

Final decision

Transgrid transmission determination
1 July 2023 to 30 June 2028

Attachment 13 – Pass through events

April 2023

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Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601
Tel: 1300 585 165

AER reference: 202187

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13 Pass through events

During the regulatory control period, a service provider can apply to us to pass material changes in its costs arising from pre-defined exogenous events through to customers, in the form of higher or lower network charges. These events are called cost pass through events.

Positive pass throughs exist in the rules as a mechanism to allow service providers to recover their efficient costs incurred as a result of events that could not be forecast as part of their proposal that otherwise would have a significant financial effect on the ability of networks to invest in, and operate their, networks.¹

The National Electricity Rules (NER) include the following pass through events for all transmission determinations:²

- a regulatory change event
- a service standard event
- a tax change event
- an insurance event
- an inertia shortfall event.³

In addition to these prescribed events, other (nominated) pass through events may be specified in a determination for a regulatory control period.⁴

Our final decision must include a decision on the nominated pass through events that are to apply for the regulatory control period.⁵

This attachment sets out our final decision on the nominated pass through events that will apply to Transgrid for the 2023–28 regulatory control period (2023–28 period).

13.1 Final decision

This final decision is the same as our draft decision. Our final decision is that the following nominated pass through events will apply to Transgrid for the 2023–28 period:

- insurance coverage event
- insurer's credit risk event

¹ AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 2.

² NER, cl. 6A.7.3(a1)(1)–(4) and (6). Each of these prescribed events is defined in Chapter 10 (Glossary) of the NER.

³ This type of event does not apply in Victoria (see NER, cl 5.20B.4(a)). Relative to our draft decision, we have deleted reference to 'fault level shortfall event' because this event has been removed from chapter 6A following the *Managing system strength* rule change. See: <https://www.aemc.gov.au/rule-changes/efficient-management-system-strength-power-system> (p. 117 [here](#)).

⁴ NER, cl. 6A.7.3(a1)(5).

⁵ NER, cl. 6A.14.1(9).

- natural disaster event
- terrorism event.

These events are defined in Table 13.1.

We do not accept Transgrid’s proposal of a new ‘non-network option’ event for a regulatory investment test – transmission (RIT-T) project because we are not satisfied that it meets the nominated pass through considerations under the NER. We discuss this further in section 13.4 below.

Table 13.1: AER’s final decision nominated pass through events

Proposed event	Proposed definition
Insurance coverage event	<p>An insurance coverage event occurs if:</p> <ol style="list-style-type: none"> 1. Transgrid: <ol style="list-style-type: none"> a) makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy or set of insurance policies; or b) would have been able to make a claim or claims under a relevant insurance policy or set of insurance policies but for changed circumstances; and 2. Transgrid incurs costs: <ol style="list-style-type: none"> a) beyond a relevant policy limit for that policy or set of insurance policies; or b) that are unrecoverable under that policy or set of insurance policies due to changed circumstances; and 3. The costs referred to in paragraph 2 above materially increase the costs to Transgrid in providing prescribed transmission services. <p>For the purpose of this insurance coverage event:</p> <p><i>‘changed circumstances’</i> means movements in the relevant insurance market, including liability insurance, that are beyond the control of Transgrid, where those movements mean that it is no longer possible for Transgrid to take out an insurance policy or set of insurance policies at all or on reasonable commercial terms that include some or all of the costs referred to in paragraph 2 above within the scope of that insurance policy or set of insurance policies.</p> <p><i>‘costs’</i> means the costs that would have been recovered under the insurance policy or set of insurance policies had:</p> <ol style="list-style-type: none"> i. the limit not been exhausted; or ii. those costs not been unrecoverable due to changed circumstances. <p>A relevant insurance policy or set of insurance policies is an insurance policy or set of insurance policies held during the regulatory control period or a previous regulatory control period in which Transgrid was regulated; and</p>

