

Draft Decision

Ausgrid Electricity Distribution Determination 2024 to 2029 (1 July 2024 to 30 June 2029)

Attachment 15 Pass through events

September 2023

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Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601
Tel: 1300 585 165

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15 Pass through events

During the regulatory control period Ausgrid can apply to pass through to its customers, in the form of higher or lower network charges, certain material changes in its efficient 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.

The National Electricity Rules (NER) prescribe the following pass through events for all distribution determinations:¹

- a regulatory change event
- a service standard event
- a tax change event
- a retailer solvency event.

In addition to these prescribed events, other pass through events may be 'nominated' by a service provider for a regulatory control period.² This attachment sets out our draft decision on the nominated pass through events to apply to Ausgrid's' distribution network for the 2024–29 regulatory control period.

15.1 Draft decision

Our draft decision is to accept the terrorism, insurance coverage, and insurer's credit risk events proposed by Ausgrid.³

While we also accept the proposed natural disaster event, we do not accept the proposed amendments to the definition of this event because, in our view, the issues that Ausgrid's proposed amendments seek to address are already captured in our current definition.⁴ We discuss our considerations in section 15.5.

Our definitions for this draft determination are set out in Table 15.2.

15.2 Ausgrid's proposal

Ausgrid's proposed nominated pass through events are set out in Table 15.1.

¹ NER, cl. 6.6.1(a1)(1)–(4). Each of these prescribed events is defined in Chapter 10 (Glossary) of the NER.

² NER, cl. 6.6.1(a1)(5).

³ This is one of the constituent decisions we must make under NER, cl 6.12.1(14).

⁴ For example, AER, *Final Decision – AusNet Services distribution determination 2021–26 – Attachment 15 – Pass through events*, April 2021, pp. 16–19; AER, *Final Decision – CitiPower distribution determination 2021–26 – Attachment 15 – Pass through events*, April 2021, pp. 13–16.

Table 15.1 Ausgrid's nominated pass through events

Proposed event	Ausgrid's proposed definition
Insurance coverage event	<p>An insurance coverage event occurs if:</p> <ol style="list-style-type: none"> 1. Ausgrid: <ol style="list-style-type: none"> a) makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy or set of insurance policies; or b) would have been able to make a claim or claims under a relevant insurance policy or set of insurance policies but for changed circumstances; and 2. Ausgrid incurs costs: <ol style="list-style-type: none"> a) beyond a relevant policy limit for that policy or set of insurance policies; or b) that are unrecoverable under that policy or set of insurance policies due to changed circumstances; and 3. The costs referred to in paragraph 2 above materially increase the costs to Ausgrid in providing direct control services. <p>For the purposes of this insurance coverage event:</p> <p>'changed circumstances' means movements in the relevant insurance liability market that are beyond the control of Ausgrid, where those movements mean that it is no longer possible for Ausgrid to take out an insurance policy or set of insurance policies at all or on reasonable commercial terms that include some or all of the costs referred to in paragraph 2 above within the scope of that insurance policy or set of insurance policies.</p> <p>'costs' means the costs that would have been recovered under the insurance policy or set of insurance policies had:</p> <ol style="list-style-type: none"> i. the limit not been exhausted; or ii. those costs not been unrecoverable due to changed circumstances. <p>A relevant insurance policy or set of insurance policies is an insurance policy or set of insurance policies held during the regulatory control period or a previous regulatory control period in which Ausgrid was regulated; and</p> <p>Ausgrid will be deemed to have made a claim on a relevant insurance policy or set of insurance policies if the claim is made by a related party of Ausgrid in relation to any aspect of Ausgrid's network or business; and</p> <p>Ausgrid will be deemed to have been able to make a claim on a relevant insurance policy or set of insurance policies if, but for changed circumstances, the claim could have been made by a related party of Ausgrid in relation to any aspect of Ausgrid's network or business.</p>

