

# Combined Proposal 2024-2029

## Attachment 17 Pass through events



**Outline:** This attachment to TasNetworks' Combined Proposal sets out the additional nominated pass through events proposed by TasNetworks for the 2024-2029 regulatory control period.



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# 17 Pass through events

## 17.1 Introduction

The National Electricity Rules (**NER**) recognise that a network service provider (**NSP**) cannot reasonably be expected to forecast costs for major events beyond its control that could potentially occur during a regulatory control period.

The regulatory framework addresses this issue by including a cost pass through mechanism within Chapters 6 and 6A of the NER. Under the pass through mechanism, NSPs can seek the Australian Energy Regulator's (**AER's**) approval to recover the costs (or pass through the savings) in excess of a 'materiality' threshold, that are related to the occurrence of defined, unpredictable and high cost exogenous event(s) for which a determination does not provide a regulatory allowance.

To this end, the NER prescribes a number of pass through events that apply to all distribution determinations, as well as a range of pass through events applying to transmission determinations (see *Regulatory requirements*, below). These prescribed events ensure that NSPs do not face significant, irrecoverable costs arising from, among other things, occurrences such as unexpected regulatory changes or changes in the service standards applying to network services.

In addition to the pass through events specified in the NER, NSPs also can nominate additional pass through events through the revenue and regulatory proposals they submit to the AER. Most NSPs have used this provision within the NER to nominate incidents and occurrences such as acts of terrorism or natural disasters as pass through events, and the AER has accepted those nominations on the basis that NSPs cannot reasonably be expected to mitigate or avoid those events or insure against them.

Therefore, in addition to the pass through events specified in the NER, TasNetworks proposes the following additional pass through events for the 2024–2029 regulatory control period:

- insurance coverage event (transmission and distribution)
- terrorism event (transmission and distribution)
- natural disaster event (transmission and distribution)
- insurer credit risk event (transmission and distribution)
- Australian Energy Market Operator (**AEMO**) participant fee structure event (distribution)
- Renewable Energy Zone design report (transmission).

Each of the pass through events proposed by TasNetworks is consistent with the nominated pass through event considerations (defined in the NER) that the AER must consider when deciding whether to accept a pass through event proposed by an NSP.

The approval by the AER of the pass through events nominated by TasNetworks will not expose customers to additional costs through their network charges during the 2024-2029 regulatory control period, unless those events occur and the AER approves a cost pass through application from TasNetworks.

Each additional pass through event nominated by TasNetworks is discussed further in section 17.3.

## 17.2 Regulatory requirements

Clause 6.6.1 of the NER specifies that a pass through event for a distribution determination is any of the following:

- a 'regulatory change event'
- a 'service standard event'
- a 'tax change event'
- a 'retailer insolvency event'
- any other event specified in a distribution determination as a pass-through event for the determination.

Clause 6A.7.3 of the NER specifies that a pass through event for a transmission determination is any of the following:

- a 'regulatory change event'
- a 'service standard event'
- a 'tax change event'
- an 'insurance event'
- any other event specified in a transmission determination as a pass-through event for the determination
- an 'inertia shortfall event'
- a 'fault level shortfall event'.

Under the NER, TasNetworks can request in its regulatory proposal for the 2024–2029 regulatory control period, the inclusion of additional pass through events (see NER clauses 6.5.10(a), 6.6.1(a1)(5), 6A.6.9(a) and 6A.7.3(a1)(5)) in its determination having regard to the *nominated pass through event* considerations in Chapter 10.

The *nominated pass through event considerations* are defined in Chapter 10 of the NER as:

- (a) whether the event proposed is an event covered by a category of pass through event specified in clause 6.6.1(a1)(1) to(4) (in the case of a distribution determination) or clause 6A.7.3(a1)(1) to(4) (in the case of a transmission determination)
- (b) whether the nature or type of event can be clearly identified at the time the determination is made for the service provider
- (c) 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
- (d) whether the relevant service provider could insure against the event, having regard to:
  - (1) the availability (including the extent of availability in terms of liability limits) of insurance against the event on reasonable commercial terms; or

(2) whether the event can be self-insured on the basis that:

- (i) it is possible to calculate the self-insurance premium
- (ii) the potential cost to the relevant service provider would not have a significant impact on the service provider's ability to provide network services

(e) any other matter the AER considers relevant and which the AER has notified Network Service Providers is a nominated pass through event consideration.

