

Final Decision

**APA Victorian Transmission System
(VTS)**

Access Arrangement 2023 to 2027
(1 January 2023 to 31 December 2027)

Attachment 10
**Reference tariff variation
mechanism**

December 2022

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Note

This attachment forms part of the AER’s final decision on the access arrangement that will apply to APA’s Victorian Transmission System (VTS) for the 2023–27 access arrangement period. It should be read with all other parts of the final decision.

As a number of issues were settled at the draft decision stage or required only minor updates, we have not prepared all attachments. The final decision attachments have been numbered consistently with the equivalent attachments to our draft decision. In these circumstances, our draft decision reasons form part of this final decision.

The final decision includes the following documents:

Overview

Attachment 2 – Capital base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Operating expenditure incentive mechanism

Attachment 10 – Reference tariff variation mechanism

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10 Reference tariff variation mechanism

This attachment sets out our consideration of the reference tariff variation mechanism and cost pass through mechanism proposed by APA for its Victorian Transmission System (VTS). The reference tariff variation mechanism:

- permits building block revenues to be recovered smoothly over the access arrangement period subject to any differences between forecast and actual demand
- accounts for actual inflation
- accommodates other reference tariff adjustments that may be required, such as for an approved cost pass through event
- sets administrative procedures for the approval of any proposed changes to reference tariffs – that is, updating tariffs each year.

The cost pass through mechanism allows us to vary reference tariffs for the occurrence of a specified event which materially increases or decreases the cost of providing the reference service. The inclusion of a pass through mechanism recognises a service provider can face risks beyond its control, which may have a material impact on costs.

10.1 Annual reference tariff variation mechanism

APA proposed the continuation of the current reference tariff structures during the 2023–27 access arrangement period, which we have accepted subject to updates required to give effect to other parts of this decision. Stakeholders have again noted the complexity of the VTS tariff structure, which establishes locational tariffs based on the physical flow of gas across the VTS network. In future access arrangement periods, APA intends to move away from the existing VTS tariff model and tariff structure towards something more straightforward. We look forward to its engagement on this reform, which we expect to see completed in time for APA’s next access arrangement review.

Our final decision largely accepts APA’s revised proposal on its annual tariff variation mechanism, which incorporated the revisions required by our draft decision with the exception of its proposed cost pass through events.

10.2 Cost pass through mechanism

10.2.1 Final decision

Our final decision is to accept, with minor amendments to the Terrorism and Insurer Credit Risk cost pass through events, seven of the eight cost pass through events in APA’s revised proposal for the VTS. These events are consistent with the cost pass through events we approved in APA’s 2018–22 Access Arrangement, and with recent decisions we have made for other network service providers.¹

¹ AER, Draft decision, Roma to Brisbane Pipeline Access Arrangement 2022 to 2027 – Attachment 10 – Reference tariff variation mechanism, November 2021, p. 12–13; AER, Draft Decision, Transgrid Transmission Determination 2023 to 2028 (1 July 2023 to 30 June 2028) – Attachment 13 – Pass through events, September 2022, p. 4.

Consistent with our draft decision, we do not accept APA’s revised proposal for the Pre-approved capital expenditure (capex) cost pass through event. This is because firstly, we do not consider that the Pre-approved capex event is likely to contribute to the achievement of the National Gas Objective (NGO) and the revenue and pricing principles (RPP). Secondly, while APA considered that the combination of a rule 80 application and the proposed pre-approved capex cost pass would go some way to replicate the contingent project provisions in electricity regulation, we note there are no contingent project provisions in the National Gas Rules (NGR) and we consider that if rule 80 had been intended to replicate the contingent project framework, it would have been drafted that way. Further, that the cost pass through and contingent project frameworks are distinct elements of the uncertainty regime for Network Service Providers, applied in different circumstances, including notably different materiality thresholds, and that it does not make sense to bring these together in the gas context through the proposed pass through.