Proposed event	Ausgrid's proposed definition
	<p>Note for the avoidance of doubt, in assessing an insurance coverage event through application under rule 6.6.1(j), the AER will have regard to:</p> <ul style="list-style-type: none"> i. the relevant insurance policy or set of insurance policies for the event ii. the level of insurance that an efficient and prudent DNSP would obtain, or would have sought to obtain, in respect of the event; iii. any information provided by Ausgrid to the AER about Ausgrid's actions and processes; and iv. any guidance published by the AER on matters the AER will likely have regard to in assessing any insurance coverage event that occurs.
Insurer's credit risk event	<p>An insurer's credit risk event occurs if an insurer of Ausgrid becomes insolvent, and as a result, in respect of an existing or potential claim for a risk that was insured by the insolvent insurer, Ausgrid:</p> <ul style="list-style-type: none"> a) is subject to a higher or lower claim limit or a higher or lower deductible than would have otherwise applied under the insolvent insurer's policy; or b) incurs additional costs associated with funding an insurance claim, which otherwise have been covered by the insolvent insurer. <p>Note: In assessing an insurer's credit risk event pass through application, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> i. Ausgrid's attempts to mitigate and prevent the event from occurring by reviewing and considering the insurers track record, size, credit rating and reputation. ii. in the event that a claim would have been made after the insurance provider became insolvent, whether Ausgrid had reasonable opportunity to insure the risk with a different provider.
Natural disaster event	<p>Natural disaster events will include, but may not be limited to, natural disasters declared by a relevant government authority. Where a government authority has made a declaration that a natural disaster has occurred, the temporal and geographic scope of the natural disaster event will be defined by reference to the terms of that declaration.</p>
Terrorism event	<p>Terrorism event means an act (including, but not limited to, the use of force or violence or the threat of force or violence) of any person or group of persons (whether acting alone or on behalf of or in connection with any organisation or government), which:</p> <ul style="list-style-type: none"> a) from its nature or context is done for, or in connection with, political, religious, ideological, ethnic or similar purposes or reasons (including the intention to influence or intimidate any government and/or put the public, or any section of the public, in fear); and b) changes the costs to Ausgrid in providing direct control services.

Proposed event	Ausgrid's proposed definition
	<p>Note: In assessing a terrorism event pass through application, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> i. whether Ausgrid has insurance against the event ii. the level of insurance that an efficient and prudent NSP would obtain in respect of the event; and iii. whether a declaration has been made by a relevant government authority that a terrorism event has occurred.

Source: Ausgrid, *Att. 7.2 – Nominated pass through events*, January 2023, pp. 4–8.

15.3 Assessment approach

The NER set out how we must assess nominated pass through events, and how we must assess an application from a service provider to pass through changes in costs where an event occurs.⁵

Our assessment approach is guided by the National Electricity Objective (NEO)⁶ and the Revenue and Pricing Principles (RPPs).⁷ The RPPs include that the service provider should have a reasonable opportunity to recover at least the efficient costs of providing services and complying with regulatory obligations.⁸ The NEO and the RPPs also reflect the importance of incentives to promote economic efficiency, and balance the risks of under and over investment.

In the context of pass through events, we have particular regard to the impact on price, quality, reliability and security of supply that may arise as a result of any change in the efficient operation of, and ability and incentive of, a service provider to invest in its network. This is a similar approach to that taken by the Australian Energy Market Commission (AEMC) when considering pass through event rule changes.⁹

In determining whether we accept a nominated pass through event, we must take into account the 'nominated pass through event considerations' as defined,¹⁰ which are as follows:¹¹

- a) whether the event proposed is an event covered by a category of pass through event specified in clause 6.6.1(a1)(1) to (4) (in the case of a distribution determination) or clause 6A.7.3(a1)(1) to (4) (in the case of a transmission determination);

⁵ NER, cl. 6.5.10(b), 6.6.1.

⁶ The NEO is defined in s. 7 of the NEL.

⁷ The revenue and pricing principles are set out in s. 7A of the NEL.

⁸ NEL, s. 7A(2).

⁹ AEMC, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 6.

¹⁰ NER, cl. 6.5.10(b).

¹¹ NER, Chapter 10, definition of 'nominated pass through event considerations'.

- b) whether the nature or type of event can be clearly identified at the time the determination is made for the service provider;
- c) whether a prudent service provider could reasonably prevent an event of that nature or type from occurring or substantially mitigate the cost impact of such an event;
- d) whether the relevant service provider could insure against the event, having regard to:
 - 1) the availability (including the extent of availability in terms of liability limits) of insurance against the event on reasonable commercial terms; or
 - 2) whether the event can be self-insured on the basis that:
 - i) it is possible to calculate the self-insurance premium; and
 - ii) the potential cost to the relevant service provider would not have a significant impact on the service provider's ability to provide network services; and
- e) any other matter the AER considers relevant and which the AER has notified network service providers is a nominated pass through event consideration.

