

Determination Network support pass through for 2021–22 Transgrid

November 2022

© Commonwealth of Australia 2021

This work is copyright. In addition to any use permitted under the *Copyright Act 1968* all material contained within this work is provided under a Creative Commons Attributions 3.0 Australia licence with the exception of:

- the Commonwealth Coat of Arms
- the ACCC and AER logos
- any illustration diagram, photograph or graphic over which the Australian Competition and Consumer Commission does not hold copyright but which may be part of or contained within this publication.

The details of the relevant licence conditions are available on the Creative Commons website as is the full legal code for the CC BY 3.0 AU licence.

Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001
Tel: 1300 585 165

AER reference: AER213605

Contents

Overview	1
1 Determination	2
2 Transgrid’s application	3
2.1 Background.....	3
2.2 Regulatory requirements.....	3
2.3 Guidelines for transmission network support pass through applications.....	4
2.4 Transgrid’s proposed pass through amount	4
3 AER assessment	6
3.1 Negative network support event.....	6
3.2 Relevant factors.....	6
3.3 Calculation of pass through event.....	6
3.4 Timing matters	7
Glossary	8

Overview

On 21 September 2022, Transgrid applied to the Australian Energy Regulator (AER) to pass through costs relating to network support for the 2021–22 regulatory year.

Transgrid is a provider of electricity transmission network services in New South Wales.

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 pass throughs, network support 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 Transgrid's pass through application in accordance with the National Electricity Rules (NER) and our procedural guideline for preparing a transmission network support pass through application.²

We determine that a negative network support event has occurred, and the appropriate negative network support pass through amount is \$10,510,025 (\$nominal, 2023–24). This amount will be subtracted from allowed revenues for the next regulatory year (2023–24) and result in slightly lower transmission charges (other things constant).

¹ See, 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 negative network support event has occurred³ and approve a negative network support pass through amount of \$10,510,025 (\$nominal, 2023–24). This is due to network support costs being lower in 2021–22 than the allowance forecast for such costs in Transgrid's revenue determination. The approved network support pass through amount will be adjusted in Transgrid's maximum allowed revenue in the 2023–24 regulatory year in accordance with the procedures set out in Transgrid's 2023–28 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. Transgrid proposed a negative network support pass through amount of \$10,509,065 (\$nominal, 2023–24) to recover from its transmission network users.

We have adjusted Transgrid's proposed pass through amount by applying the 2022–23 weighted average cost of capital (WACC) from Transgrid's current 2018–23 determination when escalating the figure to the end of the 2022–23 regulatory year, and the 2023–24 WACC from Transgrid's 2023–28 draft decision when escalating the figure to the middle of the 2023–24 regulatory year. This approach ensured we used the most up to date data in our calculation.

³ A negative change event is defined in the NER as a pass through event which entails the transmission network service provider incurring materially lower 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).

2 Transgrid's application

Transgrid submitted its network support pass through application on 21 September 2022. The application is available on our website.⁵

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.⁶

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;

⁵ <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/cost-pass-throughs>

⁶ 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 transmission network support pass through applications

We released a guideline detailing our approach to assessing network support cost pass throughs in June 2011 (guideline).⁷ 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 Transgrid's application for a network support pass through in accordance with the NER and the guideline, and our reasoning is set out below.

2.4 Transgrid's proposed pass through amount

On 21 September 2022, Transgrid applied to the AER for a negative network support pass through of \$10,509,065 (\$nominal, 2023–24). This reflects Transgrid's calculation of the difference between the allowance Transgrid received for network support payments as part of its revenue determination and what Transgrid actually spent on network support in the relevant period. Transgrid's revenue determination for the 2018–23 regulatory control period included an allowance for \$10,863,385 (\$2021–22) for the 2021–22 regulatory year.⁸

The pass through relates to network support services incurred in relation to Transgrid's Powering Sydney's Future (PSF) project. The network support allowance approved in Transgrid's 2018–23 determination was intended to enable Transgrid to use non-network

⁷ AER, *Procedural guideline for preparing a transmission network support pass through application*, June 2011.

