

Decision

ElectraNet

**2022-23 Inertia Shortfall
Cost Pass Through**

June 2022

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Overview

On 17 February 2022, ElectraNet submitted a written statement applying for cost pass-through of forecast inertia network services costs. It sought to recover revenue of \$4.16 million of estimated costs to procure inertia network services in South Australia for the 2022-23 regulatory year.

We published ElectraNet's written statement on 3 March 2022 and sought submissions from interested stakeholders by 17 March 2022. No submissions were received.

For a validly submitted written statement applying for a positive pass through, we must make a determination on the application and, if we determine that a positive change event has occurred, determine the approved pass through amount and the amounts to pass through in each regulatory year.

This is the first time the Australian Energy Regulator (AER) has considered an application for pass through relating to inertia network services costs. As part of our review, we have considered a threshold matter regarding the timing of the occurrence of the event as described in ElectraNet's application.

We consider that, for the purposes of clause 6A.7.3(c) of the National Electricity Rules (NER), the event referred to in ElectraNet's written statement of 17 February 2022 as a "positive change event" occurred on 17 December 2020 when the Australian Energy Market Operator (AEMO) published and provided to ElectraNet in accordance with clause 5.20B.3(c) of the NER a notice of an expected inertia shortfall in South Australia in 2022-2023.

On that basis, ElectraNet's written statement of 17 February 2022 was not submitted within 90 business days of the occurrence of the event referred to as a "positive change event" in the statement, as required under clause 6A.7.3(c) of the NER.

ElectraNet's written statement is therefore not a valid statement for the purposes of clause 6A.7.3(c) of the NER, and therefore there is no decision for the AER to make under clause 6A.7.3(d) of the NER in relation to that statement.

ElectraNet's obligation to provide the inertia services requested by AEMO is not conditional upon a cost pass through application being approved. ElectraNet is obliged to have used reasonable endeavours to provide inertia services within the timeframe specified in AEMO's notice under clause 5.20B.3(c) of the NER. The requirement to make the services available by the date specified by AEMO should not be departed from lightly, and ElectraNet's costs are not the only relevant consideration. Costs to other market participants, and benefits to all those who participate in the electricity market if the inertia service provider does make services available by the due date, are also relevant.

We note that, subject to the requirements of clause 6A.7.2 of the NER, ElectraNet will be able to recover costs efficiently incurred to provide inertia network services in 2022-23 under the network support cost pass through arrangements. This will include allowance for the time value of money due to any lag in recovering costs after the services have been provided. This is consistent with the revenue and pricing principle of the National Electricity Law (NEL) that a TNSP should be provided with a reasonable opportunity to recover at least the efficient costs it incurs in complying with a regulatory obligation or requirement.

Based on the information available, we consider that ElectraNet's process to procure and contract for the provision of inertia network services in 2022-23 is likely to have resulted in an efficient estimate of the price of procuring the services.

1 Introduction

During the regulatory control period, ElectraNet can apply to pass through to its customers, in the form of higher or lower network charges, certain material changes in its costs caused by pre-defined exogenous events. These events are called cost pass through events. Such events are limited to circumstances where the business can recover potential costs of defined yet unpredictable, high-cost events that are outside the control of the business.

Under the NER an inertia shortfall event is a prescribed event that applies only to Transmission Network Service Providers (TNSPs).¹ An inertia shortfall event occurs when a TNSP is required to provide, or cease providing, inertia network services during the course of a regulatory control period and this materially increases or decreases the TNSP's costs of providing prescribed transmission services.²

1.1 Who we are and our role in the process

We, the AER, exist to ensure all Australian energy consumers are better off, now and in the future. Consumers are at the heart of our work, and we focus on ensuring a secure, reliable and affordable energy future for Australia. We are the economic regulator for electricity and gas distribution and transmission services in the National Electricity Market (NEM), and our electricity-related powers and functions are set out in the National Electricity Law (NEL) and the NER.

ElectraNet's revenues are regulated by the AER through a five year transmission determination. The current transmission determination commenced on 1 July 2018 and will finish on 30 June 2023.

We are responsible for assessing pass through applications. Under the pass through provisions in the NER, a transmission business may apply to us to seek the recovery of additional costs incurred during a regulatory control period arising from predefined events, specified in either the NER or in its revenue determination.

1.2 ElectraNet's application

On 27 August 2020, AEMO declared an inertia shortfall in South Australia for 2020-21. On 17 December 2020, AEMO extended this declaration to require ElectraNet to make inertia network services available in 2021-22 and 2022-23, in accordance with clause 5.20B of the NER.