The AEMC described the purpose of the nominated pass through event considerations as:

...to incorporate and reflect the essential components of a cost pass through regime in the NER. It was intended that in order for appropriate incentives to be maintained, any nominated pass through event should only be accepted when event avoidance, mitigation, commercial insurance and self-insurance are unavailable.¹²

...that a pass through event should only be accepted when it is the least inefficient option and event avoidance, mitigation, commercial insurance and self-insurance are found to be inappropriate. That is, it is included after ascertaining the most efficient allocation of risks between a service provider and end customers.¹³

This protects the incentive regime under the NER by limiting erosion of a service provider's incentives to use market based mechanisms to mitigate the cost impacts that would arise. This promotes the efficient investment in, and efficient operation and use of, network services for the long term interests of consumers with respect to price.¹⁴

¹² AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 19.

¹³ AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 20.

¹⁴ AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 8.

As a matter of good regulatory practice, we also take into account the desirability of consistency in our approach to assessing nominated pass through events across our electricity determinations and gas access arrangements.¹⁵

15.4 Interrelationships

The pass through mechanism is not the only way service providers can manage their risks under a distribution or transmission determination. It is interrelated with other parts of this decision, in particular with the forecast operating and capital expenditure (opex and capex) and rate of return included in our revenue determination. We must specify and take account of these interrelationships.¹⁶ This requires us to balance the incentives in the various parts of our decision.

For systemic risks, service providers are compensated through the allowed rate of return. Service providers also face business-specific, or residual, risks. Service providers are compensated for the prudent and efficient management of these risks through the forecast opex and capex we include in our revenue determination for strategies such as:

- prevention (avoiding the risk)
- mitigation (reducing the probability and impact of the risk)
- insurance (transferring the risk to another party)
- self-insurance (putting aside funds to manage the likely costs associated with a risk event).

An efficient business will manage its risk by employing the most cost effective combination of these strategies. In order to maintain appropriate incentives under our determinations, we only accept nominated pass through events where we are satisfied that event avoidance, mitigation, commercial insurance and self-insurance under approved forecasts of prudent and efficient opex and capex are either unavailable or inappropriate.¹⁷

In general, in respect of unforeseen costs that are relatively minor, a service provider should manage them by using up its existing expenditure allowance, or reprioritising or substituting its projects, to avoid seeking cost recovery through the pass through mechanisms.¹⁸ This is reflected in the materiality threshold that applies to cost pass through applications.¹⁹

¹⁵ AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 18.

¹⁶ NEL, s. 16(1)(c).

¹⁷ AEMC, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, pp. 19–20.

¹⁸ AEMC 2012, *Economic Regulation of Network Service Providers, and Price and Revenue Regulation of Gas Services, Final Position Paper*, 29 November 2012, p. 186.

¹⁹ NER, Chapter 10: Glossary, definition of 'materially'.

Cost pass through amounts approved in a regulatory control period are added to (or in the case of a negative pass through deducted from) forecast opex and capex for the purpose of calculating efficiency carryover amounts under the Efficiency Benefit Sharing Scheme and Capital Expenditure Sharing Scheme.²⁰

Any capex that has already been recovered in a regulatory control period by way of a cost pass through cannot be recovered again in the roll-forward of the regulatory asset base for the next regulatory control period.²¹

15.5 Reasons for draft decision

15.5.1 Insurance coverage, insurer's credit risk, natural disaster and terrorism events

We consider Ausgrid's proposed terrorism, natural disaster, insurer's credit risk and insurance coverage pass through events²² are consistent with the nominated pass through event considerations set out in the NER.²³

- the proposed events are not covered by an existing category of pass through event
- the nature of the events are clearly identifiable at this time
- a prudent service provider could not reasonably prevent an event of that nature or type from occurring or substantially mitigate its cost impact and could not insure (or self-insure) against the events on reasonable commercial terms.

With regard to the latter point, while Ausgrid could take steps to reduce its risk exposure to these events, expenditure beyond a certain level aimed at completely eliminating the risk is likely to be imprudent or inefficient. In that context, sharing the risk between Ausgrid and its customers is appropriate and more likely to be in the long-term interests of consumers with respect to price.

We accept the definitions proposed by Ausgrid for the terrorism and insurance coverage events, as these are consistent with our recent determinations for other network service providers.²⁴ While we accept the insurer's credit risk proposed by Ausgrid, we have amended the proposed definition to include some missing words, and therefore align with our current definition for other network service providers.

²⁰ AER, *AER efficiency benefit sharing scheme – November 2013*, November 2013, p. 7; AER, *Capital Expenditure Incentive Guideline for Electricity Network Service Providers*, November 2013, p. 6.

