

Determination Network support cost pass through for 2021–22 TasNetworks

October 2022

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Overview

On 15 August 2022, TasNetworks applied to the Australian Energy Regulator (AER) to pass through costs relating to network support for the 2021–22 regulatory year.

TasNetworks is the provider of electricity transmission network services in Tasmania.

Network support refers to non-network solutions used by transmission network service providers (TNSPs) as a cost-effective substitute for network augmentation. Potential non-network solutions include local generation, co-generation, demand side response and services from a Market Network Service Provider. Generally, network support is seen as desirable where it can cost effectively substitute for network build and is promoted by allowing TNSPs to pass through network support payments which are different to those forecast and are beyond the TNSPs' control¹. In addition, unlike other cost pass throughs, network support cost pass through events are not subject to any materiality test under the regulatory regime, which is intended to further promote such measures.

We have assessed TasNetworks' cost pass through application in accordance with the National Electricity Rules (NER) and our procedural guideline for preparing a transmission network support cost pass through application.²

We determine that a positive pass through event has occurred, and the appropriate positive pass through amount is \$192,776 (\$nominal, 2023–24). This amount will be added to allowed revenues for the next regulatory year (2023–24) and result in slightly higher transmission charges (other things constant).

¹ See, National Electricity Rules (NER), Chapter 10 (definition of 'network support payment').

² AER, *Procedural guideline for preparing a transmission network support pass through application*, June 2011.

1 Determination

We consider that a positive network support event has occurred³ and approve a positive pass through amount of \$192,776 (\$nominal, 2023–24). This is due to network support costs being higher in 2021–22 than the allowance forecast for such costs in TasNetworks' revenue determination. The approved pass through amount will be adjusted in TasNetworks' maximum allowed revenue in the 2023–24 regulatory year in accordance with the procedures set out in TasNetworks' 2019–24 revenue determination.

The NER require us to determine the amount that should be passed through to customers.⁴ We base our decision on an assessment of the factors set out in clause 6A.7.2(i) of the NER. TasNetworks proposed a positive pass through amount of \$192,779 (\$nominal, 2023–24) to recover from its transmission network users, submitted on 15 August 2022.⁵ We have adjusted TasNetworks' proposed pass through amount by applying unrounded consumer price index (CPI) and weighted average cost of capital (WACC) values when escalating the figure to the 2023–24 regulatory year.

³ A positive change event is defined in the NER as a pass through event which entails the transmission network service provider incurring materially higher costs in providing prescribed transmission services than it would have incurred but for that event. See NER, chapter 10 Glossary.

⁴ NER, cl. 6A.7.2(d).

⁵ TasNetworks transmission, *Network support pass through application for 2021-22*, August 2022, p. 1.

2 TasNetworks' application

TasNetworks submitted its network support pass through application on 15 August 2022. The application is available on our website.⁶

2.1 Background

Revenue determinations for TNSPs include forecast allowances for network support payments.

A network support event occurs when the actual amount of network support payments differs from the forecast amount allowed in the determination. Differences generally arise because the amount of network support required by a TNSP in a regulatory year is dependent on factors that are outside the control of the TNSP, such as weather conditions, demand levels and electricity usage patterns. The difference between the forecast cost of network support and the actual cost of network support is passed through to users in higher (or lower) charges for the use of the TNSP's transmission services.

2.2 Regulatory requirements

Clause 6A.7.2 of the NER provides that a TNSP may apply to the AER for a determination on a positive or negative network support event following a regulatory year.

A positive or negative network support event entails a TNSP making higher or lower network support payments in the preceding regulatory year than the amount of network support payments (if any) that is provided for in the annual building block revenue requirements for the TNSP for that regulatory year.

