

Mr Sebastian Roberts  
General Manager Electricity  
Australian Competition and Consumer Commission  
GPO Box 520J  
Melbourne VIC 3000

Dear Mr Roberts

## **TRANSGRID'S REVENUE CAP DETERMINATION 2004 TO 2009: OPERATING EXPENDITURE 'PASS THROUGH' ARRANGEMENTS**

I am writing in response to your letter of 4 August 2004 in which you invite TransGrid to provide further information to assess TransGrid's revenue cap application, and to comment on the Commission's proposed pass-through rules. This letter addresses the pass through rules.

### **Pass Through Rules**

We thank the Commission for the draft rules and the opportunity to comment on them. We welcome the Commission's intention to adopt a standard set of pass-through rules since this is likely to foster certainty and transparency in regulatory decision-making, reducing the possibility of disputes and allowing TNSPs to focus on their core business.

We would note from the outset the merits of the Commission clarifying the status of the proposed standard rules. We presume that (despite the wording of 2.1) that the Commission is only suggesting that the finalised standard rules would form the basis for specific consideration of pass-through rules appropriate for each TNSP in relation to each Revenue Cap period. The Commission is, of course, not able to fetter its discretion in relation to specific future decisions.

We understand that TransGrid is being asked not only to comment on the standard rules in generality, but also to comment on specific rules that would apply to TransGrid for the coming Revenue Cap period.

We have reviewed the draft rules as well as the Commission's previous decisions (the Draft Decision in the NSW and ACT Transmission Network Revenue Caps – Energy Australia (28 April 2004), the Tasmanian Transmission Network Revenue Cap (10 December 2003), Murraylink Transmission Company Application for Conversion and Maximum Allowed Revenue (1 October 2003), South Australian Transmission Revenue Cap (11 December 2003), and the South Australian Electricity Act 1996 Section 35B Electricity Pricing Order, 11 October 1999.

In light of these reviews and subsequent analysis of the issues the Commission is the following comments and proposals are offered. Where TransGrid proposes specific amendments to the draft rules, they are indicated in **bold**.

As you will see, TransGrid have proposed a series of specific pass through events not included in the Commission's draft. This is due to the fact that the Commission is currently developing a set of generic rules which would apply to all TNSPs, and therefore must cover the full range of possible pass-through events which may occur. While many of the specific

pass-through events proposed could be subsumed within a general category of "legislative and regulatory events", we understand that the Commission is reluctant to allow such a broad category. We have therefore proposed a series of more specifically defined pass-through events wherever possible.

#### *Operation of the rules*

We note that the proposed rules, if adopted for a specific Revenue Cap period, provide the Commission with a relatively limited ongoing discretion in relation to categories and amounts of pass-through. We agree that this approach is likely to foster certainty and transparency and reduce the scope for dispute over the application of the rules.

#### *Demand side management payments and the ACCC Regulatory Test*

##### Explanation

As previously communicated to the Commission, TransGrid wishes to ensure that demand side management payments, to the extent that they cannot be reasonably foreseen, can be passed through. Initially, TransGrid proposed that this be achieved through amendment of the definition of "Service Standard Event". However, we note that if this option were pursued, demand side management fees could only be passed through, based upon the ACCC's proposed draft rules, if they result from "a decision made by an Authority or introduction or amendment to an applicable law". In fact demand side management payments are currently incurred by TNSPs as a result of the obligations in chapter 4 to negotiate connection agreements which provide for interruptible loads and grid support, and may arise from other circumstances such as the operation of the ACCC's *Regulatory Test*. The costs are inherently difficult to forecast. As such it is appropriate to include a separate category of positive or negative pass through which may result from the application of these Code and related obligations.

##### Proposed Drafting

#### **2.2 Pass Through Events**

Each of the following is a Pass Through Event:...

*[insert following text]* **f) A Power System Event...**

##### **Definitions**

*[insert following text]*

**A Power System Event is a material financial impact arising from the operation, application or amendment of:**  
**the ACCC's Regulatory Test for New Interconnectors and Network Augmentations, 15 December 1999 or successor, and/or 5.6.6(b)(1)(iii) of the National Electricity Code;**  
**and/or**  
**the obligations on TNSPs to secure grid support and/or interruptible loads under Chapter 4 of the National Electricity Code.**

#### *Costs imposed by Environmental Agencies*

##### Explanation

TransGrid notes that agencies such as the Environmental Protection Agency (EPA), in line with powers granted under relevant statutes, can and do impose unforeseen costs on TNSPs which should be passed through. The Commission is already aware of new requirements that



have been imposed in relation to vegetation management. Such costs, however, may not be considered by the Commission as being the result of Service Standards Events per se. We therefore propose a separate category of pass through for costs imposed by actions of the Environmental Agencies. We understand that the Commission has referred in passing to a reluctance to accept environmental levies as pass through events if the cost is imposed in order to change TNSPs' behaviour.<sup>1</sup> In such cases, it would be better borne by the TNSP than passed through to other parties. However, TransGrid does not consider that this justifies the exclusion of all costs imposed on TNSPs for environmental purposes.