## 17.3 Proposed additional pass through events

TasNetworks proposes the following additional pass-through events for the 2024–2029 regulatory control period:

- insurance coverage event
- terrorism event
- natural disaster event
- insurer credit risk event
- AEMO participant fee structure event
- Renewable Energy Zone design reports event.

Definitions for each nominated pass-through event and TasNetworks' reasons for proposing them are set out in the sections below.

### 17.3.1 Insurance coverage event

TasNetworks proposes a pass through event for an 'insurance coverage event' defined as follows:

An insurance coverage event occurs if:

1. *TasNetworks:*

(a) *makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy (in whole or in part) or set of insurance policies; or*

(b) *would have been able to make a claim or claims under a relevant insurance policy (in whole or in part) or set of insurance policies but for changed circumstances;*

2. *TasNetworks incurs costs:*

(a) *both within and beyond the relevant policy limit 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 point 2 above materially increase the costs to TasNetworks in providing direct control or prescribed transmission services.

For this insurance coverage event:

- ‘changed circumstances’ means movements in the relevant insurance liability market that are beyond the control of TasNetworks, where those movements mean that it is not possible for TasNetworks to take out an insurance policy (in whole or in part) 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.
- ‘costs’ means the costs that would have been recovered under the insurance policy or set of insurance policies had:
  - the claimable component up to the limit not been exhausted; or
  - those costs not been unrecoverable due to changed circumstances.
- a relevant insurance policy is an insurance policy (in whole or in part) or set of insurance policies held during the 2024–2029 regulatory control period or a previous regulatory control period in which TasNetworks was regulated.
- TasNetworks will be deemed to have made a claim on a relevant insurance policy (in whole or in part) or set of insurance policies if the claim is made by a related party of TasNetworks in relation to any aspect of TasNetworks’ network or business.

In assessing a cost pass through application for an insurance coverage event, the AER has said in recent determinations it will have regard to:<sup>1</sup>

- the relevant insurance policy or set of insurance policies for the event
- the level of insurance that an efficient and prudent NSP would obtain, or would have sought to obtain, in respect of the event
- any information provided by TasNetworks to the AER about TasNetworks’ actions and processes.

In support of this proposed pass through event, TasNetworks notes that:

- an insurance coverage event is not covered already by any of the categories of pass through events specified in the NER for distribution or transmission networks

- this type of event can be clearly identified
- TasNetworks cannot prevent this type of event from occurring (i.e., it is an outcome arising from conditions in the general insurance market and the requirement for TasNetworks to obtain a prudent level of insurance having regard to major network and business risk factors) and cannot substantially mitigate the cost impacts of this type of event (both prior to and after the occurrence of this type of event)
- TasNetworks cannot obtain appropriate insurance on reasonable commercial terms covering costs that exceed its policy limits
- the occurrence of a particular insurance coverage event has a low probability of occurrence but a high financial consequence or magnitude.

### 17.3.2 Terrorism event

TasNetworks proposes a pass through event for a ‘terrorism event’ defined as follows:

*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:*

- 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
- materially increases the costs to TasNetworks in providing direct control services and/or, prescribed services.

In assessing a pass through application for a terrorism event, the AER has said in recent determinations it will have regard to:<sup>2</sup>

- whether TasNetworks has insurance against the event
- the level of insurance that an efficient and prudent NSP would obtain in respect of the occurrence of the event.