²¹ NER, cl. S6.2.1(e)(1)(ii).

²² Ausgrid, *Att. 7.2 – Nominated pass through events*, 31 January 2023, pp. 4–8.

²³ NER, cl. 6.5.10(b); Chapter 10: Glossary, definition of 'nominated pass through event considerations'.

²⁴ AER, *Final Decision – AusNet Services distribution determination 2021–26 – Attachment 15 – Pass through events*, April 2021, pp. 16–19; AER, *Final Decision – CitiPower distribution determination 2021–26 – Attachment 15 – Pass through events*, April 2021, pp. 14–16.

However, we do not accept the proposed definition for the natural disaster event for the reasons set out in the next section. Our alternative definition provides greater drafting consistency between Ausgrid and other network service providers.

15.5.1.1 Natural disaster event

Ausgrid proposed to define the natural disaster event as follows:²⁵

Natural disaster events will include, but may not be limited to, natural disasters declared by a relevant government authority. Where a government authority has made a declaration that a natural disaster has occurred, the temporal and geographic scope of the natural disaster event will be defined by reference to the terms of that declaration.

Ausgrid considered our current definition (see below in Table 15.2) emphasises defining broad terms and includes overlapping considerations that are already included in the NER.²⁶ Ausgrid stated its proposed new definition for a natural disaster event:

- shifts the focus away from:
 - defining broad terms such as ‘major’, in favour of establishing a clear mechanism to determine the temporal and geographic limits of a natural disaster
 - factors that do not necessarily have to be included in the definition of ‘natural disaster’ because the AER is already required to consider them, under the NER, when assessing a cost pass through application for natural disaster (e.g., insurance).
 - Ausgrid considered that under clause 6.6.1(j) of the NER, the AER is to consider whether insurance has been obtained in relation to a natural disaster event, stating it would be directly relevant to the ‘decisions and actions in relation to the risk of the positive change event’ (clause 6.6.1(j)(3)).
- brings a reference, in our current definition, of ‘a declaration by a government authority’ to a more central position.
 - Ausgrid considered these declarations confirm whether a natural disaster event has occurred and are accompanied by information regarding the time of the event and the impacted locations.

Our draft decision is to not accept Ausgrid’s proposed definition for natural disaster. We consider that while a government declaration may assist in determining whether a natural disaster has occurred, and inform the scope of such a disaster, it is only one of the factors we will have regard to in assessing a cost pass through application. Importantly, these declarations are made for a purpose that is different to that of the cost pass through provisions in the NER, and therefore, should not be used

²⁵ Ausgrid, *Att. 7.2 – Nominated pass through events*, 31 January 2023, p. 10.

²⁶ Ausgrid, *Att. 7.2 – Nominated pass through events*, 31 January 2023, p. 10.

deterministically in defining the scope of a natural disaster event.²⁷ In addition, we consider our current definition for the natural disaster event is sufficiently broad to capture other factors. For example, we extensively discussed our assessment of relevant ‘government declarations’ in our recent determinations for natural disaster cost pass through applications relating to bushfires.²⁸

For the above reasons we have not adopted Ausgrid’s proposed definition, but rather we have maintained our current definition of this event in this draft decision. This outcome provides greater drafting consistency for this event between Ausgrid and other network service providers.

Table 15.2 summarises the nominated pass through events for the draft decision.

Table 15.2 AER pass through event definitions

Pass through event	Draft decision definition
Insurance coverage event	<p>An insurance coverage event occurs if:</p> <ol style="list-style-type: none"> 1. Ausgrid: <ol style="list-style-type: none"> a) makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy or set of insurance policies; or b) would have been able to make a claim or claims under a relevant insurance policy or set of insurance policies but for changed circumstances; and 2. Ausgrid incurs costs: <ol style="list-style-type: none"> a) beyond a relevant policy limit for that policy or set of insurance policies; or b) that are unrecoverable under that policy or set of insurance policies due to changed circumstances; and 3. The costs referred to in paragraph 2 above materially increase the costs to Ausgrid in providing direct control services. <p>For the purposes of this insurance coverage event:</p> <ul style="list-style-type: none"> • 'changed circumstances' means movements in the relevant insurance liability market that are beyond the control of Ausgrid, where those movements mean that it is no longer possible for Ausgrid to take out an insurance policy or set of insurance policies at all or on reasonable commercial terms that include some or all of the costs referred to in paragraph 2 above within the scope of that insurance policy or set of insurance policies.

