



**FINAL DECISION**  
**AusNet Services transmission**  
**determination**  
**2017 – 2022**

**Attachment 13 – Pass through**  
**events**

April 2017

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Inquiries about this publication should be addressed to:

Australian Energy Regulator  
GPO Box 520  
Melbourne Vic 3001

Tel: 1300 585 165

Email: [AERInquiry@aer.gov.au](mailto:AERInquiry@aer.gov.au)

AER reference: 56417

## Note

This attachment forms part of the AER's final decision on AusNet Services' revenue proposal 2017–22. It should be read with other parts of the final decision.

The final decision includes the following documents:

Overview

Attachment 1 – maximum allowed revenue

Attachment 2 – regulatory asset base

Attachment 3 – rate of return

Attachment 4 – value of imputation credits

Attachment 5 – regulatory depreciation

Attachment 6 – capital expenditure

Attachment 7 – operating expenditure

Attachment 8 – corporate income tax

Attachment 9 – efficiency benefit sharing scheme

Attachment 10 – capital expenditure sharing scheme

Attachment 11 – service target performance incentive scheme

Attachment 12 – pricing methodology

Attachment 13 – pass through events

Attachment 14 – negotiated services

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## Shortened forms

Shortened form	Extended form
AARR	aggregate annual revenue requirement
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
ASRR	annual service revenue requirement
augex	augmentation expenditure
capex	capital expenditure
CCP	Consumer Challenge Panel
CESS	capital expenditure sharing scheme
CPI	consumer price index
DRP	debt risk premium
EBSS	efficiency benefit sharing scheme
ERP	equity risk premium
MAR	maximum allowed revenue
MRP	market risk premium
NEL	national electricity law
NEM	national electricity market
NEO	national electricity objective
NER	national electricity rules
NSP	network service provider

Shortened form	Extended form
NTSC	negotiated transmission service criteria
opex	operating expenditure
PPI	partial performance indicators
PTRM	post-tax revenue model
RAB	regulatory asset base
RBA	Reserve Bank of Australia
repex	replacement expenditure
RFM	roll forward model
RIN	regulatory information notice
RPP	revenue and pricing principles
SLCAPM	Sharpe-Lintner capital asset pricing model
STPIS	service target performance incentive scheme
TNSP	transmission network service provider
TUoS	transmission use of system
WACC	weighted average cost of capital

## 13 Pass through events

During the regulatory control period, a service provider can apply to us to pass material changes in its costs arising from pre-defined exogenous events through to customers, in the form of higher or lower network charges. These events are called cost pass through events. Positive pass throughs exist in the rules as a mechanism to allow service providers to recover their efficient costs incurred as a result of events that could not be forecast as part of their proposal that otherwise would have a significant financial effect on the ability of networks to invest in and operate their networks.<sup>1</sup>

The NER include the following pass through events for all transmission determinations:<sup>2</sup>

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

In addition to these prescribed events, other (nominated) pass through events may be specified in a determination for a regulatory control period.<sup>3</sup>

Our final decision must include a decision on the nominated pass through events that are to apply for the regulatory control period.<sup>4</sup>

This attachment sets out our final decision on the nominated pass through events that will apply to AusNet Services for the 2017–22 regulatory control period.

### 13.1 Final decision

Our final decision is that the nominated pass through events detailed in Table 13-1 will apply to AusNet Services for the 2017–22 regulatory control period.

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<sup>1</sup> AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, Sydney, p. 2.

<sup>2</sup> NER, cl. 6A.7.3(a1)(1)–(4). Each of these prescribed events is defined in Chapter 10 (Glossary) of the NER.

<sup>3</sup> NER, cl. 6A.7.3(a1)(5).

<sup>4</sup> NER, cl. 6A.14.1(9).

