Attachment 13

Cost Pass-through Mechanism

This Attachment sets out TransGrid's proposal for a cost pass-through mechanism to be applied to unexpected, external cost changes within the regulatory period. The rationale for the cost pass-through approach was discussed in Chapter 5, 6 and 7 of TransGrid's Application.

TransGrid proposes that cost pass-through arrangements apply where there is a material impact on its costs as a result of one of the following categories of events:

- A Change in Taxes Event
- A Service Standard Event
- An Insurance Event
- An Unforeseen External Event (including, but not limited to, events caused by terrorism)
- Grid Support Payments.

Below we discuss each of the above types of event in turn, and provide a proposed definition for each. These definitions are in line with those approved by the ACCC for other electricity transmission businesses and with those adopted by the jurisdictional regulators in Victoria and South Australia.

TransGrid has also set out a proposed process by which pass-through events would be applied for and approved amounts recovered. Again, this process is in line with precedents established for other regulated businesses.

1.1 Definition of Pass-through Events

1.1.1 Change in Taxes Event

Changes in taxes are external events over which TransGrid has no control, but which can potentially affect the costs which TransGrid faces. As such, TransGrid proposes that changes in taxes which have a material impact on its costs should be eligible for pass-through.

The ACCC has previously approved pass-through arrangements for changes in taxes for Murraylink, SPI PowerNet and GasNet. Change in taxes are also covered by pass-through arrangements for the electricity transmission and distribution business in South Australia and for the electricity and gas distribution businesses in Victoria.

TransGrid proposes to define a **Change in Tax Event** as:

> *"A change in the way or rate at which a Relevant Tax is calculated (including a change in the application or official interpretation of Relevant Tax); or*
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> *The removal of a Relevant Tax or imposition of a new Relevant Tax".*
>
> which, in each case, occurs after the date of the ACCC's Determination.

In line with the pass-through provisions applying for other regulated businesses, TransGrid proposes that Relevant Taxes be considered as being any tax, rate, duty, charge or levy or other like or analogous impost that is imposed by or payable directly or indirectly by TransGrid to any authority of the Commonwealth of Australia (including goods and services tax), but excluding:

(a) Income tax (or State equivalent income tax) or capital gains tax;

(b) Stamp duty, financial institutions duty, bank account debits tax or similar taxes or duties;

(c) Penalties and interest for late payment relating to any tax; and

(d) Any tax which replaces the tax referred to in (a) to (c) above, where ‘tax’ includes any rate, duty, charge or other like or analogous impost.

1.1.2 Service Standards Events

Changes in legislation or regulations can impact the service which TransGrid is required to provide. As noted in Chapter 2, there needs to be a process for accommodating changes to formal service obligations as they occur during a regulatory reset period, in order to allow TNSPs to respond to changes without commercial penalty.

TransGrid notes that the ACCC in its Determination for SPI PowerNet has recognized the risk which regulated electricity transmission businesses face as a result of changes in external requirements which impact the number or scope of service standard requirements.[1] A pass-through for Service Standard Events has been allowed by the ACCC for Murraylink and for GasNet.[2] The electricity transmission and distribution businesses in South Australia also have pass-through provisions to address the costs associated with mandatory changes in service standards..

TransGrid proposes that **Service Standard Events** should be defined as follows:

> *“Any decision made by the ACCC, NECA, NEMMCO, WorkCover, the EPA or any other Authority or any amendment to an applicable law (including but not limited to the National Electricity Code, TransGrid’s transmission licence, the NSW Electricity Supply Act) which has the effect of:*
>
> - *substantially varying the manner in which TransGrid is required to undertake any activity forming part of prescribed services (including, but not limited to, the scheduling of transmission outages);*
> - *imposing or varying a set of minimum service standards on TransGrid in respect of prescribed services that are different to the minimum standards applicable to TransGrid at the date of the Determination;*
> - *altering the nature or scope of prescribed services TransGrid is required to undertake from those at the date of the Determination; or*
> - *increasing or reducing TransGrid’s risk in providing the prescribed services.”*

In addition, any costs payable by TransGrid in association with the establishing of a new national energy regulator would be considered to be eligible for pass-through as a Service Standard Event.