10.2.2 APA’s proposal

APA’s revised proposal for the VTS accepted most of the changes we requested in our draft decision, namely the changes to the definitions of the Insurance Credit Risk event, Natural Disaster event and Terrorism event.² However, we found that APA had not made some minor amendments as requested in our draft decision for the Insurer Credit Risk event and the Terrorism event.³ Regarding the Terrorism event, APA subsequently confirmed that the omission was an oversight and it was comfortable with the change that had been proposed.⁴

APA’s revised proposal for the VTS also did not accept our draft decision to remove the Pre-approved capex event.⁵ As a result, it included the following Pre-approved capex event pass through in the Access Arrangement associated with its revised proposal:⁶

A pre-approved capex event occurs when:

- a) the service provider has applied to the AER under rule 80 for a determination to the effect that, if capital expenditure is made in accordance with proposals made by the service provider and specified in the determination, the expenditure will meet the new capital expenditure criteria;
- b) the AER has made a determination under rule 80 to the effect that, if capital expenditure is made in accordance with proposals made by the service provider and specified in the determination, the expenditure will meet the new capital expenditure criteria

² APA VTS, *APA Victorian Transmission System 2023–27 access arrangement. Revised proposal – Overview of Revised Proposal*, 10 August 2022, p. 109, APA VTS, *Victorian Transmission System 2023–27 access arrangement (markup)*, 10 August 2022 pp. 18-21; AER, *Draft decision, APA Victorian Transmission System (VTS) Access Arrangement 2023 to 2027 (1 January 2023 to 31 December 2027) – Attachment 10 Reference tariff variation mechanism*, June 2022, p. 9.

³ APA VTS, *Victorian Transmission System 2023–27 access arrangement (markup)*, 10 August 2022 pp. 18-21; AER, *Draft decision, APA Victorian Transmission System (VTS) Access Arrangement 2023 to 2027 (1 January 2023 to 31 December 2027) – Attachment 10 – Reference tariff variation mechanism*, June 2022, pp. 14-15.

⁴ APA VTS, *Information request 32 – Q1*, 27 October 2022.

⁵ APA VTS, *APA Victorian Transmission System 2023–27 access arrangement. Revised proposal – Overview of Revised Proposal*, 10 August 2022, pp. 109-110; AER, *Draft decision, APA Victorian Transmission System (VTS) Access Arrangement 2023 to 2027 (1 January 2023 to 31 December 2027) – Attachment 10 Reference tariff variation mechanism*, June 2022, p. 14.

⁶ APA VTS, *Victorian Transmission System 2023–27 access arrangement (markup)*, 10 August 2022 p. 19.

- c) capital expenditure has been made in accordance with proposals made by the service provider and specified in the determination
- d) the assets the subject of the capital expenditure have been brought into service in the provision of pipeline services.

In its revised proposal, APA noted an application under rule 80 seeks the AER's pre-approval that capex, if made in accordance with the application, will be considered to be conforming capex at the commencement of the next access arrangement period. However, APA further noted that this does not allow the service provider to earn a return on the capital invested between the time the investment comes into service and the commencement of the next access arrangement period. APA also noted that while the rule 80 application in its initial proposal is no longer required, that it is possible further expansion of the VTS may be required in the upcoming access arrangement period for security of supply purposes, for which a rule 80 application may be required. In this regard, APA stated that the rejection of the Pre-approved capex pass through event would limit its flexibility to address potential supply shortfalls occurring during the upcoming access arrangement period.⁷

APA also considered that the combination of a rule 80 application and this proposed pass through go some way to replicate the contingent project provisions in electricity regulation.⁸ Further, that the proposed Pre-approved capex pass through event would be twice subject to AER discretion, first on any rule 80 application and then on the reasonableness of the costs proposed to be passed through.⁹