The inertia shortfall relates to the required secure operating level of inertia in circumstances where South Australia is 'islanded' from the rest of the NEM. At present, there are no inertia network services contracted to meet the shortfall. AEMO's existing operating procedure for situations when the South Australian region is islanded from the rest of the NEM requires that under certain conditions AEMO direct the actions of market participants to ensure power system security.

¹ NER, cl 6A.7.3.

² NER, chapter 10 (definition of 'inertia shortfall event')

The NER recognise the risk that inertia services may be requested unexpectedly during a regulatory control period. In circumstances where these increases are 'material', the NER allows for ElectraNet to recover through cost pass through its costs incurred providing these services from customers.

On 17 February 2022, ElectraNet submitted a written statement relating to an inertia shortfall cost pass through to recover forecast costs of \$4,159,525 associated with procuring inertia network services for the 2022-23 regulatory year. This cost includes a combination of fixed and variable costs, with the variable component based on an estimate of the duration for which the services will be called upon in the 2022-23 year. ElectraNet's estimate exceeds the materiality threshold (1% of MAR) of \$3.478 million, with an estimated cost of \$1.70 to the average household.³

ElectraNet has claimed confidentiality regarding some aspects of its written statement and supporting documentation, including specific details of the costs associated with procurement of inertia network services, which we have accepted.

³ ElectraNet, *Inertia shortfall event – cost pass through application*, February 2022.

2 Decision

The AER considers the event referred to in ElectraNet's written statement of 17 February 2022 as a "positive change event" occurred on 17 December 2020 when AEMO published and provided to ElectraNet in accordance with clause 5.20B.3(c) of the NER a notice of an expected inertia shortfall in South Australia in 2022-23.

ElectraNet provided its written statement in relation to this event on 17 February 2022. ElectraNet therefore did not submit its written statement seeking the approval of the AER for a positive pass through within 90 business days of the occurrence of the event referred to as a "positive change event" in the statement, as required under clause 6A.7.3(c) of the NER.

We therefore consider that ElectraNet's written statement is not a valid statement for the purposes of clause 6A.7.3(c) of the NER, and there is no decision for the AER to make under clause 6A.7.3(d) of the NER in relation to that statement.

While we have not determined an approved pass through amount in relation to the event, we note that inertia service payments are defined as network support payments under the NER. Therefore, subject to the requirements of clause 6A.7.2 of the NER, ElectraNet will be able to recover costs efficiently incurred to provide inertia network services in 2022-23 under annual network support pass through arrangements.

3 Assessment and reasons for decision

3.1 Timing of the application

The NER requires ElectraNet to submit a cost pass through application to us within 90 business days of a positive change event occurring.⁴

We must then make a determination within 40 business days of ElectraNet's application to us, or within 40 business days of receipt of a response to our request for further information required for the purpose of making a determination.⁵

ElectraNet submitted its pass through application on 17 February 2022 and we received responses to an information request on 19 April 2022 and 1 June 2022.

Occurrence and timing of an inertia shortfall event

In its written statement, ElectraNet submitted that a positive change event occurred on 5 November 2021. This date reflects ElectraNet's interpretation of the inertia shortfall event definition in the NER to mean that the relevant inertia shortfall event did not occur until the date on which ElectraNet confirmed that the costs of the inertia network services would exceed the materiality threshold. ElectraNet's written statement was submitted within 90 business days of the conclusion of its second round of tenders for inertia network services.

ElectraNet provided legal advice from Allens supporting this interpretation.⁶

Having considered ElectraNet's written statement and supporting information, including the additional information provided in response to our information request, we consider that, for the purposes of clause 6A.7.3(c) of the NER, the event referred to in ElectraNet's written statement as a positive change event occurred on 17 December 2020 when AEMO published and gave to ElectraNet a notice of an expected inertia shortfall in South Australia in 2022-2023 in accordance with clause 5.20B.3(c) of the NER.

We consider that the timing of the occurrence of a positive change event is distinct from the timing of knowing that the cost impact of the underlying event is material and that the event meets all the conditions in the definition of the relevant cost pass through event and positive change event.

If ElectraNet's interpretation of event timing were to be adopted, the timing of a positive change event would ultimately be at the discretion of the TNSP as it controls its cost assessment and quantification process. This would not be consistent with the intention of the positive pass through provisions, which provide transparency and certainty through specified timeframes for pass through applications and determinations.

When a TNSP needs more time to assess the cost impact of an event it may seek extension of the time limit under clause 6A.7.3(k) of the NER. That clause provides for extensions to

⁴ NER, 6A.7.3(c).

⁵ NER, 6A.7.3(e).