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[1] See Australian Competition and Consumer Commission, Victorian Network Revenue Caps 2003-2008, 11 December 2002, p.81-85.

[2] In relation to GasNet, it is permitted to pass-through costs from a ‘Regulatory Event’, the definition of which is equivalent to the Service Standard Event discussed above.

The following would be *excluded* from being eligible for pass-through as a Service Standard Event:

- costs arising from voluntary increases in service standards; and
- costs arising from any fees and charges payable for failing to meet increased service standards.

TransGrid notes that the above definition (with the exception of explicit reference to the proposed new national energy regulator) is consistent with that approved by the ACCC for other TNSPs.

1.1.3 Insurance Event

Under the Commission's Determination for the current regulatory period, TransGrid is able to pass-through increases in costs associated with obtaining third party liability insurance, where such a cost is material, efficient and reasonable. To date, TransGrid has made one application for a pass-through under this provision, which was approved by the ACCC.

The rationale for the ACCC permitting the pass-through of third-party liability costs at the time of the last review was the difficulty in forecasting future insurance costs. The Commission considered at the time of its Determination that the forecasting of insurance costs may be more straightforward in future regulatory periods. However, experience in the current regulatory period has indicated that this is not the case.

As a result, TransGrid considers that it remains necessary to allow for insurance costs to be a pass-through. TransGrid notes that the ACCC has permitted a pass-through mechanism for Insurance Events for SPI PowerNet, GasNet, PowerLink and, most recently, Murraylink.

TransGrid proposes to define **Insurance Events** as follows:

Any change in the cost of insurance as a result of:

- insurance becoming unavailable per se;
- unavailable at reasonable commercial rates;
- unavailable on terms at least as favourable as those generally available at the date of the Determination;
- where the cost of insurance (including, without limitation, premiums or deductibles) becomes materially higher or lower than at the date of the Determination; or
- where an insurance benefit payment to TransGrid under its insurance in respect of any risk is reduced by a deductible amount.

TransGrid notes that this definition is consistent with that approved by the ACCC for other TNSPs.

1.1.4 Unforeseen External Event

TransGrid notes that both SPI PowerNet and Murraylink proposed cost pass-through provisions in relation to 'Terrorism Events'. These pass-through categories have been approved by the Commission.

TransGrid agrees that the events of the recent past highlight the importance of explicitly identifying terrorism as a potential source of unexpected (and material) cost increases during the regulatory period. However, the emergence of terrorism as a potentially significant risk facing regulated electricity transmission businesses has been relatively recent, and would have been hard (if not impossible) to predict at the beginning of the current regulatory period.

It is important that the cost pass-through provisions adopted for the upcoming regulatory period are sufficiently flexible to accommodate other currently unforeseen events which may occur during the next regulatory period. Whilst the major category of such events which may currently be envisaged is a terrorism event, there is the potential for other significant external events to emerge which have a material impact on costs.

As discussed in Chapter 10 of the Application, a benefit associated with cost pass-through arrangements is that it sets out now the process which would be followed in the event of an uncertain or unforeseen event. This improves the flexibility of the regulatory regime, and increases certainty for both the regulated business and the regulator. The capability of the regulatory regime to address the pass-through of costs from unforeseen events does not imply that such costs will *necessarily* be passed through if such an event actually occurs, since the ACCC would retain the role of assessing and approving each pass-through application. However, it does enable the regulatory regime to address such unexpected costs, in the event that they do occur.

As a result, TransGrid proposes that pass-through provisions should encompass **Unforeseen External Events**, defined as follows:

> *"Any external event which is reasonably considered to be unforeseen at the time of the Determination and results in costs which are substantially different to those anticipated by the parties at the time of the Determination, including (but not limited to) events caused by terrorism".*

1.2 Grid Support Payments

TransGrid notes that in some circumstances contracting with generators to provide grid support may be a cost effective means of addressing network reliability issues. Under the regulatory test, TransGrid is required to consider both generation and demand-side management projects as alternatives to augmentation of the transmission network.