10.2.3 Stakeholder submissions

We received four submissions on APA's revised proposal for the VTS that provided views in relation to the Pre-approved capex event. AGL noted that although it is unclear how this cost-pass through process would work in practice, it would in theory support this revenue trigger if it minimised the risk of any delays to augmentations and therefore the commencement of any finalised projects.¹⁰ Venice Energy submitted a similar position, stating that approving the "pre-approved capex" pass-through is a cost-free option. Venice Energy also argued that should demand and supply developments occur such that augmentation of the VTS is not required, then the proposed pass through would never be used. Further, it stated that there does not appear to be any scope for harm in approving this proposed pass-through mechanism, since any application would have to be approved by the AER.¹¹ Overall, Venice Energy suggested that approving this cost pass through event would allow APA to respond

⁷ APA VTS, *APA Victorian Transmission System 2023–27 access arrangement. Revised proposal – Overview of Revised Proposal*, 10 August 2022, pp. 109-110.

⁸ APA VTS, *APA Victorian Transmission System 2023–27 access arrangement. Revised proposal – Overview of Revised Proposal*, 10 August 2022, p. 110.

⁹ APA VTS, *APA Victorian Transmission System 2023–27 access arrangement. Revised proposal – Overview of Revised Proposal*, 10 August 2022, p. 110..

¹⁰ AGL, *Draft Decision: APA Victorian Transmission System (VTS) Access Arrangement 2023–27 (1 January 2023 to 31 December 2027)*, 6 September 2022, p. 1

¹¹ Venice Energy, *APA Victorian Transmission System – Access Arrangement 2023–27 Submission*, 5 September 2022, p. 1.

to any security of supply developments in a timely fashion, particularly as this removes the incentive to delay investment.¹²

Conversely, the Brotherhood of St Laurence emphasised the need to develop alternative solutions to building long-term infrastructure at short notice to address short term supply – demand imbalances.¹³ The Brotherhood of St Laurence stated that it does not support a mechanism to bring a return on rule 80 projects into the period of construction, and that overall it does not support this adjustment.¹⁴ TRAC Partners for the Brotherhood of St Laurence also stated that it does not support APA’s retention of the Pre-approved capex event pass through mechanism, particularly if this is as a result of a rule 80 determination.¹⁵ It considered that if this were to occur, the nature of the changes would be likely to warrant a full revision being submitted for approval as there are likely to be implications for a range of the building blocks.¹⁶

We also observe Red Energy and Lumo Energy’s general stakeholder comments that the AER must ensure that consumers do not underwrite any of APA’s commercial risks. Further, that Red Energy and Lumo Energy appealed to the AER to reject those parts of the proposals where it concludes that APA is passing on a commercial risk to consumers that it should be underwriting itself.¹⁷

10.2.4 Assessment approach

The NGR state that a reference tariff variation mechanism may provide for the variation of a reference tariff.¹⁸

...as a result of a cost pass through for a defined event (such as a cost pass through for a particular tax).

As a component of the reference tariff variation mechanism, a cost pass through mechanism must be assessed having regard to the matters in rule 97(3)¹⁹ of the NGR and must give us adequate oversight and power to approve reference tariff variations.²⁰

We must approach this assessment in a manner likely to contribute to the achievement of the NGO,²¹ which states that the purpose of the National Gas Law (NGL) is to promote efficient

¹² Venice Energy, *APA Victorian Transmission System – Access Arrangement 2023–27 Submission*, 5 September 2022, pp. 2–3.

¹³ Brotherhood of St. Laurence, *2023–2028 Victorian Gas Transmission System (VTS) Access Arrangement – Submission from BSL to the AER’s Draft Determination and APA’s Revised Proposal*, September 2022, p. 16.

¹⁴ Brotherhood of St. Laurence, *2023–2028 Victorian Gas Transmission System (VTS) Access Arrangement – Submission from BSL to the AER’s Draft Determination and APA’s Revised Proposal*, September 2022, p. 16.