Where a positive or negative network support event occurs, the AER must determine a network support pass through amount.⁷

Clause 6A.7.2(i) of the NER lists the relevant factors that the AER must consider when making a determination on a positive or negative network support event:

- (1) the matters and proposals set out in any statement given to the AER by the Transmission Network Service Provider under paragraph (c);
- (2) in the case of a positive network support event, the increase in costs in the provision of prescribed transmission services that the provider has incurred in the preceding regulatory year as a result of the positive network support event;
- (3) in the case of a positive network support event, the efficiency of the provider's decisions and actions in relation to the risk of the event, including whether the provider has failed to take any action that could reasonably be taken to reduce the magnitude of the positive network support event and whether the provider has taken or omitted to take any action where such action or omission has increased the magnitude of the amount in respect of that event;
- (4) the time cost of money based on the allowed rate of return for the provider for the relevant regulatory control period;

⁶ <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/cost-pass-throughs>

⁷ NER, cl. 6A.7.2(d) and 6A.7.2(f).

- (5) the need to ensure that the provider only recovers any actual increment in costs under this paragraph (i) to the extent that such increment is solely as a consequence of a network support event; and
- (6) any other factors the AER considers relevant.

The NER does not require that any materiality threshold be applied to network support pass throughs as opposed to other types of pass through events. The reason for this is to encourage the use of non-network solutions.

2.3 Guidelines for a network support pass through application

We released a guideline detailing our approach to assessing network support cost pass throughs in June 2011 (guideline).⁸ The guideline was prepared in order to assist TNSPs in preparing their network support pass through applications. The guideline increases the transparency of the process applying to network support pass through arrangements.

The guideline provides information regarding what steps we will take in assessing an application for a network support cost pass through, and what information is required from TNSPs for the process. The basic steps to assessing an application are:

- Assessing whether a network support event has occurred
- Verifying the network support payments
- Checking the calculations for the pass through amount, including steps taken to compensate the TNSP or its users for the time cost of money
- Assessing the efficiency of a network support provider's decisions and actions in relation to the risk of an event.

For further detail, the guideline can be found at <http://www.aer.gov.au/node/972>.

We have considered TasNetworks' application for a network support pass through in accordance with the NER and the guideline, and our reasoning is set out below.

2.4 TasNetworks' proposed pass through amount

On 15 August 2022, TasNetworks applied to the AER for a positive network support pass through of \$192,779 (\$nominal, 2023–24). This reflects TasNetworks' calculation of the difference between the allowance TasNetworks received for network support payments as part of its revenue determination and what TasNetworks actually spent on network support in the relevant period. TasNetworks' revenue determination for the 2019–24 regulatory control period included an allowance for \$0 (\$2021–22) for the 2021–22 regulatory year.⁹ Thus, this network support pass through application relates to network support payments which TasNetworks has incurred as a result of entering into a network support contract after its revenue determination for the 2019–24 regulatory control period was made.

The pass through relates to network support services incurred in response to the Australian Energy Market Operator (AEMO's) declaring a "Notice of Inertia and Fault Level Shortfalls" in

⁸ AER, *Procedural guideline for preparing a transmission network support pass through application*, June 2011.

⁹ AER, *TasNetworks transmission - Post-tax revenue model - 2022-23 return on debt update*, March 2022.

Tasmania in November 2019¹⁰ and a “Notice of system strength and inertia shortfalls” in May 2021.¹¹ To address the shortfalls identified by AEMO, TasNetworks has entered into an inertia and system strength services procurement contract with a third-party, following a competitive Expression of Interest (EOI) process.¹² TasNetworks noted that the expense relating to this network support pass through application would not have been incurred were it not for the AEMO declaration.¹³

¹⁰ AEMO, *Notice of Inertia and Fault Level Shortfalls in Tasmania*, November 2019

¹¹ AEMO, *Notice of Tasmania system strength and inertia shortfalls*, May 2021

¹² TasNetworks transmission, *Network support pass through application for 2021-22*, August 2022, p. 3.

¹³ TasNetworks transmission, *Network support pass through application for 2021-22*, August 2022, p. 3.

3 AER assessment

3.1 Positive network support event

The NER defines network support event as follows¹⁴:

Network support event

If, at the end of a regulatory year of a regulatory control period, the amount of network support payments made by a Transmission Network Service Provider for that previous regulatory year is higher or lower than the amount of network support payments (if any) that is provided for in the annual building block revenue requirement for the Transmission Network Service Provider for that regulatory year, this constitutes a network support event.