**Table 13-1 AusNet Services' proposed pass through events**

Proposed event	Proposed definition
Terrorism event	<p>A terrorism event occurs if:</p> <p>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 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 which increases the costs to AusNet Services in providing prescribed transmission services.</p> <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"> <li>i. whether AusNet Services has insurance against the event;</li> <li>ii. the level of insurance that an efficient and prudent NSP would obtain in respect of the event; and</li> <li>iii. whether a declaration has been made by a relevant government authority that an act of terrorism has occurred.</li> </ul>
Insurance cap event	<p>An insurance cap event occurs if:</p> <ul style="list-style-type: none"> <li>1. AusNet Services makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy;</li> <li>2. AusNet Services incurs costs beyond the relevant policy limit; and</li> <li>3. the costs beyond the relevant policy limit materially increase the costs to AusNet Services in providing prescribed transmission services.</li> </ul> <p>For this insurance cap event:</p> <ul style="list-style-type: none"> <li>4. a relevant insurance policy is an insurance policy held during the 2017–22 regulatory control period or a previous regulatory control period in which AusNet Services was registered as a TNSP for the purposes of s.11 of the NEL.</li> </ul> <p>Note: In making a determination on an insurance cap event, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> <li>i. the relevant insurance policy for the event;</li> <li>ii. the level of insurance that an efficient and prudent TNSP would obtain in respect of the event.”</li> <li>iii. any assessment by the AER of AusNet Services' insurance in making its transmission determination for the relevant period.</li> </ul>
Natural disaster event	<p>Natural disaster event means any natural disaster including but not limited to fire, flood or earthquake that occurs during the 2017-22 regulatory control period and that increases the costs to AusNet Services in providing prescribed transmission services, provided the fire, flood or other event was not a consequence of the acts or omissions 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> <ul style="list-style-type: none"> <li>i. whether AusNet Services has insurance against the event; and</li> <li>ii. the level of insurance that an efficient and prudent NSP would obtain in respect of the event.</li> </ul>



Proposed event	Proposed definition
Insurer credit risk event	<p>An insurer's credit risk event occurs if:</p> <p>A nominated insurer of AusNet Services becomes insolvent, and as a result, in respect of an existing, or potential, claim for a risk that was insured by the insolvent insurer, AusNet Services:</p> <ol style="list-style-type: none"> <li>1. is subject to a materially higher or lower claim limit or a materially higher or lower deductible than would have otherwise applied under the insolvent insurer's policy; or</li> <li>2. incurs additional costs associated with self-funding an insurance claim, which would otherwise have been covered by the insolvent insurer.</li> </ol> <p>Note: In assessing an insurer's credit risk event pass through application, the AER will have regard to, amongst other things:</p> <ol style="list-style-type: none"> <li>i. AusNet Services' attempts to mitigate and prevent the event from occurring by reviewing and considering the insurer's track record, size, credit rating and reputation; and</li> <li>ii. in the event that a claim would have been made after the insurance provider became insolvent, whether AusNet Services had reasonable opportunity to insure the risk with a different provider.</li> </ol>

## 13.2 AusNet Services' revised proposal

Our draft decision approved the following nominated pass through events, with minor modifications to the definitions proposed by AusNet Services:

- terrorism event
- insurance cap event
- natural disaster event, and
- insurer credit risk event.

We did not accept AusNet Services' proposed:

- decommissioning of Point Henry-Geelong Terminal Station 220kV Lines Event; and
- confidential nominated pass through event.<sup>5</sup>

In its revised proposal AusNet Services:

- accepted our amendments to the terrorism event
- accepted and proposed minor amendments to the insurer credit risk event, insurance cap event and natural disaster event
- accepted our rejection of the decommissioning of Point Henry – Geelong Terminal Station 220kV lines event, and

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<sup>5</sup> AER, *Draft decision AusNet Services transmission determination 2017-18 to 2021-22, attachment 13 - pass through events*, July 2016, p. 13-6.

- did not accept our rejection of the confidential event.<sup>6</sup>

### 13.3 AER's assessment approach

The NER set out how we must assess nominated pass through events proposed by a service provider, and how we must assess an application from a service provider to pass through changes in costs where an event occurs.<sup>7</sup>

Our approach to assessing nominated pass through events proposed by service providers is guided by the National Electricity Objective (NEO) and the Revenue and Pricing Principles. These provide the service provider with a reasonable opportunity to recover at least the efficient costs incurred in providing services and complying with its obligations.<sup>8</sup> They also provide incentives to promote economic efficiency.<sup>9</sup> Together, they promote a balance between the economic costs and risks of the potential for under and over investment by a service provider, to promote efficient investment.<sup>10</sup> 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.<sup>11</sup>

In determining whether we accept a nominated pass through event, we must take into account the nominated pass through event considerations:<sup>12</sup>

*The nominated pass through event considerations are:*

(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*);

(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:

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<sup>6</sup> AusNet Services, *AusNet Transmission Group Pty Ltd Transmission Revenue Proposal 2017-22, Revised Revenue Proposal*, 21 September 2016, p. 223.

<sup>7</sup> NER, cl. 6A.7.3.

<sup>8</sup> NEL, s. 7A(2).

<sup>9</sup> NEL, s. 7A(3).

<sup>10</sup> NEL, s. 7A(6).

<sup>11</sup> NEL, s. 7; AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, Sydney, p. 6.

<sup>12</sup> NER, cl. 6A.6.9(b); NER Chapter 10: Glossary, definition of 'nominated pass through event considerations'.