¹⁵ TRAC Partners – prepared for Brotherhood of St. Laurence, *Response to AER draft decision & APA Victorian Transmission System (VTS) Revised 2023–27 Access Arrangement Proposal*, September 2022, p. 34.

¹⁶ TRAC Partners – prepared for Brotherhood of St. Laurence, *Response to AER draft decision & APA Victorian Transmission System (VTS) Revised 2023–27 Access Arrangement Proposal*, September 2022, p. 34.

¹⁷ Red Energy and Lumo Energy, *Draft decision for APA Victorian Transmission System access arrangement 2023–27*, 14 September 2022, p. 1.

¹⁸ NGR, r. 97(1)(c).

¹⁹ In summary: efficient reference tariff structures; administrative costs; prior regulatory arrangements; consistency between regulatory arrangements; risk sharing arrangements implicit in the access arrangement any other relevant factor.

²⁰ NGR, r. 97(4).

²¹ NGL, s. 28(1)(a).

investment, operation and use of natural gas services for the long term interest of consumers with regard to price, quality, safety and security of supply.²²

In addition, we must take into account the RPP whenever we exercise discretion in approving or making those parts of an access arrangement relating to a reference tariff.²³ The RPP include a principle that the service provider should be provided with a reasonable opportunity to recover at least the efficient costs incurred in providing reference services and complying with a regulatory obligation or requirement.²⁴ They also provide incentives to promote economic efficiency.²⁵ The RPP require us to have regard to the economic costs and risks of the potential for under- and over-investment by a service provider, to promote efficient investment.²⁶

In the context of pass through events, we interpret the NGO as requiring us to have particular regard to the impact on price, quality, safety, reliability and security of supply that may arise as a result of any change in the efficient operation of, and ability and incentive of, a service provider to invest in its network.²⁷

Our decision on the reference tariff variation mechanism includes a decision on what categories of pass through event to approve as part of it.²⁸ In approaching this part of our task, we also take into account the following relevant factors:²⁹

- whether the type of event is covered by another category of pass through event
- whether the nature or type of event can be clearly identified at the time the access arrangement is approved for the service provider
- whether a prudent service provider could reasonably prevent an event of that nature or type from occurring or substantially mitigate the cost impact of such an event
- whether the relevant service provider could insure against the event, having regard to:
 - the availability (including the extent of availability in terms of liability limits) of insurance against the event on reasonable commercial terms
 - whether the event can be self-insured on the basis that: it is possible to calculate the self-insurance premium; and the potential cost to the relevant service provider would not have a significant impact on the service provider’s ability to provide network services.

These factors appear in the NER, which we apply when regulating electricity. The factors guide our electricity decisions when considering whether to approve additional categories of

²² NGL, s. 23.

²³ NGL, s. 28(2)(a).

²⁴ NGL, s. 24(2).

²⁵ NGL, s. 24(3).

²⁶ NGL, s. 24(6).

²⁷ NGL, s. 23; See also AEMC, *Rule Determination, National Electricity Amendment (Cost pass through arrangements for Network Service Providers) Rule 2012*, 2 August 2012.

²⁸ NGR, r. 97(1)(c).

²⁹ NGR, r. 97(3)(e).

pass through event beyond those already included in the NER.³⁰ We consider they are consistent with the factors referred to in the NGR (rule 97(3)), and pertinent to our examination of the degree to which a proposed category of event is likely to contribute to the achievement of the NGO.³¹

The Australian Energy Market Commission (AEMC) described the purpose of these considerations as:

“...to incorporate and reflect the essential components of a cost pass through regime. It was intended that in order for appropriate incentives to be maintained, any nominated pass through event should only be accepted when event avoidance, mitigation, commercial insurance and self-insurance are unavailable. That is, a cost pass through event is the least efficient option for managing the risk of unforeseen events.”³²

“...that a pass through event should only be accepted when it is the least inefficient option and event avoidance, mitigation, commercial insurance and self-insurance are found to be inappropriate. That is, it is included after ascertaining the most efficient allocation of risks between a service provider and end customers.”³³