	<p>Transgrid will be deemed to have made a claim on a relevant insurance policy or set of insurance policies if the claim is made by a related party of Transgrid in relation to any aspect of Transgrid’s network or business; and</p> <p>Transgrid will be deemed to have been able to make a claim on a relevant insurance policy or set of insurance policies if, but for changed circumstances, the claim could have been made by a related party of Transgrid in relation to any aspect of Transgrid’s network or business.</p> <p>Note: For the avoidance of doubt, in assessing an insurance coverage event through application under rule 6A.7.3(j), the AER will have regard to:</p> <ul style="list-style-type: none"> i. the relevant insurance policy or set of insurance policies for the event; ii. the level of insurance that an efficient and prudent NSP would obtain, or would have sought to obtain, in respect of the event; iii. any information provided by Transgrid to the AER about Transgrid’s actions and processes; and iv. any guidance published by the AER on matters the AER will likely have regard to in assessing any insurance coverage event that occurs.
<p>Insurer’s credit risk event</p>	<p>An insurer’s credit risk event occurs if an insurer of Transgrid becomes insolvent, and as a result, in respect of an existing or potential claim for a risk that was insured by the insolvent insurer, Transgrid:</p> <ul style="list-style-type: none"> a) is subject to a higher or lower claim limit or a higher or lower deductible than would have otherwise applied under the insolvent insurer’s policy; or b) incurs additional costs associated with funding an insurance claim, which would otherwise have been covered by the insolvent insurer. <p>Note: In assessing an insurer credit risk event pass through application, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> i. Transgrid’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 ii. in the event that a claim would have been covered by the insolvent insurer’s policy, whether Transgrid had reasonable opportunity to insure the risk with a different provider.
<p>Natural disaster event</p>	<p>Natural disaster event means any natural disaster including but not limited to cyclone, fire, flood or earthquake that occurs during the 2023–28 regulatory control period that changes the costs to Transgrid in providing prescribed transmission services, provided the cyclone, fire, flood, earthquake or other event was:</p> <ul style="list-style-type: none"> a) a consequence of an act or omission that was necessary for the service provider to comply with a regulatory obligation or requirement or with an applicable regulatory instrument; or

	<p>b) not a consequence of any other act or omission of the service provider.</p> <p>Note: In assessing a natural disaster event pass through application, the AER will have regard to, amongst other things:</p> <ol style="list-style-type: none"> i. whether Transgrid has insurance against the event; and ii. the level of insurance that an efficient and prudent NSP would obtain in respect of the event
Terrorism event	<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 or in connection with any organisation or government), which:</p> <ol style="list-style-type: none"> 1. 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 2. changes the costs to Transgrid in providing direct control services. <p>Note: In assessing a terrorism event pass through application, the AER will have regard to, amongst other things:</p> <ol style="list-style-type: none"> i. whether Transgrid has insurance against the event; ii. the level of insurance that an efficient and prudent NSP would obtain in respect of the event; and iii. whether a declaration has been made by a relevant government authority that a terrorism event has occurred.

Source: AER analysis

13.2 Transgrid's revised proposal

Transgrid accepted all aspects of our draft decision on cost pass through events. However, it also proposed a new non-network option event for a RIT-T project to address the risk Transgrid faces in not being able to secure non-network services to meet its regulatory obligations.⁶ Transgrid also proposed two contingent projects to address the same risk.⁷

Transgrid proposed that a 'non-network option event' for a RIT-T project be defined as one or more of the following:⁸

(i) the non-network solution identified in the associated RIT-T being found not to be technically feasible, and/or

(ii) no non-network proponent being able to provide the required service in time to meet the requirements of Schedule 5.1.4 of the National Electricity Rules.

⁶ Transgrid, *Transgrid - 2023-28 Revised Revenue Proposal - 2 Dec 2022*, December 2022, p. 151.

⁷ Transgrid, *Transgrid - 2023-28 Revised Revenue Proposal - 2 Dec 2022*, December 2022, p. 155.

⁸ Transgrid, *Transgrid - 2023-28 Revised Revenue Proposal - 2 Dec 2022*, December 2022, p. 152.

Where a ‘RIT-T project’ refers to the Managing Reliable Supply to the Bathurst Orange Parkes area project and the Managing Reliable Supply to the North West Slopes area project.