In support of this proposed pass through event, TasNetworks notes that:

- a terrorism event is not already covered by any of the categories of pass through events specified in the NER
- this type of event can be clearly identified
- TasNetworks cannot prevent this type of event from occurring and cannot substantially mitigate the cost impacts of this type of event (both prior to and after the occurrence of the event)

1 AER, Powerlink Queensland Transmission Determination 2022 to 2027 (1 July 2022 to 30 June 2027), Final Decision, p 85

2 AER, AusNet Services Transmission Determination 2022 to 2027, Final Decision, Attachment 13 Pass through events, p 13-7

- TasNetworks cannot obtain appropriate insurance on reasonable commercial terms covering the full range of costs that could potentially be incurred as a result of the occurrence of this type of event
- the occurrence of a particular terrorism event has a low probability of occurrence but a high financial consequence or magnitude.

### 17.3.3 Natural disaster event

TasNetworks proposes a pass through event for a 'natural disaster event' defined as:

*Natural disaster event means any natural disaster (including but not limited to cyclone, fire, flood or earthquake) that occurs during the 2024–2029 regulatory control period that increases the costs to TasNetworks of providing direct control and, or, prescribed services, provided the cyclone, fire, flood, earthquake or other event was:*

- *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*
- *not a consequence of the negligent acts or omissions of the service provider.*

In assessing a cost pass through application for a natural disaster event, the AER has said in recent determinations it will have regard to:<sup>3</sup>

- whether TasNetworks has insured against the event
- the level of insurance that an efficient and prudent NSP would obtain in respect of the event.

In support of this proposed pass through event, TasNetworks notes that:

- a natural disaster event is not already covered by any of the categories of pass through events specified in the NER
- this type of event can be clearly identified
- TasNetworks cannot prevent this type of event from occurring and cannot substantially mitigate the cost impacts of this type of event (both prior to and after the occurrence of the event)
- TasNetworks cannot obtain appropriate insurances on reasonable commercial terms covering the full range of costs that could potentially be incurred as a result of the occurrence of this type of event
- the occurrence of a particular natural disaster event has a low probability of occurrence but a high consequence or magnitude.

<sup>3</sup> AER, Powerlink Queensland Transmission Determination 2022 to 2027 (1 July 2022 to 30 June 2027), Final Decision, pp 85–86

### 17.3.4 Insurer credit risk event

TasNetworks proposes a pass through event for an 'insurer credit risk event'. This event is triggered where TasNetworks' insurer becomes insolvent and TasNetworks is subject to higher or lower costs, a higher or lower claims limit or a higher or lower deductible than those allowed under its insurance policy with that insurer. The proposed definition of an insurance credit risk event is:

*An insurer credit risk event occurs if an insurer of TasNetworks becomes insolvent, and as a result, in respect of an existing or potential claim for a risk that was insured by the insolvent insurer, TasNetworks:*

- *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*
- *incurs additional costs associated with funding an insurance claim, which would otherwise have been covered by the insolvent insurer.*

In assessing a cost pass through application for an insurer credit risk event, the AER has said in recent determinations it will have regard to:<sup>4</sup>

- TasNetworks' attempts to mitigate and prevent the event from occurring, by reviewing and considering the insurer's track record, size, credit rating and reputation prior to taking out the relevant insurance policy
- if a claim would have been covered by the insolvent insurer's policy, whether TasNetworks had reasonable opportunity to insure the risk with a different provider.

In support of the acceptance of this proposed pass through event, TasNetworks notes that:

- an insurer credit risk event is not already covered by any of the categories of pass through events specified in the NER
- this type of event can be clearly identified
- TasNetworks cannot prevent this type of event from occurring and cannot substantially mitigate the cost impacts of this type of event (both prior to and after the occurrence of the event)
- TasNetworks cannot obtain appropriate insurance on reasonable commercial terms covering the occurrence of this type of event
- the occurrence of a particular insurer credit risk event has a low probability of occurrence but a high financial consequence or magnitude.

<sup>4</sup> AER, Powerlink Queensland Transmission Determination 2022 to 2027 (1 July 2022 to 30 June 2027), Final Decision, p 86

TasNetworks submits that the occurrence of increased insurance premiums (or deductibles) from external insurers (where the original insurer becomes insolvent) is beyond its control. Higher insurance premiums also are beyond the control of TasNetworks in that they cannot be reasonably mitigated.