⁶ Allens, *Letter to AER re NER Cost Pass Through Provisions*, 1 June 2022.

the timeframe for submitting a written statement where the AER is satisfied the difficulty in assessing or quantifying the effect of the relevant pass through event justifies the extension.

The AER's position is consistent with the past practice of TNSPs and the AER in applying the cost pass through provisions in the NER. On a number of occasions, in circumstances where the costs of a particular event are uncertain, TNSPs (including ElectraNet) have requested, and the AER has provided, extensions to the time limit fixed in clause 6A.7.3(c) of the NER for submitting a written statement relating to a pass through event.⁷

ElectraNet requested, in the alternative, that the AER grant an extension of the prescribed time limit in clause 6A.7.3(c) to at least 18 February 2022. Even if clause 6A.7.3(k) permits the AER to approve such a request, the AER has decided that it should not be allowed in this case. ElectraNet had visibility of the likely costs of providing inertia network services from November 2021. The AER is not satisfied that an extension of time to submit this application until 18 February 2022 is justified by the difficulty of assessing or quantifying these costs. If a network service provider wishes to seek an extension of time for submitting a positive pass through application, as a matter of good practice the AER encourages it to do so before the 90 business day period expires and before it submits a pass through application, noting that clause 6A.7.3(k) permits the AER to then extend the time for lodgement until the likely costs can be quantified.

Application timing

On the basis of our interpretation of the occurrence and timing of inertia shortfall events, ElectraNet's written statement of 17 February 2022 was not submitted within 90 business days of the occurrence of the event referred to as a "positive change event" in the statement, as required under clause 6A.7.3(c) of the NER.

We consider that ElectraNet's written statement is therefore not a valid statement for the purposes of clause 6A.7.3(c) of the NER, and there is no decision for the AER to make under clause 6A.7.3(d) of the NER in relation to that statement.

3.2 Costs of providing inertia network services

We have not made a determination of any approved pass through amount in relation to ElectraNet's provision of inertia network services in 2022-23 at this time.

We understand that, since the declaration of the inertia shortfall, ElectraNet has worked closely with AEMO to develop the agreed technical specifications of the inertia network services required to meet the declared shortfall (200MW of raise Fast Frequency Response (FFR) and 110MW of lower FFR). ElectraNet has also undertaken a process of engagement with market participants to procure the services at the lowest cost to customers.

ElectraNet sought proposals from Frequency Control Ancillary Services (FCAS) providers, battery energy storage systems and loads as providers of FFR and South Australian generators as providers of synchronous inertia, conducting two rounds of competitive tenders, approaching 38 parties in total, which concluded with the second tender round on 5 November 2021. As no single tender was able to meet the AEMO 200MW raise

requirement, a combination of the expected lowest cost tenders was chosen based on this price comparison analysis.⁸

Based on the information available, we consider that the outcome of ElectraNet's tendering and contracting process will likely result in efficient market based prices for the required services.

We note that, subject to the requirements of clause 6A.7.2 of the NER, ElectraNet will be able to recover costs efficiently incurred to provide inertia network services in 2022-23 under annual network support cost pass through arrangements. This is because inertia service payments are defined as network support payments under the NER. Where there is a difference between actual network support payments and any network support payment allowance in a given regulatory year, TNSPs can 'true-up' that difference through the annual network support cost pass through arrangements.

The AER has published a guideline which sets out how TNSPs should prepare a network support pass through application to the AER.⁹ This guideline also sets out the process, timing and information requirements that TNSPs should consider when preparing network support pass through applications, and provides information on the procedures the AER will undertake when conducting an assessment of the application.

In this guideline, we recognise that circumstances may arise within a regulatory control period whereby a new network support agreement is introduced that has not been previously considered by the AER as part of the TNSP's revenue determination. Accordingly, the AER will review all applications for network support pass through where the definition of a network support event is met, including where new network support agreements such as ElectraNet's inertia service contracts are required within a regulatory control period. The guideline sets out our information requirements and assessment approach in these circumstances.

⁸ ElectraNet, *Inertia shortfall event – cost pass through application*, February 2022.

⁹ AER, [Procedural guideline for preparing a transmission network support pass through application](#), June 2011.

Glossary

| Term | Definition |
|------|--------------------------------------|
| AEMO | Australian Energy Market Operator |
| AER | Australian Energy Regulator |
| FCAS | Frequency Control Ancillary Services |
| FFR | Fast Frequency Response |
| MAR | Maximum Allowed Revenue |
| NEL | National Electricity Law |
| NEM | National Electricity Market |
| NER | National Electricity Rules |