For example, some environmental costs will be better borne by other parties, since they, not the TNSP are the eventual intended target of behavioural change. Other environmental costs arise not through the specific imposition of a levy, but through the imposition of other specific obligations (eg to reconfigure networks) which happen to impose costs on TNSPs. In such cases it is the obligation not the cost which changes the TNSP's behaviour. If the costs cannot be passed through, this may frustrate the very purpose of such legislation. Due to their potential impact, environmental costs could also affect the commercial viability of one or more TNSPs, in which case, as the Commission has noted, it would be unreasonable to force the TNSP to bear the cost. We have therefore drafted a pass through category of Environmental Law events which capture the costs which legitimately should be passed through, but excludes the levy scenario outlined by the Commission.

#### Proposed Drafting – Environmental Agencies

### **2.2 Pass Through Events**

Each of the following is a Pass Through Event...

*[insert following text]* **g) An Environmental Law Event...**

#### **Definitions**

*[insert following text]* **An Environmental Law Event is a material financial impact arising from a decision of an Environmental Agency acting in accordance with their powers, or from the enactment, variation, amendment or removal of any relevant Environmental legislation, excluding levies which specifically intend to impose costs on TNSPs.**

#### *Costs imposed by OH&S*

#### Explanation

Occupational Health and Safety legislation and authorities can have a significant impact upon TransGrid's costs. TransGrid usually cannot anticipate or avoid such costs. In common with the Environmental Law events outlined above, compliance with Health and Safety legislation and authorities results from the imposition of mandatory obligations, and costs for failure to comply (i.e. penalties), not from the imposition of costs of compliance per se. If TNSPs are not permitted to recover costs from third parties through pass-through events, the purpose of the OH&S legislation or decision may be frustrated.

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<sup>1</sup> ACCC, Draft Decision, NSW and ACT Transmission Network Revenue Caps – Energy Australia, 2004/5-2008/9, p. 104.

## 2.2 Pass Through Events

Each of the following is a Pass Through Event...

*[insert following text]* h) An OH&S Event...

### Definitions

*[insert following text]* An OH&S Event is a material financial impact arising from a decision of WorkCover, or other Authority charged with Occupational Health and Safety, or from the enactment, variation, amendment or removal of any relevant legislation which materially affects the TNSP's costs associated with Occupational Health and Safety.

## Public Safety

### Explanation

In order to ensure public safety from time to time, a wide range of unforeseeable costs can be imposed upon TNSPs. For example, a change in the interpretation or application of the general law of tort may result in substantial changes for TNSPs – eg a requirement to provide a safety awareness campaign on a particular issue to the many thousands of property owners in reasonable proximity to transmission line routes. As with Health and Safety obligations, compliance with public safety requirements results primarily from the imposition of mandatory obligations, and the imposition of costs for a failure to comply. If TNSPs cannot pass through the costs of compliance, either the financial viability of TNSPs or the purpose of the legislation or decision may be threatened.

## Proposed Drafting – Public Safety

## 2.2 Pass Through Events

Each of the following is a Pass Through Event...

*[insert following text]* i) A Public Safety Event...

### Definitions

*[insert following text]* A Public Safety Event is a material financial impact arising from an action the TNSP is required to take for reasons of public safety.

## Relevant tax

TransGrid has previously pointed out that New Land Tax Requirements can have a material unforeseen impact. The definition of "Relevant Tax" appears broad enough to ensure such costs can be passed through under subsection a). TransGrid would, however, appreciate the Commission's confirmation of whether this is also the Commission's understanding.



*NEL and National Electricity Rules (Code).*

Explanation:

In order to ensure the delivery of National Electricity Market objectives from time to time, a wide range of unforeseeable costs can be imposed upon TNSPs. For example, a change in the National Electricity Law, Rules, Code, or requirements of bodies empowered to impose new requirements on TNSPs under these instruments eg a requirement to carry out additional testing of the compliance of NEM generators with the technical provisions of the Code or deliver information or awareness programs to NEM Participants in relation to transmission performance. These result in additional costs associated with the imposition of mandatory obligations, and the imposition of costs for a failure to comply. If TNSPs cannot pass through the costs of compliance, either the financial viability of TNSPs or the purpose of the new NEM requirement may be threatened.