### 17.3.5 AEMO participant fee structure event

TasNetworks is proposing a pass through event for an 'AEMO participant fee structure event', which would be triggered by a change in AEMO's electricity market participant fee structure that leads to an allocation of AEMO's core NEM function costs to DNSPs.

AEMO recovers its budgeted revenue requirements from market participants within the NEM. Under the NER, AEMO has the power to recover market fees only from registered participants. The NER require AEMO to publish a structure setting out how its budgeted revenue is to be recovered through participant fees. AEMO determines the allocation of participant fees every five years, with the actual amounts charged determined on an annual basis, via the AEMO budgeting process.

As part of AEMO's most recent review of its electricity market participant fee structure, AEMO initially proposed<sup>5</sup> that it would introduce an allocation of its core NEM function costs to both transmission network service providers (TNSPs) and distribution network service providers (DNSPs). In its final determination<sup>6</sup> of the electricity fee structures to apply to participant fees from 1 July 2021, AEMO adopted the proposal from its Draft Report to recover costs from TNSPs. As AEMO had also proposed, the commencement of allocations to TNSPs was delayed by two years, and will commence from 1 July 2023, to provide time for TNSPs to seek the transitional arrangements needed to recover the fees.

It was determined that DNSPs would not be charged participant fees. However, not unlike the cost pass through arrangements applying to TNSPs and DNSPs, the NER allows for AEMO to determine a separate fee to recover the costs of specific projects (declared NEM projects) during the term of a participant fee structure determination. Accordingly, in the final determination of its electricity fee structure for the period from 1 July 2021 to 30 June 2026, AEMO indicated that DNSPs' involvement with AEMO's systems and processes would be monitored throughout the next fee period. Should there be a material increase in the level of that involvement, AEMO flagged that it will consider a declared NEM fee project consultation process to recover those costs from DNSPs.

The potential introduction of participant fee allocations for DNSPs mid-way through TasNetworks' next regulatory control period creates a step change risk for TasNetworks and its customers, should a direct pass-through mechanism not be allowed as part of the AER's regulatory determination for the 2024-2029 regulatory control period. TasNetworks therefore is proposing that an AEMO participant fee structure event be a nominated pass through event in TasNetworks' 2024-2029 regulatory control period. The proposed definition of an AEMO participant fee structure event is:

*An AEMO participant fee structure event occurs if AEMO makes a determination in relation to its electricity market participant fee structure that requires DNSPs to contribute to the recovery of AEMO's core NEM function costs during the 2024-2029 regulatory control period, increasing the costs to TasNetworks of providing direct control services.*

In support of the acceptance of this proposed pass through event, TasNetworks notes that:

- TasNetworks' distribution annual revenue allowances for the 2024-2029 regulatory control period will not include the recovery of market fees paid to AEMO because no such obligation currently exists in relation to the provision of standard control services by DNSPs within the NEM
- a change in AEMO's participant fee structure is not already covered by the categories of pass through events specified in the NER
- this type of event can be clearly defined and identified
- TasNetworks cannot prevent this type of event from occurring and cannot substantially mitigate the cost impacts of this type of event (either prior to or after the occurrence of such an event)
- TasNetworks cannot obtain appropriate insurances on reasonable commercial terms covering the costs that could potentially be incurred as a result of the occurrence of this type of event.

5 Electricity Fee Structure Draft Report and Determination, AEMO, November 2020

6 Electricity Fee Structures Final Report and Determination, AEMO, March 2021



### 17.3.6 Renewable Energy Zone design report event

TasNetworks proposes a new pass through event for the 2024-2029 regulatory control period, to enable the costs incurred by TasNetworks in the preparation of Renewable Energy Zone (**REZ**) design reports to be recovered through the AER approved pricing methodology applying to TasNetworks' prescribed transmission services. The pass through event would be triggered by a request from AEMO for TasNetworks to prepare a design report for a REZ in Tasmania, made through the release of an Integrated System Plan (**ISP**) or updated ISP.

