



# **DRAFT DECISION**

## **AusNet Services Distribution Determination 2021 to 2026**

### **Attachment 15 Pass through events**

September 2020

© Commonwealth of Australia 2020

This work is copyright. In addition to any use permitted under the Copyright Act 1968, all material contained within this work is provided under a Creative Commons Attributions 3.0 Australia licence, with the exception of:

- the Commonwealth Coat of Arms
- the ACCC and AER logos
- any illustration, diagram, photograph or graphic over which the Australian Competition and Consumer Commission does not hold copyright, but which may be part of or contained within this publication. The details of the relevant licence conditions are available on the Creative Commons website, as is the full legal code for the CC BY 3.0 AU licence.

Requests and inquiries concerning reproduction and rights should be addressed to the:

Director, Corporate Communications  
Australian Competition and Consumer Commission  
GPO Box 3131, Canberra ACT 2601

or [publishing.unit@acc.gov.au](mailto:publishing.unit@acc.gov.au).

Inquiries about this publication should be addressed to:

Australian Energy Regulator  
GPO Box 520  
Melbourne Vic 3001

Tel: 1300 585 165  
Email: [VIC2021-26@aer.gov.au](mailto:VIC2021-26@aer.gov.au)

## Note

This attachment forms part of the AER's draft decision on the distribution determination that will apply to AusNet Services for the 2021–26 regulatory control period. It should be read with all other parts of the draft decision.

The draft decision includes the following attachments:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency benefit sharing scheme

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 11 – Demand management incentive scheme and demand management innovation allowance mechanism

Attachment 12 – Customer service incentive scheme

Attachment 13 – Classification of services

Attachment 14 – Control mechanisms

Attachment 15 – Pass through events

Attachment 16 – Alternative control services

Attachment 17 – Negotiated services framework and criteria

Attachment 18 – Connection policy

Attachment 19 – Tariff structure statement

Attachment A - Victorian f-factor incentive scheme

# Contents

<b>Note</b> .....	<b>15-2</b>
<b>Contents</b> .....	<b>15-3</b>
<b>15 Pass through events</b> .....	<b>15-4</b>
<b>15.1 Draft decision</b> .....	<b>15-4</b>
<b>15.2 AusNet Services' proposal</b> .....	<b>15-5</b>
<b>15.3 Assessment approach</b> .....	<b>15-9</b>
<b>15.4 Interrelationships</b> .....	<b>15-11</b>
<b>15.5 Reasons for draft decision</b> .....	<b>15-12</b>
15.5.1 Insurance coverage, insurer's credit risk, natural disaster, terrorism and retailer insolvency events.....	15-12
15.5.2 Insurance premium and electric vehicle uptake events.....	15-15
<b>A Jemena proposed insurance coverage event amendments</b> .....	<b>15-22</b>
<b>Shortened forms</b> .....	<b>15-25</b>

# 15 Pass through events

During the regulatory control period AusNet Services 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:<sup>1</sup>

- 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.<sup>2</sup> This attachment sets out our draft decision on the nominated pass through events to apply to AusNet Services' distribution network for the 2021–26 regulatory control period.

## 15.1 Draft decision

Our draft decision is to:<sup>3</sup>

- accept five of AusNet Services' proposed nominated pass through events (terrorism, natural disaster, insurance coverage, insurer's credit risk and retailer insolvency event).
- make minor amendments to the retailer insolvency event definition to incorporate new legislative terms and the natural disaster and insurance coverage pass through events to ensure consistency with our recent decisions for other network service providers.<sup>4</sup>
- not accept AusNet Services' proposed insurance premium event and electric vehicle uptake pass through event.

Our reasons are set out in section 15.5 and our amended definitions in Table 15.2.

---

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

<sup>2</sup> NER, cl. 6.6.1(a1)(5).

<sup>3</sup> NER, cl 6.12.1(14).

<sup>4</sup> E.g. AER, *Draft Decision, Essential Energy Distribution Determination 2019–24, Attachment 14 Pass through events*, November 2018, pp. 11–13; AER, *Final Decision, SA Power Networks Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 5–6.