In relation to the nominated pass through considerations in the NER, Transgrid submitted that:⁹

- this event is not covered by any of the categories of pass through event in clause 6A.7.3(a1)(1) to(4)
- the nature of the event can be clearly identified at the time the determination is made, as evidenced by the proposed definition
- Transgrid could not reasonably prevent an event of this type from occurring, as whether a non-network option (NNO) is technically feasible and/or able to provide the service within the required timeframe is outside of Transgrid’s direct control, and
- Transgrid cannot insure against this event.

Transgrid submitted that the cost pass through event would be triggered where Transgrid either:

- receives no compliant responses in its procurement process for non-network services for these RIT-T projects, or
- receives notification from either AEMO or a non-network option provider that the non-network option is unable to provide the required service within the timeframe required to avoid an expected breach of the requirements of Schedule 5.1.4 of the NER.¹⁰

13.2.1 Submissions on Transgrid’s revised proposal

We received two submissions on this matter.¹¹ The submissions broadly agreed with Transgrid’s efforts to pursue non-network solutions. They also supported Transgrid seeking to ensure there are measures that can be used to address the risk of these not being delivered for reasons beyond Transgrid’s control.¹² However, they questioned Transgrid’s approach in proposing a new nominated cost pass through event.

Our Consumer Challenge Panel (CCP25) observed, based on Transgrid’s engagement with its key stakeholder engagement group – the Transgrid Advisory Council (TAC):¹³

⁹ Transgrid, *Transgrid - 2023-28 Revised Revenue Proposal - 2 Dec 2022*, December 2022, p. 153.

¹⁰ Schedule 5.1.4 of the NER provides that Transmission Network Service Provider must plan and design its transmission system and equipment for control of voltage such that the minimum steady state voltage magnitude, the maximum steady state voltage magnitude and variations in voltage magnitude are consistent with the levels stipulated in clause S5.1a.4 of the system standards.

¹¹ Public Interest Advocacy Centre (PIAC), *Submission – 25 January 2023, 25 January 2023*; Consumer Challenge Panel, Sub-panel 25 (CCP25), *Submission – 20 January 2023, 20 January 2023*.

¹² PIAC, *Submission on Transgrid 2023–28 Revised Revenue Proposal*, January 2023, p. 3.

¹³ CCP25, *Submission to the AER Draft Decision – Transgrid Transmission Determination 2023–28 and Transgrid Revised Revenue Proposal 2023–28*, January 2023, pp. 10–11.

- the proposed cost pass throughs (and contingent projects) were the most contentious issues that arose during Deep Dive 6 and absorbed considerable amount of TAC meeting time
- the TAC agreed it was important to encourage and support the adoption of non-network solutions but there was not consensus on if, and how, the risks to Transgrid associated with the non-network solution should be managed
- “the engagement on this issue was rushed and suffered from a lack of objective information” and noted it was Transgrid’s responsibility to equip its TAC with the information required to engage on the matter including the nature of Transgrid’s risks, how this risk should be shared between customers and the service provider, and how the Rules applied in this situation
- that it remains unclear if the cost pass through or contingent projects mechanisms are compliant with the NER
- the detail on the cost pass through and contingent projects (such as definitions and trigger events) were not provided to the TAC, and have therefore not been the subject of engagement.

The Public Interest Advocacy Centre (PIAC) submitted that it:¹⁴

- “supports Transgrid’s efforts to pursue non-network solutions and fully supports Transgrid seeking to ensure there are measures that can be used to address the risk of these not being delivered for reasons beyond Transgrid’s control.”
- considers a cost pass through is the appropriate mechanism so that Transgrid can have some “assurance it will be able to pass through the costs of any unavoidable and unforeseen events.”
- recommends that Transgrid propose a rule change to the AEMC to clarify that cost pass through provisions can be used for this purpose.

13.3 Assessment approach

We have applied the same assessment approach as in the draft decision.¹⁵

13.4 Reasons for final decision

Consistent with our draft decision, we accept that four nominated pass through events (insurance coverage, insurer’s credit risk, natural disaster, and terrorism) will apply to Transgrid over the 2023–28 period. Transgrid accepted all aspects of our draft decision relating to these nominated events.¹⁶ However, we do not accept Transgrid’s non-network option event because, as set out below, we are not satisfied it meets the criteria for inclusion as a nominated cost pass through event under the NER.¹⁷

¹⁴ PIAC, *Submission on Transgrid 2023–28 Revised Revenue Proposal*, January 2023, p. 3.

