31 July 2020

Mr Sebastian Roberts
General Manager, Transmission and Gas
Australian Energy Regulator
Sent via email

Dear Mr. Roberts,

AusNet Services – Cost pass through – 500kV Transmission Line Tower Collapse

Thank you for the opportunity to comment on AusNet Services' 500kV transmission line tower collapse cost pass through application.

Energy Networks Australia is the national industry body representing Australia's electricity transmission and distribution and gas distribution networks. Our members provide more than 16 million electricity and gas connections to almost every home and business across Australia.

Cost pass through events

The cost pass through mechanism is an important feature of the regulatory framework that provides network service providers (NSPs) with the opportunity to recover their efficient costs should a pass through event occur during the regulatory control period.

Pass through events are specific, pre-defined events that are unpredictable in nature, beyond the control of the NSP and, if they occur, would involve the NSP incurring high costs. Without this mechanism, an NSP would be unable to recover the efficient costs of these events, which could then have a significant financial effect on its ability to invest in and operate its network to deliver services for customers.

Clause 6A.7.3 of the *National Electricity Rules* (NER) provides for the reopening of a transmission revenue determination to accommodate the pass through of costs in specified circumstances.

An event must satisfy the materiality threshold in order to constitute a pass through event. Materially is defined in the glossary of the NER as:

> For the purposes of the application of clause 6A.7.3, an event (other than a *network support event*) results in a *Transmission Network Service Provider* incurring materially higher or materially lower costs if the change in costs (as opposed to the revenue impact) that the *Transmission Network Service Provider* has incurred and is likely to incur in any *regulatory year* of a *regulatory control period*, as a result of that event, exceeds 1% of the *maximum allowed revenue* for the *Transmission Network Service Provider* for that *regulatory year*.

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Materiality assessment

Energy Networks Australia is supportive of AusNet Services' conclusion that the cost pass through materiality threshold must be based on an assessment of the cost impact of a pass through event, not the revenue impact.

Energy Networks Australia notes that the NER definition of materiality explicitly references the change in costs (rather than the revenue impact) as a proportion of the annual revenue requirement (ARR).

Under an incentive framework, using costs, rather than the revenue, as the basis for the materiality threshold is even more important to ensure that the regulatory framework continues to provide NSPs with the same level of protection against uncontrollable costs that was embedded in the regulatory regime prior to the 2013 introduction of the Capital Efficiency Sharing Scheme (CESS). It is also fundamental that this protection is equivalent for both operating expenditure (opex) and capital expenditure (capex).

The CESS incentivises NSPs to pursue efficient capex by rewarding NSPs for capex efficiency gains and penalising NSPs for capex efficiency losses. Under this framework, the Australian Energy Regulator's CESS Explanatory Statement[1] recommends that NSPs, where appropriate, submit a pass through application to avoid a CESS penalty.

There is, however, an asymmetrical treatment between opex and capex if the revenue impact, rather than the expenditure impact, as a proportion of the ARR is used as the basis for the materiality threshold. This is because the expenditure required to meet a revenue impact materiality threshold is considerably higher under capex cost pass through applications (like the one proposed by AusNet Services).

Network assets generally have long asset lives, and capital costs are recovered through the return on capital and regulatory depreciation building blocks. A materiality assessment based on the revenue impact therefore may create an inefficient bias towards opex solutions.

If you wish to discuss any of these matters raised in this letter further, please contact Lucy Moon, Head of Regulation, at lmoon@energynetworks.com.au.

Yours sincerely,

Andrew Dillon
Chief Executive Officer

[1] Australian Energy Regulator, *Explanatory Statement: Capital Expenditure Incentive Guideline for Electricity Network Service Providers*, November 2013.