(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. That is, a cost pass through event is the least efficient option for managing the risk of unforeseen events.<sup>13</sup>
- 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.<sup>14</sup>

In turn, this protects the incentive regime under the NER by limiting the erosion of incentives on service providers to use market based mechanisms to mitigate the cost impacts that would arise.<sup>15</sup> 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.<sup>16</sup>

As a matter of good regulatory practice, one additional matter<sup>17</sup> we take into account is consistency in our approach to assessing nominated pass through events across our electricity determinations and gas access arrangements.<sup>18</sup>

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<sup>13</sup> AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, Sydney, p. 19.

<sup>14</sup> AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, Sydney, p. 20.

<sup>15</sup> AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, Sydney, p.8.

<sup>16</sup> AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, Sydney, p.8.

<sup>17</sup> NER, Chapter 10: Glossary, definition of 'nominated pass through event considerations', cl. (e).

<sup>18</sup> AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, Sydney, p. 18.

### 13.3.1 Interrelationships

The pass through mechanism is not the only way in which service providers can manage their risks under a transmission determination. It is interrelated with other parts of this decision, in particular with the forecast opex and capex and rate of return included in our revenue determination. These interrelationships require 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.<sup>19</sup>

In general, in respect of smaller projects a service provider should be using up its existing expenditure allowance, or reprioritising or substituting its projects, to avoid seeking cost recovery through the pass through mechanisms.<sup>20</sup> This is reflected in the materiality threshold that applies to applications for cost pass through determinations.<sup>21</sup>

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 EBSS and CESS.<sup>22</sup>

Cost pass through amounts that have already been recovered in a regulatory period cannot be recovered again in the roll-forward of the regulatory asset base (RAB) for the next regulatory period.<sup>23</sup>

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<sup>19</sup> AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, Sydney, pp. 19–20.

<sup>20</sup> AEMC 2012, *Economic Regulation of Network Service Providers, and Price and Revenue Regulation of Gas Services, Final Position Paper*, 29 November 2012, Sydney, p. 186.

<sup>21</sup> NER, Chapter 10: Glossary, definition of 'materially'.

<sup>22</sup> AER, *Efficiency Benefit Sharing Scheme for Electricity Network Service Providers*, November 2013, p. 9; AER, *Capital Expenditure Incentive Guideline for Electricity Network Service Providers*, November 2013, p. 18.

## 13.4 Reasons for final decision

In this section we set out the reasons for our final decision on each of AusNet Services' proposed pass through events.

We received no submissions on this element of AusNet Services' proposal.

### 13.4.1 Terrorism event, insurance cap event, natural disaster event and insurer credit risk event

Our final decision accepts AusNet Services' proposed terrorism event. We also accept AusNet Services' proposed insurance cap event, natural disaster event and insurer credit risk event, with some minor amendments.

We are satisfied that these four nominated pass through events are consistent with the nominated pass through event considerations because:

- these events are not covered by the prescribed pass through events under the NER.<sup>24</sup>
- the nature and type of events can be clearly identified at the time of our decision, and where there is room for doubt appropriate parameters can be applied through our assessment of a pass through application.<sup>25</sup>
- while a prudent service provider could take steps to reduce the likelihood of these events and the cost impact of the events should they occur,<sup>26</sup> and could insure or self-insure against the event,<sup>27</sup> expenditure beyond a certain point (e.g. to eliminate, rather than manage, risk) is likely to be imprudent or inefficient. In such circumstances we consider a sharing of risk between AusNet Services and its customers is appropriate and more likely to be in the long term interest of consumers with respect to price.

In its revised proposal AusNet Services proposed some minor amendments to the definitions of the insurer's credit risk event, natural disaster event and insurance cap event.<sup>28</sup> We accepted some, but not all of these amendments.

For the definition of the insurer's credit risk event AusNet Services proposed to replace the term 'insolvent' with 'an insurer becoming unable to pay a claim.' We do not accept

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<sup>23</sup> NER, cl. S6A.2.1(f)(1)(ii).

<sup>24</sup> NER, Chapter 10: Glossary, definition of 'nominated pass through event considerations', cl. (a).

<sup>25</sup> NER, Chapter 10: Glossary, definition of 'nominated pass through event considerations', cl. (b).

<sup>26</sup> NER, Chapter 10: Glossary, definition of 'nominated pass through event considerations', cl. (c).

<sup>27</sup> NER, Chapter 10: Glossary, definition of 'nominated pass through event considerations', cl. (d).

<sup>28</sup> AusNet Services, *AusNet Transmission Group Pty Ltd Transmission Revenue Proposal 2017-22, Revised Revenue Proposal*, 21 September 2016, p. 223.

this proposed amendment and consider the term insolvent to satisfactorily capture circumstances in which an insurer is unable to pay a claim.