In 2021, the Energy Security Board (**ESB**) developed a set of changes<sup>7</sup> to the NER to support the design of REZs. The planning rules devised by the ESB built on previous changes to the NER designed to co-ordinate and optimise transmission and generation investment within the NEM, which had created the ISP framework and made them actionable.

As a result, REZs are subject to a special planning regime,<sup>8</sup> which includes the preparation of REZ design reports by Jurisdictional Planning Bodies. In most regions of the National Electricity Market the Jurisdictional Planning Body is also the local TNSP and TasNetworks is the Jurisdictional Planning Body for Tasmania. Under those arrangements, if an ISP requires a design report to be prepared for a REZ in Tasmania, TasNetworks must commence the preparation of the report as soon as practicable, or in accordance with the timeframes specified in the ISP.

AEMO has identified several potential REZs and offshore wind zones (**OWZ**) across the NEM. Three of those REZs and one OWZ are in Tasmania. As part of REZ development, under Clause 5.24.1 of the NER AEMO can require a jurisdictional planner to develop a REZ design report. A REZ design report is a significant planning exercise that considers the design, route and construction costs of the transmission infrastructure that would be required to connect new generation within a REZ to the power system.

If the requirement for the production of a REZ design report is known at the time of a revenue determination, the estimated costs of preparing that report can be included as part of a TNSP's operating expenditure in its revenue proposal. However, the requirement to produce a REZ design report during an upcoming regulatory control period and the timing of that work may not be known sufficiently in advance of a revenue determination for this to be possible.

ISPs are published by AEMO biennially. One ISP is due to be finalised in 2024, just before the start of TasNetworks' next regulatory control period, and two ISPs are due for release in 2026 and 2028 during TasNetworks' next regulatory control period. The obligation to prepare a REZ design report can also arise through the release of updated ISPs.

It is not expected that AEMO will require TasNetworks to commence preparation of a REZ design report prior to TasNetworks submitting its 2024-2029 revenue proposal. However, it is reasonably likely that TasNetworks will be required to produce one or more REZ design reports during the 2024-2029 regulatory control period, and that the obligation to do so will not be known in time for the costs of producing the report(s) to be factored in to TasNetworks' revenue allowance for that regulatory control period. Without the provision of a pass through mechanism, this would leave TasNetworks unable to recover the costs involved in the preparation of those reports.

The ESB recommended<sup>9</sup> that in the case of requirements to produce REZ design reports that are not known about at the time of a revenue determination, the cost pass through framework could be used by TNSPs to nominate unanticipated REZ design reports as a category of pass through event. Consistent with the ESB's recommendation, TasNetworks is nominating the preparation of a REZ design report event as a pass through event for the 2024-2029 regulatory control period.

Given that the requirement to undertake a REZ design report during the 2024-2029 regulatory control period is uncertain, including a 'REZ design report event' as a nominated pass through event will provide some protection for TasNetworks from the risk of unrecoverable expenditure, while at the same time ensuring that customers will only bear additional cost if AEMO requires a REZ design report to be produced. TasNetworks considers this approach to be more efficient and equitable than providing an upfront allowance in our building block costs for the preparation of REZ design reports that at the time of TasNetworks' next revenue determination are yet to be commissioned.

However, even with a nominated pass through event in place for REZ design reports that have not been funded through the revenue determination process, it is possible that TasNetworks could incur significant costs in preparing a report and still be unable to recover those costs, if the costs incurred in a given year are insufficient to qualify the report's preparation as a positive change event. This would particularly be the case if the preparation of a REZ design report and, therefore, its cost, is spread across more than one regulatory year.

7 Renewable Energy Zones planning final recommendations, Energy Security Board, February 2021

8 National Electricity Amendment (Renewable energy zone planning) Rule 2021, May 2021

9 Energy Security Board, Renewable Energy Zones Planning, Final Recommendations, February 2021

The risk of unfunded expenditure incurred in the preparation of REZ design reports not reaching a level that meets the materiality threshold in a particular regulatory year is exacerbated by the fact that some of the work involved with the preparation of REZ design reports is likely to have already been undertaken as part of TasNetworks' own transmission planning. If that is the case, while potentially still being substantial, the incremental costs associated with the preparation of REZ design reports are even less likely to meet the materiality threshold.