We consider that viewing pass throughs as a ‘last resort’ and accepting them only when event avoidance, mitigation and insurance are unavailable, is consistent with the RPP and will contribute to the achievement of the NGO. This approach maintains the incentives on service providers to use market based mechanisms to mitigate the cost impacts that would arise if the event is triggered.³⁴ In turn, this promotes the efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers with respect to price.³⁵

We also look to promote consistency in our approach to pass through categories across our electricity determinations and gas access arrangement decisions.³⁶

10.2.5 Interrelationships

Except as provided by a reference tariff variation mechanism, a reference tariff is not to vary during the course of an access arrangement period.³⁷ In assessing and approving a reference tariff variation mechanism, we consider the potential impact of the proposed

³⁰ NER, cl. 6.5.10(b) and 6A.6.9(b); NER Chapter 10: Glossary, definition of ‘nominated pass through event considerations’.

³¹ NGR, r. 100(1(a)).

³² AEMC, *Rule Determination, National Electricity Amendment (Cost pass through arrangements for Network Service Providers) Rule 2012*, 2 August 2012, p. 19.

³³ AEMC, *Rule Determination, National Electricity Amendment (Cost pass through arrangements for Network Service Providers) Rule 2012*, 2 August 2012, p. 20.

³⁴ AEMC, *Rule Determination, National Electricity Amendment (Cost pass through arrangements for Network Service Providers) Rule 2012*, 2 August 2012, p. 8.

³⁵ NGL, s. 23; AEMC, *Rule Determination, National Electricity Amendment (Cost pass through arrangements for Network Service Providers) Rule 2012*, 2 August 2012, p. 8.

³⁶ NGR r. 97(3)(d).

³⁷ NGR, r. 97(5).

mechanism on the service provider's incentives under the access arrangement to operate its network—and manage its risks—in a manner consistent with the NGO and RPP.³⁸

The pass through component of the reference tariff variation mechanism is also interrelated with other parts of this decision, in particular with the forecast operating expenditure (opex) and capex and rate of return included in our forecast revenue requirement. These interrelationships require us to balance the incentives in the various parts of our decision.

Pass through events are one way, but not the only way, in which service providers can manage their risks under an access arrangement. For systemic risks, service providers are compensated through the allowed rate of return. Service providers also face business-specific, or residual, risks. Service providers are compensated for the prudent and efficient management of these risks through the forecast opex and capex we include in our forecast revenue requirement for strategies such as:

- prevention (avoiding the risk)
- mitigation (reducing the probability and impact of the risk)
- insurance (transferring the risk to another party)
- self-insurance (putting aside funds to manage the likely costs associated with a risk event).

An efficient business will manage its risk by employing the most cost effective combination of these strategies. In order to maintain appropriate incentives under an access arrangement, we only accept pass through events where we are satisfied that event avoidance, mitigation, commercial insurance and self-insurance under approved forecasts of prudent and efficient opex and capex are either unavailable or inappropriate.³⁹

For smaller expenditure, a service provider should generally utilise its existing expenditure allowance or reprioritise its work program rather than seek approval of a pass through.⁴⁰ This is reflected in the materiality threshold that applies to applications for cost pass through under the approved access arrangement.⁴¹

Opex cost pass through amounts approved in an access arrangement period are added to forecast opex for the purpose of calculating efficiency carryover amounts under the operating expenditure incentive mechanism in the approved access arrangement.⁴²

³⁸ NGL, ss. 23 and 24.

³⁹ This is consistent with the AEMC's conclusions in its review of the NER pass through arrangements. See: AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, pp. 19.

⁴⁰ This is consistent with the AEMC's conclusions in its review of the regulation of network prices. See: AEMC 2012, *Economic Regulation of Network Service Providers, and Price and Revenue Regulation of Gas Services, Final Rule Determination*, 29 November 2012, p. 186.