For the definition of the insurance cap event AusNet Services proposed two minor amendments. The first amendment involves including the words 'held during', and is a grammatical recommendation. We do not accept this amendment as we consider the words 'held during' earlier in the sentence sufficiently highlights that the insurance policy needs to be held during either the 2017–22 regulatory control period or a previous regulatory control period. The second amendment includes words to specify that AusNet Services is registered under the NER as a TNSP. We accept AusNet Services' intention to improve the clarity and in the definition of the insurance cap event we have included the following to give effect to this, 'was registered as a TNSP for the purposes of s.11 of the NEL'.

For the natural disaster event AusNet Services proposed a minor amendment to allow AusNet Services to recover the efficient costs in responding to a natural disaster regardless of when the natural disaster occurred. We do not accept this proposed amendment as we consider amendments to the NER in 2012 address this issue.<sup>29</sup> There are provisions in the NER that allow a service provider to increase (or decrease) the costs in the provision of prescribed transmission services until the end of the regulatory control period following that in which the positive (or negative) change event occurred.<sup>30</sup> If the service provider continues to incur costs beyond the following regulatory period these costs should be incorporated into the businesses revenue proposals going forward.

### **13.4.2 Decommissioning of Point Henry - Geelong Terminal Station 220kV Lines Event**

In its revised proposal, AusNet Services accepted our rejection of this event. However, AusNet Services stated it would welcome clarification in the Final decision that the AER considers the event would unambiguously be covered by at least one of the prescribed pass through events.<sup>31</sup>

The definition for this event proposed by AusNet Services in its regulatory proposal included the following:

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<sup>29</sup> AEMC, Rule Determination, *National Electricity Amendment (Cost pass through arrangements for Network Service Providers) Rule 2012*, 2 August 2012.

<sup>30</sup> NER Chapter 6A.7.3(j)(2) and (2A), NER Chapter 10: Glossary, definition of 'eligible pass through amount', p. 1150.

<sup>31</sup> AusNet Services, *AusNet Transmission Group Pty Ltd Transmission Revenue Review 2017-22, Revised Revenue Proposal*, 21 September 2016, p. 228.

A PTH-GTS line decommissioning event occurs if AusNet Services is required by a relevant authority to remove all, or part of, the 220kV lines between Point Henry and Geelong Terminal Station and associated infrastructure...<sup>32</sup>

We consider that, providing the use of the term 'relevant authority' refers to a government body, such an event would likely be covered by the prescribed regulatory change event or the service standard event. These events are defined in the NER and relate to events that have occurred as a result of a legislative or administrative act or because of a change to the regulatory environment.<sup>33</sup>

### 13.4.3 Confidential nominated pass through event

In its revised proposal AusNet Services does not accept our draft decision to reject this event. AusNet Services submits the event:

- satisfies the nominated pass through event considerations; and
- provides efficiency incentives for AusNet Services.

Consistent with our draft decision we do not accept this proposed event.

AusNet Services did not provide any additional information in its revised proposal to demonstrate that options to mitigate and minimise the costs of this event were not possible.

Therefore, consistent with our draft decision, we are not satisfied that this nominated event is consistent with the nominated pass through considerations, in particular because:

- the event is foreseeable, and the likely outcomes are identifiable.
- the event is controllable. AusNet Services has control over mitigating the costs associated with such an event. The nature and impact of the event will be a direct result of AusNet Services' actions and decisions. This provides AusNet Services substantial opportunity to use market mechanisms to minimise the cost impact. Therefore, AusNet Services is better placed to manage this risk than its customers.<sup>34</sup> Including a pass through event for this risk weakens the incentives AusNet Services would otherwise have to choose the most prudent and efficient option.
- AusNet Services' proposal includes forecast opex that addresses this risk in whole (in the case of one possible scenario) or in part (in the case of another). Inclusion of a nominated pass through event for this risk weakens the incentive AusNet Services would otherwise have to outperform that forecast.

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<sup>32</sup> AusNet Services, *AusNet Transmission Group Pty Ltd Transmission Revenue Review 2017-22*, 30 October 2015, p. 318.

<sup>33</sup> NER, Chapter 10: Glossary, definition of 'regulatory change event', p. 1200 and definition of 'service standard event', p. 1212. NEL, s. 2D—Meaning of regulatory obligation or requirement.

<sup>34</sup> NER, Chapter 10: Glossary, definition of 'nominated pass through event considerations', cl. (c).

Our reasons for our final decision on this nominated pass through event are set out in full in attachment 13 - confidential appendix A.