¹⁵ AER, Draft decision, *Transgrid transmission 2023–28, Attachment 13, Pass through events*, September 2022, pp. 4-7.

¹⁶ Transgrid, *Transgrid - 2023-28 Revised Revenue Proposal - 2 Dec 2022*, December 2022, pp. 150-152.

¹⁷ NER Ch.10 *nominated pass through event considerations*, para. (c).

As stated earlier, in proposing this non-network option event, Transgrid also proposed two contingent projects to address the same risk. Transgrid submitted that the proposed contingent projects are related to RIT-Ts that identified non-network options as part of the preferred solutions for managing reliable supply to the Bathurst Orange Parkes (BOP) area, and North West Slopes (NWS) area.¹⁸ Transgrid also submitted that the NWS project is currently progressing to competitive procurement and commercial negotiations with non-network proponents for network support contracts, and Transgrid is still looking to finalise a network support agreement for the BOP project.¹⁹

Transgrid stated that it is committed to engaging with potential non-network providers to successfully conclude network support agreements in line with the RIT-T outcomes. However, until the conclusion of procurement process, there is a risk that non-network proponents are not able to provide the required service in the time required for it to meet its obligations under the NER.²⁰

The NER sets out a range of factors we are to take into account when considering whether to allow a nominated cost pass through event.²¹ One of these factors is that the event is outside of the regulated business' direct control;²² that is, that Transgrid could not reasonably prevent an event of this type (failure of non-network service provision) from occurring.

We consider that Transgrid has a reasonable degree of control over the conduct, timing, and outcome of the respective procurement processes for the NWS and BOP projects. Therefore, the risk of failure in the procurement of non-network services should not be directly passed through to consumers. In our view, Transgrid has control over key aspects of the conduct, timing and outcome of its procurement and contracting processes including:

- which, if any, parties are contracted to provide non-network services
- assessing the compliance of proposals, including how any identified technical deficiencies identified through the process are assessed and remedied
- the timing of the process, including as it may relate to the provision of services within the timeframe required.

This view is also shared by CCP25. Specifically, CCP25 questioned whether the proposed cost pass through event is compliant with the NER, noting the proposed event contains elements that may be within the control of Transgrid.²³ CCP25 also stated:²⁴

“The CCP considers that it was probable that Transgrid would adopt a non-network solution as a result of one of the RIT-Ts underway. As such, Transgrid

¹⁸ Transgrid, *Transgrid - 2023-28 Revised Revenue Proposal - 2 Dec 2022*, December 2022, p. 152.

¹⁹ Transgrid, *2023-28 Revised Revenue Proposal*, December 2022, pp. 161–162.

²⁰ Transgrid, *Transgrid - 2023-28 Revised Revenue Proposal - 2 Dec 2022*, December 2022, p. 152.

²¹ NER Ch.10 *nominated pass through event considerations*, para. (a)-(e).

²² NER Ch.10 *nominated pass through event considerations*, para. (c).

²³ CCP25, *Submission to the AER Draft Decision – Transgrid Transmission Determination 2023–28 and Transgrid Revised Revenue Proposal 2023–28*, January 2023, p. 10.

²⁴ CCP25, *Submission to the AER Draft Decision – Transgrid Transmission Determination 2023–28 and Transgrid Revised Revenue Proposal 2023–28*, January 2023, p. 11.

could have anticipated its desire to address its project risks and commenced engagement on the potential risk mitigation measures earlier in the process.”

For the above reasons, we do not accept Transgrid’s non-network option event as a nominated cost pass through for the 2023–28 regulatory control period. This matter, including the related proposed contingent projects, is discussed further in Attachment 5 (capital expenditure) of this final decision (section B.4.7).

Glossary

Term	Definition
AEMO	Australian Energy Market Operator
BOP	Bathurst Orange Parkes (BOP) area
CCP25	Consumer Challenge Panel, sub-panel 25
NER	National Electricity Rules
NNO	Non-network option
NWS	North West Slopes area
PIAC	Public Interest Advocacy Centre
RIT-T	Regulatory investment test – transmission
TAC	Transgrid Advisory Council