As discussed in chapter 5 of this Application, additional new generation will be required within New South Wales. It is possible that some of the additional generation may be capable of providing network support in areas where such support is required.

TransGrid notes that the ACCC has approved pass-through arrangements for grid support payments for PowerLink, as an effective way of dealing with the forecasting uncertainty associated with future grid support payments.[3]

TransGrid presently has no formal plans to enter into any network support agreements, and has not included any grid support payment forecasts in its expenditure projections for the current regulatory period. However, it is prudent that the ACCC's revenue determination facilitates such agreement, should they become appropriate. As such, TransGrid proposes that the pass-through provisions include the possibility of a pass-through for Grid Support Payment Events.

A **Grid Support Payment Event** is defined as a material change in the expected payments made by TransGrid to generators to provide reliability support compared with that allowed for in the ACCC determination.

[3] Australian Competition and Consumer Commission, Queensland Transmission Network Revenue Cap 2002-2006/7, 1 November 2001.

1.3 Application Process for Cost Pass-through

TransGrid proposes an approach to applying for a cost pass-through consistent with that applying to SPI PowerNet and GasNet. This proposed approach is more formal than the approach which has applied for TransGrid in the current regulatory period in relation to the pass-through of insurance costs.

TransGrid would make an annual application to cover all cost pass-through events, 50 days prior to the start of the regulatory year. This timing allows the ACCC to assess applications for cost-pass at the same time as it assesses the annual transmission tariff review. TransGrid notes the ACCC's earlier comments in its Determination for GasNet that its preference is for a single annual pass-through, on the basis of administrative simplicity and since it would result in users only facing one tariff change per year.[4]

The Commission would also be able to initiate a cost pass-through application, where it considered that the costs faced by TransGrid were materially changed by an event falling into one of the categories described in the previous section, and where TransGrid had not made a pass-through application.

Specifically, in making an application to the Commission for a cost pass-through (or in responding to the Commission's request for a pass-through application), TransGrid would specify the following information:

(a) The details of the pass-through event;

(b) The date the pass through event took effect (or takes effect);

(c) The estimated financial impact of the pass-through event on TransGrid, and the basis on which this impact has been calculated (including supporting documentation, as relevant);

(d) The pass through amount proposed by TransGrid in relation to the pass-through event; and

(e) The basis on which the pass-through amount is to apply (if this differs from an adjustment to the MAR).

The ACCC would then evaluate the application, and decide whether the specified pass through event occurred (or is expected to occur) and, if so, the appropriate pass-through amount which should be approved. Such approval would be granted at the same time that proposed tariffs for the forthcoming year were approved.

The above process does not limit TransGrid to applying for a cost pass-through only for events which have already occurred. In general, it would be expected that applications would be made after the event triggering the application has occurred, given that the pass-through provisions are to address uncertain and unforeseen events. However, there may be instances (such as an change in legislation which will affect service standards) where the change is known in advance, and where the estimated financial impact can be calculated with a high degree of certainty. In such cases, it would seem advantageous for the framework to allow flexibility for the costs to be assessed and passed through. TransGrid notes that this approach is consistent with the cost pass-through arrangements set out by Murraylink which have been endorsed by the ACCC.

In relation to the way in which approved cost pass-through amounts are translated into charges, TransGrid proposes that there is a presumption that the approved amount would directly impact the MAR. This approach is consistent with that proposed by Murraylink. However, TransGrid proposes that it also has the flexibility to propose alternative means of recovery, if the particular circumstances leading to the cost pass-through event meant that the MAR approach was not the most appropriate. The ACCC would approve both the pass-through amount and the method of recovery.

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[4] Australian Competition and Consumer Commission, GasNet Australia Access Arrangement Revisions for the Principal Transmission System, 13 November 2002, p.37.