



Cost pass through amendments

Draft rule determination – 10 May 2012

The AEMC today calls for public submissions on its draft rule determination regarding amendments to the National Electricity Rules on the cost pass through provisions applying to transmission and distribution businesses.

The aim of these amendments are to enable network businesses to recover their efficient costs, while also helping to ensure that prices for consumers are no more than necessary to provide an appropriate level of service.

Addressing unexpected events

The forecast efficient expenditure of network businesses is recovered through their allowed revenue. This includes recovery of the cost of premiums for commercial insurance and self-insurance.

Currently where a significant event occurs that was not forecast as part of a revenue determination, there are two ways for the network business to recover the costs incurred as a result of the event, namely:

1. Cost pass throughs – where expenditure is incurred in a permitted category the electricity network can apply to the AER to recover the amount from retailers in the next year's prices.
 - Distribution network businesses can propose categories for future cost pass throughs (at the time of the AER revenue determination). Example: In the AER's 2010 review of Victorian Electricity Distribution Price Review for 2011-2015, the distribution network businesses proposed a natural disaster cost pass through category. The AER reviewed the proposal by the networks and included a cost pass through category as part of its determination.
 - Unlike distribution networks, transmission networks can't propose new pass through categories. And there are currently no national electricity rules that specifically allow a transmission network to pass through natural disaster costs.
 - Cost pass through categories proposed at the time of the revenue determination only cover events that occur after the category is accepted by the AER.
2. Capital expenditure reopener - transmission network businesses can currently propose a capital expenditure reopener to the AER. This only covers capital expenditure (eg the replacement cost of assets poles and wires swept away by flooding). It does not enable recovery of repair costs to assets which are damaged – not destroyed. The capital expenditure re-opener is currently not available to distribution businesses.

Categories of pass through event

The currently prescribed pass through events for each type of network business is outlined below.

Distribution network service providers

- a regulatory change event;
- a service standard event;
- a tax change event;
- a terrorism event; and
- a nominated event in addition to those above for a regulatory control period.

Transmission network service providers

- a regulatory change event;
- a service standard event;
- a tax change event;
- a terrorism event; and
- an insurance event.

Transmission businesses also have the ability to utilise the capital expenditure re-opening and contingent event mechanisms under the NER.

Draft amendments to the rules

Grid Australia's proposed amendments

Grid Australia submitted that under the NER, transmission and distribution network service providers are exposed to the risk of significant cost impacts arising from natural disasters and insurance liability limits that are outside of their reasonable control. To address these risks, Grid Australia proposed a number of amendments to the NER. The details of those amendments may be found in Grid Australia's rule change request on the AEMC's homepage.

Overview of the AEMC's draft rule

The AEMC has determined to make a more preferable draft rule, containing some elements of the rule proposed by Grid Australia and other elements that the AEMC considers will, or is likely to, better contribute to achievement of the National Electricity Objective.

The AEMC considers that cost pass throughs should be used where other, more suitable, means of addressing these costs are unavailable.

In order to achieve this the AEMC has determined to:

- provide transmission businesses with the ability to nominate additional pass through events as part of their revenue proposals;
- include a set of 'nominated cost pass through considerations' in the National Electricity Rules (NER) that the Australian Energy Regulator (AER) must consider when deciding whether to accept the network businesses proposed pass through event. This provisions applies to both transmission and distribution businesses;
- remove the terrorism event from prescribed pass through events under the NER for both transmission and distribution businesses; and
- provide transitional arrangements to enable:
 - for legal reasons retain the terrorism event for network service providers for the current regulatory control periods; and
 - Powerlink (whose regulatory control period commences 1 July 2012) to nominate pass through events within three months of commencement of the amending rule.

The AEMC has also agreed to the inclusion of amendments to address the 'dead zone', a known anomaly in the drafting in the NER relating to the timing of cost pass throughs for both transmission and distribution businesses.

However, in reaching its decision, the AEMC has determined not to include Grid Australia's:

- definition for a prescribed natural disaster event applying to both transmission and distribution businesses;
- definition for a prescribed insurance cap event applying to both transmission and distribution businesses; or
- proposal to remove the current sub-ordination of the capital expenditure re-opening provisions to that of the cost pass through provisions.

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