## 15.2 AusNet Services' proposal

AusNet Services' proposed nominated pass through events are set out in Table 15.1.

**Table 15.1 AusNet Services' nominated pass through events**

Pass through event	AusNet Services' proposed definition
Insurance coverage	<p>1. An Insurance Coverage Event occurs if:</p> <ul style="list-style-type: none"><li>(a) AusNet Services makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy or program of insurance policies;</li><li>(b) AusNet Services incurs costs beyond the policy limit, or which otherwise fall outside the scope of the cover provided, under the relevant insurance policy or program of insurance policies; and</li><li>(c) the costs beyond the policy limit, or otherwise outside the scope of the cover provided, under the relevant insurance policy or program of insurance policies increase the costs to AusNet Services in providing direct control services.</li></ul> <p>2. For this Insurance Coverage Event:</p> <ul style="list-style-type: none"><li>(a) a relevant insurance policy is an insurance policy held during the 2021–26 regulatory control period or a previous regulatory control period in which AusNet Services was regulated;</li><li>(b) the scope of cover under a program of policies considers the bands of liability for which AusNet Services is insured, and within those bands, the minimum and maximum cover amounts of each insurance policy; and</li><li>(c) AusNet Services will be deemed to have made a claim on a relevant insurance policy if the claim is made by a related party of AusNet Services in relation to any aspect of the network or AusNet Services' business.</li></ul> <p>3. In making a determination on an Insurance Coverage Event, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"><li>(a) the insurance policy or program of policies applicable to the event;</li><li>(b) expert advice about the level of insurance cover appropriate for AusNet Services (the benchmark level of insurance);</li><li>(c) the level and scope of insurance that a prudent and efficient NSP would obtain in respect of the event, considering factors including (but not limited to):<ul style="list-style-type: none"><li>i. the number and credit rating of insurers offering insurance cover to NSPs;</li></ul></li></ul>

Pass through event	AusNet Services' proposed definition
	<ul style="list-style-type: none"> <li>ii. the cost of purchasing the insurance cover relative to the value of the cover;</li> <li>iii. the cost of purchasing equivalent insurance cover in previous regulatory control periods;</li> <li>(d) evidence of AusNet Services' efforts to obtain the benchmark level of insurance cover;</li> <li>(e) if AusNet Services did not obtain the benchmark level of insurance cover, evidence that: <ul style="list-style-type: none"> <li>iv. AusNet Services' Board approved the lower level of insurance cover as prudent and efficient; or</li> <li>v. AusNet Services engaged with customers or customer representatives concerning the reasons for the lower level of insurance cover; and</li> </ul> </li> <li>(f) any assessment by the AER of AusNet Services' insurance cover in making its distribution determination for the relevant regulatory control period</li> </ul>
Insurance premium	<p>1. An Insurance Premium Event occurs if AusNet Services incurs costs in respect of insurance premiums, which exceed the allowance for insurance premiums included in the forecast operating expenditure allowance approved in the AER's distribution determination for the 2021–26 regulatory control period.</p> <p>Note: Insurance premiums relate to the costs payable to obtain liability insurance cover during the regulatory control period commencing 1 July 2021 to 30 June 2026.</p> <p>2. In making a determination on an Insurance Premium Event, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> <li>(a) the level of liability insurance cover that a prudent and efficient distribution network service provider operating a network similar to AusNet Services' would obtain in respect of liability exposure;</li> <li>(b) whether the insurance premiums allocated to AusNet Services is in accordance with its cost allocation methodology approved under rule 6.15 of the NER; and</li> <li>(c) any assessment by the AER of AusNet Services' liability insurance cover in making its distribution determination for the 2021–26 regulatory control period.</li> </ul>
Insurer credit risk	<p>1. An Insurer Credit Risk Event occurs if a nominated insurer of AusNet Services becomes insolvent and, as a result, in respect of an existing or potential insurance claim for a risk that was insured by the insolvent insurer, AusNet Services:</p>

