customers and Western Power are no worse or better off compared with making annual adjustments.

4.2 Decision

The ERA’s decision is to modify the proposed guideline set out in the consultation paper as discussed above. The amendments are marked in red.

Guideline
Calculation of reduction to target revenue

For any year where the total net incremental revenue from all ~~payments received by a service provider greater than the revenue it would receive if the asset provided only covered services~~ unregulated services using multi-function assets 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 net incremental revenue received in that year ~~from all payments received by a service provider greater than the revenue it would receive if the asset provided only covered services~~.

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