²⁷ AER, *AER Determination – Essential Energy 2019–20 bushfire cost pass through*, 21 March 2022, p. 9.

²⁸ AER, *AER Determination - Essential Energy 2019–20 bushfire cost pass through*, 21 March 2022, p. 9.

Pass through event	Draft decision definition
	<ul style="list-style-type: none"> • 'costs' means the costs that would have been recovered under the insurance policy or set of insurance policies had: <ul style="list-style-type: none"> – the limit not been exhausted; or – those costs not been unrecoverable due to changed circumstances. • a relevant insurance policy or set of insurance policies is an insurance policy or set of insurance policies held during the regulatory control period or a previous regulatory control period in which Ausgrid was regulated; and • Ausgrid will be deemed to have made a claim on a relevant insurance policy or set of insurance policies if the claim is made by a related party of Ausgrid in relation to any aspect of Ausgrid's network or business; and • Ausgrid will be deemed to have been able to make a claim on a relevant insurance policy or set of insurance policies if, but for changed circumstances, the claim could have been made by a related party of Ausgrid in relation to any aspect of Ausgrid's network or business. <p>Note for the avoidance of doubt, in assessing an insurance coverage event through application under rule 6.6.1(j), the AER will have regard to:</p> <ul style="list-style-type: none"> i) the relevant insurance policy or set of insurance policies for the event ii) the level of insurance that an efficient and prudent DNSP would obtain, or would have sought to obtain, in respect of the event iii) any information provided by Ausgrid to the AER about Ausgrid's actions and processes; and iv) any guidance published by the AER on matters the AER will likely have regard to in assessing any insurance coverage event that occurs.
Insurer's credit risk event	<p>An insurer credit risk event occurs if an insurer of Ausgrid becomes insolvent, and as a result, in respect of an existing or potential claim for a risk that was insured by the insolvent insurer, Ausgrid:</p> <ul style="list-style-type: none"> a) is subject to a higher or lower claim limit or a higher or lower deductible than would have otherwise applied under the insolvent insurer's policy; or b) incurs additional costs associated with funding an insurance claim, which would otherwise have been covered by the insolvent insurer. <p>Note: in assessing an insurer credit risk event pass through application, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> i) Ausgrid's attempts to mitigate and prevent the event from occurring by reviewing and considering the insurer's track record, size, credit rating and reputation, and

Pass through event	Draft decision definition
	<p>ii) in the event that a claim would have been covered by the insolvent insurer's policy, whether Ausgrid had reasonable opportunity to insure the risk with a different provider.</p>
<p>Natural disaster event</p>	<p>Natural disaster event means any natural disaster including but not limited to cyclone, fire, flood or earthquake that occurs during the 2024–29 regulatory control period that changes the costs to Ausgrid in providing direct control services, provided the cyclone, fire, flood, earthquake or other event was:</p> <p>a) a consequence of an act or omission that was necessary for the service provider to comply with a regulatory obligation or requirement or with an applicable regulatory instrument; or</p> <p>b) not a consequence of any other act or omission of the service provider.</p> <p>Note: In assessing a natural disaster event pass through application, the AER will have regard to, amongst other things:</p> <p>i) whether Ausgrid has insurance against the event;</p> <p>ii) the level of insurance that an efficient and prudent NSP would obtain in respect of the event.</p>
<p>Terrorism event</p>	<p>Terrorism event means an act (including, but not limited to, the use of force or violence or the threat of force or violence) of any person or group of persons (whether acting alone or on behalf of or in connection with any organisation or government), which:</p> <ol style="list-style-type: none"> 1. from its nature or context is done for, or in connection with, political, religious, ideological, ethnic or similar purposes or reasons (including the intention to influence or intimidate any government and/or put the public, or any section of the public, in fear); and 2. changes the costs to Ausgrid in providing direct control services. <p>Note: In assessing a terrorism event pass through application, the AER will have regard to, amongst other things:</p> <p>i) whether Ausgrid has insurance against the event</p> <p>ii) the level of insurance that an efficient and prudent NSP would obtain in respect of the event; and</p> <p>iii) whether a declaration has been made by a relevant government authority that a terrorism event has occurred.</p>

Source: AER analysis.

Shortened forms

Term	Definition
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
capex	capital expenditure
DNSP	distribution network service provider
NEL	national electricity law
NEM	national electricity market
NEO	national electricity objective
NER	national electricity rules
NSP	network service provider
opex	operating expenditure
RPP	revenue and pricing principles