⁸ AER, *Transgrid, Post Tax Revenue Model, 2022-23 return on debt update*, January 2022; AER analysis.

solutions to manage the risk of supply outages in the inner Sydney and CBD area, before the new 330kV cable becomes operational in 2022–23.⁹

Transgrid stated in its application the variation between the actual and the forecasted amounts is due to¹⁰:

- COVID-19 and the changes to office-based work patterns. This resulted in a marked reduction in Inner Sydney demand as people worked from home, which removed the need to procure higher levels of demand management; and
- One of the three contracted parties being unable to fulfil their contracted capacity resulting in no payments being made to them.

⁹ Transgrid, *Network Support Pass Through Application 2021-22*, September 2022, p.1.

¹⁰ Transgrid, *Network Support Pass Through Application 2021-22*, September 2022, p.4.

3 AER assessment

3.1 Negative network support event

The NER defines network support event as follows¹¹:

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 negative network support event has occurred because the network support payments made by Transgrid in 2021–22 (\$1,200,335, \$2021–22) were lower than the amount of network support payments provided for in Transgrid's 2018–23 determination (\$10,863,385, \$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 Transgrid
- We have calculated the decrease in costs Transgrid has occurred as a result of the negative network support event
- We are satisfied that Transgrid's 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 Transgrid will recover under this determination are solely a consequence of the aforementioned network support event
- We do not consider any other factors to be relevant.

3.3 Calculation of pass through event

To calculate the negative network support pass through amount, we have used the network support cost amount of \$1,179,875 (\$nominal, 2021–22) reported in Transgrid's 2021–22 Regulatory Financial Report, provided as part of its response to our Regulatory Information Notice. This amount matches the network support cost amount in its application. When escalated to the end of the 2021–22 regulatory year, the network support cost amount becomes \$1,200,335 (\$2021–22) compared to the \$10,863,385 (\$2021–22) network support allowance we made in our 2018–23 revenue determination for Transgrid.¹²

¹¹ NER, chapter 10 Glossary.

¹² AER, *Transgrid, Post Tax Revenue Model, 2022-23 return on debt update*, January 2022; AER analysis.

We are satisfied that Transgrid has reasonably incurred actual network support costs that are below our allowance and the variation in the expenditure meets the definition of a network support event in the NER. The contract for these network services was awarded on the basis of a competitive tender¹³ and we consider this an appropriate method for maintaining costs at an efficient level.¹⁴

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 5.75% over one year, which represents the year in which the network support pass through application is submitted and assessed by the AER.¹⁵
- a further 2023–24 nominal WACC of 5.77% for half a year, which represents the period where the network support pass through amount is passed through to customers. As this time period falls outside Transgrid’s current 2018–23 determination, we have relied on the nominal WACC figure in Transgrid’s 2023–28 draft decision which was published after Transgrid submitted its pass through application.¹⁶

This method produced a negative pass through amount slightly larger than what was proposed in Transgrid’s application, due to Transgrid’s use of the 2022–23 nominal WACC of 5.75% throughout the entire July 2022 to December 2023 escalation period.

Consequently, we determine that a negative network support event has occurred and the appropriate negative network support pass through amount is \$10,510,025 (\$nominal, 2023–24). This amount will be removed from allowed revenues for the next regulatory year (2023–24) and result in lower 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.¹⁷ We must then make a determination within 60 business days of the business's application to us.¹⁸

The relevant regulatory year ended on 30 June 2022 and Transgrid made its network support pass through application on 21 September 2022, 59 business days later.

¹³ Transgrid, *Network Support Pass Through Application 2021-22*, September 2022, pp. 5-6.

¹⁴ NER, cl. 6A.7.2(3)(i).

¹⁵ AER, *Transgrid, Post Tax Revenue Model, 2022-23 return on debt update*, January 2022.

¹⁶ AER, *Draft decision, Transgrid transmission determination 2023–28 – Post-tax revenue model*, September 2022

¹⁷ NER, cl. 6A7.2(c).

¹⁸ NER, cl. 6A7.2(e).

Glossary

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