We determine that a positive network support event has occurred because the network support payments made by TasNetworks in 2021–22 (\$179,132, \$2021–22) were higher than the amount of network support payments provided for in TasNetworks 2019–24 determination (\$0, \$2021–22).

3.2 Relevant factors

Clause 6A.7.2(i) of the NER sets out a number of factors that we must take into account when determining the approved pass through amount following a network support event.

We have given regard to the appropriate factors:

- We have considered the matters and proposals set out by TasNetworks
- We have calculated the increase in costs TasNetworks has incurred as a result of the positive network support event
- We are satisfied that TasNetworks' decisions and actions in relation to the risk of the event were efficient
- We have taken into account the time cost of money to calculate the appropriate pass through amount
- We are satisfied that the costs TasNetworks will recover under this determination are solely a consequence of the network support event
- We do not consider any other factors to be relevant.

3.3 Calculation of pass through event

We have updated the positive pass through amount calculated in TasNetworks' application submitted to the AER on 15 August 2022.

To calculate the positive pass through amount, we have used the network support cost amount of \$176,078 (\$nominal, 2021–22) reported in TasNetworks' application. TasNetworks provided invoices and, in response to our information request, further justification around the nature and key drivers of the network support costs it incurred over the 2021–22 period.¹⁵ We are satisfied that TasNetworks' has reasonably incurred actual network support costs

¹⁴ NER, chapter 10 Glossary.

¹⁵ TasNetworks, response to information request #01, 13 October 2022.

equal to this amount and the expenditure meets the definition of a network support event in the NER. The contract for these network services was awarded to the third-party on the basis of a competitive EOI process. Given this, we consider TasNetworks undertook appropriate steps to maintain the network support costs at an efficient level.¹⁶

Actual network support payments are assumed to be valued at middle of the year terms.¹⁷ Therefore, we applied half-year 2021–22 CPI to escalate the amount to the end of the 2021–22 regulatory year, which equated to \$179,132 (\$2021–22). This amount matches the network support cost amount in TasNetworks application.¹⁸

To account for the time cost of money, WACC escalations are applied for a period of one and a half years when determining the network support pass through amount. Therefore, in our calculation we applied:

- 2022–23 nominal WACC of 5.0% over one year, which represents the year in which the network support pass through application is submitted and assessed by the AER
- a further 2023–24 nominal WACC of 5.1% for half a year, which represents the period where the network support pass through amount is passed through to customers.¹⁹

Consequently, we determine that a positive pass through event has occurred and the appropriate pass through amount is \$192,776 (\$nominal, 2023–24). This amount is slightly lower than the amount proposed by TasNetworks in its application due to its use of WACC figures rounded to two decimal places. This amount will be recovered through allowed revenues for the next regulatory year (2023–24) and result in higher transmission charges (other things constant).

3.4 Timing matters

The NER provide that an application for network support pass through must be made within 60 business days of the end of the relevant regulatory year.²⁰ We must then make a determination within 60 business days of the business' application to us.²¹

The relevant regulatory year ended on 30 June 2022 and TasNetworks made its pass through application on 15 August 2022, 31 business days later.

¹⁶ NER, cl. 6A.7.2(i)(3).

¹⁷ AER, *Procedural guideline for preparing a transmission network support pass through application*, June 2011, p. 13.

¹⁸ TasNetworks transmission, *Network support pass through application for 2021-22*, August 2022, p. 2.

¹⁹ AER, *TasNetworks transmission - Post-tax revenue model - 2022-23 return on debt update*, March 2022.

²⁰ NER, cl. 6A7.2(c).

²¹ NER, cl. 6A7.2(e).

Glossary

Term	Definition
AER	Australian Energy Regulator
AEMO	Australian Energy Market Operator
CPI	Consumer price index
EOI	Expression of Interest
Guideline	Procedural guideline for preparing a transmission network support pass through application
NER	National Electricity Rules
TNSP	Transmission network service providers
WACC	Weighted average cost of capital