⁴¹ AER, *Approved access arrangement for APA VTS 2018–22 - final decision revisions marked*, November 2017, p. 23.

⁴² AER, *Draft Decision APA Victorian Transmission System (VTS) Access Arrangement 2023 to 2027 (1 January to 31 December 2027) – Attachment 8 – Operating expenditure incentive mechanism*, June 2022 and APA VTS, *Victorian Transmission System 2023-27 access arrangement*, 1 December 2021, p. 10.

10.2.6 Reasons for final decision

Consistent with our draft decision, in this final decision we have accepted seven of the eight cost pass through events included in APA's revised proposal and Access Arrangement for the VTS, with some minor changes as set out below. However, there is one event that in this final decision we are not including in the Access Arrangement, namely the Pre-approved capex event.⁴³

10.2.6.1 Cost pass through events other than the Pre-approved capex event.

Overall, and consistent with our draft decision and other past decisions, we are satisfied that the cost pass through events in APA's Access Arrangement for the VTS for an Insurance cap event, an Insurer credit risk event, a Natural disaster event, a Regulatory change event, a Service standard event, a Tax change event and a Terrorism event will promote efficient investment, operation and use of natural gas services for the long term interest of consumers with regard to price, quality, safety and security of supply. We also consider that they:

- are not covered by another category of pass through event
- can be clearly identified at the time when we are approving the access arrangement
- are of the nature or type that a prudent service provider could not reasonably prevent from occurring or substantially mitigate their cost impact
- are prohibitively costly to cover by full insurance or that there is no available insurance cover on reasonable commercial terms.

We observe that four of seven of these cost pass through events are consistent with those we approved in the 2018–22 Access Arrangement, namely the Insurance Cap event, the Regulatory Change event, the Service Standard event and the Tax Change event.⁴⁴ APA further largely adopted the amendments we sought in the draft decision to the remaining three cost pass through events, namely the Natural Disaster event, the Insurer Credit Risk event and the Terrorism event.⁴⁵ As we stated in our draft decision, these amendments are to provide greater clarity and drafting consistency between APA and other network service providers.⁴⁶

However, as noted in section 10.2.1, of the three cost pass through events for which our draft decision sought amendments, some minor amendments to the Insurer credit risk event and the Terrorism event have not yet been made as they were inadvertently missed in APA's revised proposal. Our final decision makes these minor amendments, which are set out in Table 10.1, and include:

- Insurer Credit Risk event –

⁴³ AER, *Draft decision, APA Victorian Transmission System (VTS) Access Arrangement 2023 to 2027 (1 January 2023 to 31 December 2027) – Attachment 10 – Reference tariff variation mechanism*, June 2022, p. 9 and APA VTS, *Victorian Transmission System 2023–27 access arrangement*, 10 August 2022, pp. 17–21.

⁴⁴ APA VTS, *Victorian Transmission System 2023–27 access arrangement*, 10 August 2022, pp. 17–20.

⁴⁵ AER, *Draft decision, APA Victorian Transmission System (VTS) Access Arrangement 2023 to 2027 (1 January 2023 to 31 December 2027) – Attachment 10 – Reference tariff variation mechanism*, June 2022, p. 15.

⁴⁶ AER, *Draft decision, APA Victorian Transmission System (VTS) Access Arrangement 2023 to 2027 (1 January 2023 to 31 December 2027) – Attachment 10 – Reference tariff variation mechanism*, June 2022, p. 14.

- delete “self” from “self-funding” in the second bullet point (labelled ii), so that it reads: “...associated with funding an insurance claim...”
- Terrorism event –
 - insert “or” after “behalf of”, so that it reads: “...behalf of or in connection...”. This was included in Table 10.1 in the draft decision but not labelled clearly as a change.
 - replace “changes” with “~~increases~~” and “in” with “~~of~~”, and insert “the” in the second bullet point, so that it reads: “changes the costs to the Service Provider in providing the Reference...”
 - insert “pursuant to clause 4.6.3 of this Access Arrangement” in the Note section, so that it reads: “...Terrorism Event pursuant to clause 4.6.3 of this Access Arrangement, the AER will have regard to...”. This was also included in Table 10.1 in the draft decision but not labelled clearly as a change.