Proposed Drafting: - Definition of an "Electricity Law Event"

**An Electricity Law Event is a material financial impact arising from any enactment, variation, amendment or removal of obligations on TNSPs under the National Electricity Law or National Electricity Code, or decisions of Authorities under such legislation, rules or codes.**

*Insurance deductibles*

Explanation

In circumstances where an Insurance Event occurs, but the cost of the Insurance Event is equal to or marginally in excess of the deductible, a TNSP may reasonably choose not to make an insurance claim since the costs of claiming (eg the assessment of future risk profile and/or premium by an insurance company) may outweigh that difference. In such circumstances, it would be reasonable for the TNSP to pass-through at least the amount of the deductible.

Proposed Drafting – Definition of "Insurance Event"

"An Insurance Event occurs when...

b) the risk eventuates and:

i) the TNSP incurs or will incur all or part of a deductible (where that amount is materially higher or lower than the allowance for the deductible (if any) that was provided for in the Revenue Cap *[insert the following text]*; or

**ii) the TNSP reasonably chooses not to incur the deductible (even if the cost of the Insurance Event is in excess of the deductible) in which case the amount of the deductible will be the relevant Pass Through Amount;..."**

*NEMMCO Communications Standards*

Explanation

The costs arising from the application of the NEMMCO Communications Standards cannot be reasonably estimated in advance, but does not appear to be covered by the ACCC's proposed rules.



#### Proposed Drafting – Definition of “Service Standards Event”

iv) increasing or decreasing the TNSP's risk in providing the *prescribed services*,

**[insert following text] vi) materially increasing or decreasing the TNSP's costs as a result of the imposition, alteration or removal of information and data management requirements (including but not limited to NEMMCO Communications Standards) which arise from the TNSP's obligations under the National Electricity Code,...**

#### *Initiation of pass through*

##### Explanation

TransGrid notes that the proposed pass through rules do not explicitly contemplate the circumstance where a pass-through amount is either minimal or zero (except by implication arising from the reference to materiality in 2.4(a). Although the TNSP may choose not to submit a Notice of Proposed Pass Through if the amount is positive, it may be required by a strict reading of s3.1(d) to submit such a notice even if the amount of pass-through is minimal. TransGrid proposes therefore that the rules clarify that neither positive or negative pass through would trigger the processes outlined in the code unless they are *material*.

#### Proposed Drafting – Materiality of pass through

...3.1(b) the pass through event has a **[insert following text] material** financial impact on the TNSP during the Regulatory Control Period...

#### *Timing of Events*

##### Explanation

It is not clear whether a material cost change that arises in one regulatory period as a result of a Pass Through event in another (usually prior) regulatory period is eligible for recognition as a Pass Through cost. For example, NEMMCO advised of additional communication system requirements on TransGrid in the previous regulatory reset period. However, the costs arising from this decision will primarily arise during the current regulatory reset period. While it is clearly preferable to quantify these costs for inclusion in the general calculations for the new regulatory period, it is likely that some costs will not be quantifiable. The current drafting of 2.3(a) and 3.1(a) appears to preclude pass through of events which occur in a prior regulatory period, since they require not only the *financial impact* of the event, but also the *event itself* to occur within the regulatory period. We assume, however, that it is not the Commission's intention to exclude pass through in such circumstances when the costs cannot be quantified during the regulatory reset period. It needs to be made clear that these costs can be treated as a pass through costs in order to ensure that the new requirement can be implemented without unreasonably affecting the commercial position of the TNSP. We therefore propose that 2.3(a) and 3.1(a) be deleted, requiring only that the financial impact of the pass through event occur in the given regulatory period.

#### *Instructions to issue notice*

##### Explanation

We note that, in contrast to the Transend decision, the proposed rules do not contemplate the circumstance in which the Commission may instruct TransGrid to issue a Notice of Proposed Pass Through. Since the Commission may be aware of a Pass Through Event which has a material positive or negative impact on TransGrid, when TransGrid may not be aware, we propose to include the possibility of the Commission issuing such an instruction.

**3.1 Initiation of Pass Through...**

*[insert following text]* **(e) if the ACCC believes that TransGrid is or will be entitled or required to pass-through the financial effect of a Pass Through Event, then it may give a Notice of Proposed Pass Through to the ACCC in accordance with 3.1(c) and (d).**

**Process For Finalisation**

We concur with the Commission's proposed process and welcome publication of the Commission's draft decision discussion paper. However, if the Commission intends to make any substantive changes to TransGrid's proposals, we would appreciate an opportunity to discuss any concerns the Commission before the final revenue cap decision. I trust that the matters raised in this letter are of assistance in finalising this matter.

Yours sincerely

*Philip Gall 9/9/04*  
Philip Gall  
Manager/Regulatory Affairs