It would seem inconsistent that TNSPs with jurisdictional planning responsibilities should be able to recover even incremental costs associated with the preparation of a REZ design report by virtue of the request for the report being made in time to be included as part of a TNSP's operating expenditure in a revenue proposal, yet be unable to recover similar (or potentially greater) costs, simply because the timing of the request for a REZ design report falls outside of the revenue determination process.

The ESB has expressed the view that, while the materiality threshold should apply to REZ design reports as a pass through event, the costs associated with the preparation of multiple design reports within the one regulatory year should be able to be combined in order to meet the materiality threshold for a pass through event. From this, it is clear that the ESB has recognised the risk that TNSPs could be required to prepare REZ design reports and incur significant additional, unfunded costs, simply due to the request for the design report(s) being made at a point in the regulatory cycle where the costs of producing the report(s) are unable to be provided for as part of a TNSP's revenue determination.

TasNetworks considers this to be a genuine risk, which waiving the application of the materiality threshold would remove. However, TasNetworks accepts the position articulated by the AER in its draft decision on ElectraNet's transmission determination for the 2023-2028 regulatory control period that the NER's definition of a positive change event requires the application of the materiality threshold, and that this requirement may not be bypassed in the definition for a proposed nominated pass through event.

Nonetheless, TasNetworks considers it important that the risk of incurring unrecoverable costs in preparing REZ design reports needs to be addressed to the greatest extent possible under the NER. In addition to proposing the preparation of REZ design reports as a nominated pass through event for the 2024-2029 regulatory control period, TasNetworks also proposes that the costs associated with the preparation of multiple design reports within the same regulatory year should be able to be combined in order to meet the materiality threshold for a pass through event.

The ability to combine multiple REZ design reports as a means of meeting the materiality threshold will not eliminate the risk to TasNetworks of the costs incurred in preparing a particular REZ design report becoming an unfunded cost to the business. If TasNetworks is required to prepare only one unbudgeted REZ design report during the coming regulatory control period, or during a regulatory year within that control period, it remains a possibility that the costs of preparing that report will not be sufficient to meet the materiality threshold. This is particularly the case if preparation of the report spans multiple regulatory years.

Nonetheless, in the absence of a waiver from the materiality test, the ESB's recommended approach will at least offer more protection for TasNetworks in undertaking the planning work needed to facilitate investment in new generation and transmission infrastructure in Tasmania's REZs.

Under TasNetworks' proposal, a REZ design report event will occur if:

- AEMO requires TasNetworks to undertake the preparation of a REZ design report during the 2024-2029 regulatory control period
- TasNetworks will incur increased costs in preparing that REZ design report
- the costs of preparing that REZ design report were not incorporated into the revenue that may be earned by TasNetworks from the provision of prescribed transmission services during the 2024-2029 regulatory control period.

TasNetworks' proposed definition of a REZ design report event is:

*A REZ design report event occurs if AEMO requires TasNetworks to prepare one or more REZ design report(s) during the 2024-2029 regulatory control period in accordance with clause 5.24.1(b) of the National Electricity Rules, giving rise to additional costs to TasNetworks, the recovery of which was not included in the maximum allowed revenue that TasNetworks may earn from the provision of prescribed transmission services during the 2024-2029 regulatory control period.*

In support of this proposed pass through event, TasNetworks notes that:

- the event proposed is not an event covered by an existing pass through event
- this type of event can be clearly defined and identified
- the obligation to prepare a REZ design report is unavoidable, imposes significant additional costs on TasNetworks and arises from events beyond TasNetworks' control
- treating the obligation to prepare a REZ design report which was not anticipated as part of a revenue determination promotes an appropriate risk sharing arrangement which is in the long-term interests of TasNetworks' customers
- TasNetworks cannot obtain appropriate insurances on reasonable commercial terms covering the costs that could potentially be incurred as a result of the occurrence of this type of event.