With these changes we accept the inclusion of these cost pass throughs in APA’s Access Arrangement for VTS.

Table 10.1 Cost pass through event definitions which we have amended

Pass through event	Amended Definition ⁴⁷
Terrorism	<p>Terrorism event means an act (including, but not limited to, the use of force or violence or the threat of force or violence) of any person or group of persons (whether acting alone or on behalf of <u>or</u> in connection with any organisation or government), which:</p> <ul style="list-style-type: none"> • from its nature or context is done for, or in connection with, political, religious, ideological, ethnic or similar purposes or reasons (including the intention to influence or intimidate any government and/or put the public, or any section of the public, in fear): and • <u>changes</u> increases the costs to <u>the</u> Service Provider <u>in</u> of providing the Reference Service <p>Note: In making a determination on a Terrorism Event <u>pursuant to clause 4.6.3 of this Access Arrangement</u>, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> • whether the Service Provider has insurance against the event; • the level of insurance that an efficient and prudent service provider would obtain in respect of the event; and <p>whether a declaration has been made by a relevant government authority that a terrorism event has occurred.</p>
Insurer Credit Risk event	<p>An Insurer Credit Risk event means an event where an insurer of Service Provider becomes insolvent, and as a result, in respect of an existing, or potential, claim for a risk that was insured by the insolvent insurer, the Service Provider:</p> <ul style="list-style-type: none"> • is subject to a higher or lower claim limit or higher or lower deductible than would have otherwise applied under the insolvent insurer’s policy; or • incurs additional costs associated with self-funding an insurance claim, which would otherwise have been covered by the insolvent insurer. <p>Note: In making a determination on an Insurer Credit Risk Event pursuant to clause 4.6.3 of this Access Arrangement, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> • the Service Provider’s attempts to mitigate and prevent the event from occurring by reviewing and considering the insurer’s track record, size, credit rating and reputation; and • in the event that a claim would have been covered by the insolvent insurer’s policy, whether Service Provider had reasonable opportunity to insure the risk with a different insurer.

10.2.6.2 Pre-approved capex event

Consistent with our draft decision, our final decision is not to accept APA’s re-proposed Pre-approved capex event being included in its Access Arrangement.

In terms of achieving the NGO and promoting efficient investment, operation and use of natural gas services for the long term interest of consumers with regard to price, quality, safety and security of supply, we do not consider the proposed Pre-approved capex event is required to achieve this outcome.

⁴⁷ The text underlined reflects new text and the text with strikethrough reflects text that has been removed.

The incentive framework under which we have approved the capex forecast for the VTS provides APA with some flexibility to manage, prioritise and recover the capex costs for any changes in efficient investments within that envelope, as it did during the current period. It would still be able to manage its risk in addressing any supply / demand shortfalls by seeking pre-approval of new proposed capex by lodging an application under rule 80 to seek comfort that it meets the conforming / new capital expenditure criteria. In such cases, however, we consider incentives to promote the efficient investment in, and efficient operation and use of, the required infrastructure are stronger without the Pre-approved capex event. This is particularly as under a rule 80 application the return on capital would not occur within the access arrangement period the capex is incurred. This, by its nature, ensures the risk of over-investment is not shifted to consumers, but is maintained by the business, who is incentivised to efficiently manage and prioritise its capital expenditure, i.e. the risk is managed by those best placed to manage it.

