Department of Infrastructure, Energy and Resources
OFFICE OF ENERGY PLANNING AND CONSERVATION

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Tasmania

Australian Energy Market Commission
PO Box A2449
SYDNEY NSW 1235

Dear Commissioners

Cost Pass Through Arrangements for Network Service Providers

Please find attached a submission in relation to the *Cost Pass Through Arrangements for Network Service Providers* dated 2 February 2012. Note that the comments in this submission are reflective of the views of the Office of Energy Planning and Conservation within the Department of Infrastructure, Energy and Resources and do not necessarily reflect the position of the Tasmanian Government.

Yours sincerely

A Van de Vusse

Tony van de Vusse
Director, Office of Energy Planning and Conservation

Cost pass through arrangements for network service providers

The Tasmanian Office of Energy Planning and Conservation (OEPC) welcomes the opportunity to comment on the proposed Rule change regarding cost pass through arrangements for network service providers, as submitted by Grid Australia.

Grid Australia has proposed a Rule change to allow costs resulting from natural disasters to be more easily recovered from consumers. The Rule change will allow for these costs to be addressed under the cost pass through provisions in clause 6A.7.3, where such costs are not covered by either commercial insurance or a self-insurance allowance.

Grid Australia considers that Transmission Network Service Providers (TNSP's) are unable to cover the full extent of risks arising from natural disasters through insurance and self insurance and that the cost pass through provisions provide a sensible approach to covering the remaining risks.

We note that while the rule change request from Grid Australia is written from the perspective of TNSPs, the rule changes that they are proposing also relate to the regulation of distribution network service providers.

While we recognise that there is an issue here, and that it is the long term interest of consumers that the risks are adequately managed, and are dealt with promptly in the event of a major disaster, we do not believe that the rule change proposal in its current form meets the National Electricity Objective.

Passing the risks through to customers is unsatisfactory in that there is little that customers can do to mitigate the risks and in any case they are likely to be suffering considerable strain themselves from the same disaster.

Furthermore, the risk from natural events is one of the reasons that the owners of networks are awarded a risk premium in their cost of capital. Market returns go up and down for a variety of reasons, including factors related to nature. If network owners wish to pass a higher proportion of their risks to customers then they should also be prepared to accept a lower return on their equity.

We understand the arguments put by TNSP's to be able reasonably recover cost burdens placed on them to manage risks. We also understand the suggestion to allow cost recovery by TNSPs where a pass through event occurs in the 'dead-zone' that occurs between the event and the next regulatory determination.

However these matters are quite complicated. A distinction needs to be made between risks to the assets themselves, risks to the earnings of the network owners and risks arising from third party claims for damages. In addition the write down of assets following a disaster and any subsequent adjustments to the existing allowable earnings also needs to be considered.

In principle, risks should be borne by the parties that can best manage them, and those parties should be able to recover the reasonable and efficient costs of doing so. To the extent that there may be uninsurable risks and risks that are beyond the capacity of the owners to cope with, and that it is the long term interests of consumers that the assets be restored, then some way needs to be found to spread the cost of those risks more widely.

What would be an unreasonable outcome is for owners to be able to get their networks rebuilt without reductions in their capital or earnings, with consumers bearing all the costs and the owners enjoying a weighted average return on the newly built assets.

It would also be unreasonable to create an incentive for network companies and their owners to underinsure or to reduce the capacity for self insurance, or to be able to ignore the numerous predictions of increasing severe and frequent extreme weather events without consequences.

Conversely it would be unreasonable if they undertake efficient best practice measures to reduce the increasing risks of fire, flood, storm and being sued but are then unable to recover costs of doing so.

The OPEC believes the AEMC Consultation Paper dated 2 February 2012 does a good job of asking the appropriate questions. While we do not proffer any specific answers to the questions raised we believe a thorough assessment of this Rule change proposal is warranted. As it stands, we are of the opinion that the proposed Rule Change should only be accepted following amendments to address the concerns raised above.