We also note that APA considered that the combination of a rule 80 application and the proposed pass through goes some way to replicating the contingent project provisions in electricity regulation. There are no contingent project provisions in the NGR, and we consider if rule 80 had been intended to replicate the contingent project framework, it would have been drafted that way. In this regard:

- we are not satisfied that it was an unintentional design or drafting of rule 80 to not replicate the contingent projects framework. That is, rule makers were clear in not including a design that allowed for the re-opening of an existing access arrangement and/or amending a revenue allowance. This, in turn, highlights that rule 80 has its own purpose and separate intention to the contingent project framework. We do not therefore consider it appropriate to unilaterally circumvent the design of rule 80, particularly through the combination of a second mechanism that has a specifically different intention than suggested in APA's revised proposal.⁴⁸
- we are not satisfied that APA's proposed application of the cost pass through event is appropriate or aligns with the intention of this mechanism. Importantly, we observe that the cost pass through and contingent project frameworks are distinct elements of the uncertainty regime for electricity businesses, applied in different circumstances, including notably different materiality thresholds.

In terms of the materiality thresholds, the National Electricity Rules state that the AER must be satisfied that the proposed contingent project capital expenditure exceeds either \$30 million or 5% of the value of the maximum allowed revenue for the relevant Distribution or Transmission Network Service Provider for the first year of the relevant regulatory control period, whichever is the larger amount.⁴⁹ This compares to the materiality threshold for a cost pass through event of 1% of the smoothed forecast revenue, as determined in the final decision for the respective year in which the costs were incurred.⁵⁰ The higher percentage threshold in the contingent project assessment clearly suggests that rule makers considered

⁴⁸ APA VTS, *APA Victorian Transmission System 2023–27 access arrangement. Revised proposal – Overview of Revised Proposal*, August 2022, p. 110.

⁴⁹ NER 6.6A.1(b)(2)(iii) and 6A.8.1(b)(2)(iii).

⁵⁰ NER, Chapter 10 – *Glossary – definition of materiality*, pp. 1347–1348.

a higher hurdle was required for projects to be considered a contingent project and incorporated into revenues and prices within a regulatory period.

We also highlight the disparity in intention of the contingent project and cost pass through framework. Under the National Electricity Rules, the AER is required to be satisfied that the event requiring a contingent project is ‘probable’ in occurring,⁵¹ and is therefore forward looking and by its nature allows for prudent and efficient planning and mitigation strategies. Conversely, and as noted in 10.2.4, we consider that viewing pass through events as a ‘last resort’ and accepting them only when event avoidance, mitigation and insurance are unavailable, is consistent with the RPP and will contribute to the achievement of the NGO. Namely, when unforeseen exogenous events arise where the Network Service Provider may have limited effect to mitigate the immediate impact. This approach maintains the incentives on service providers to use market-based mechanisms to mitigate the cost impacts that would arise if the event is triggered. In turn, this promotes the efficient investment in, and efficient operation and use of, natural gas services for the long-term interests of consumers with respect to price.⁵²

In coming to this final decision, we have taken into account the views in submissions, noting that while there are some which are consistent with the position in this final decision, some took the opposite view and considered the Pre-approved capex event should be approved.

10.3 Revisions

We require APA to make the following revisions to its Access Arrangement proposal consistent with the NGR and NGL.

Revision number	Detail
Revision 10.1	Amend the definitions of the Insurer Credit Risk and Terrorism events as per Table 10.1.
Revision 10.2	Remove the Pre-approved capex event.

⁵¹ NER 6.6A1(c)(5) and 6A..8.1(c)(5).

⁵² NGL, s. 23; AEMC, *Rule Determination, National Electricity Amendment (Cost pass through arrangements for Network Service Providers) Rule 2012*, 2 August 2012, p. 8.

Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
APA / APA VTS	APA VTS Australia (Operations) Pty Ltd and APA VTS Australia (NSW) Pty Ltd
Capex	Capital Expenditure
NGL	National Gas Law
NGO	National Gas Objective
NGR	National Gas Rules
Opex	Operating Expenditure
RPP	revenue and pricing principles
VTS	Victorian Transmission System