Pass through event	AusNet Services' proposed definition
	<p>(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</p> <p>(b) incurs additional costs associated with funding an insurance claim, which would otherwise have been covered by the insolvent insurer.</p> <p>2. In assessing an Insurer's Credit Risk Event pass through application, the AER will have regard to, amongst other things:</p> <p>(a) 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.</p> <p>(b) 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.</p>
Natural disaster	<p>1. A Natural Disaster Event means any natural disaster including but not limited to cyclone, fire, flood, earthquake or other natural disaster that occurs during the regulatory control period and increases the costs to AusNet Services in providing direct control services, provided the cyclone, fire, flood or other event was not a consequence of the acts or omissions of AusNet Services.</p> <p>2. In assessing a Natural Disaster Event pass through application, the AER will have regard to, amongst other things:</p> <p>(a) whether AusNet Services has insurance against the event, and</p> <p>(b) the level of insurance that an efficient and prudent DNSP would obtain in respect of the event.</p>
Terrorism	<p>1. A 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> <p>(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 to create fear amongst the public, or any section of the public); and</p> <p>(b) increases the costs to AusNet Services in providing direct control services.</p>



Pass through event	AusNet Services' proposed definition
	<p>2. In assessing a Terrorism Event pass through application, the AER will have regard to, amongst other things:</p> <p>(a) whether AusNet Services has insurance against the event;</p> <p>(b) the level of insurance that an efficient and prudent DNSP would obtain in respect of the event; and</p> <p>(c) whether a declaration has been made by a relevant government authority that a terrorism event has occurred.</p>
Retailer insolvency	<p>1. Until such time as the National Energy Retail Law set out in the Schedule to the National Energy Retail Law (South Australia) Act 2011 of South Australia is applied as a law of Victoria, Retailer Insolvency Event has the meaning set out in the NER as in force from time to time, except that:</p> <p>(a) where used in the definition of 'Retailer Insolvency Event' in the NER, the term 'retailer' means the holder of a licence to sell electricity under the Electricity Industry Act 2000 (Vic); and</p> <p>(b) other terms used in the definition of Retailer Insolvency Event in the Rules as a consequence of amendments made to that definition from time to time, which would otherwise take their meaning by reference to provisions of the NER or National Energy Retail Law not in force in Victoria, take their ordinary meaning and natural meaning, or their technical meaning (as the case may be).</p> <p>2. For the purposes of this definition, the terms 'eligible pass through amount' and 'positive change event' where they appear in the NER are modified in respect of this Retailer Insolvency Event in the same manner as those terms are modified in respect of the retailer insolvency event prescribed in the NER from time to time.</p> <p>Note: This Retailer Insolvency Event will cease to apply as a nominated pass through event on commencement of the National Energy Retail Law in Victoria.</p>
Electric vehicle uptake	<p>An Electric Vehicle Uptake event occurs if, during the regulatory control period beginning on 1 July 2021:</p> <p>1. The Commonwealth government or the government of Victoria announces a new or amended policy, program, initiative, scheme or other measure which is directed at increasing the uptake of electric vehicles; and</p> <p>2. Following the announcement there is a sustained increase in the average energy consumption on AusNet Services' network that is attributable to an increase in demand for</p>

Pass through event	AusNet Services' proposed definition
	<p>electric vehicle charging; and</p> <p>3. The cost of meeting the increase in consumption or unmet demand increases the cost of providing direct control services.</p> <p>4. If, at the time the Electric Vehicle Uptake event occurs, AusNet Services cannot provide evidence of the actual or likely increase in costs that it will or is likely to incur in providing direct control services as a result of the Electric Vehicle Uptake event, AusNet Services may seek the approval of the AER later in the regulatory control period to pass through those amounts on the basis that the materiality threshold is met.</p>

Source: AusNet Services, *Electricity Distribution Price Review (EDPR) 2022–26 Part III*, January 2020, pp. 255–265.

## 15.3 Assessment approach

The NER sets 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.<sup>5</sup>

Our assessment approach is guided by the National Electricity Objective (NEO) and the Revenue and Pricing Principles (RPPs).<sup>6</sup> 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.<sup>7</sup> The NEO and the RPPs also reflect the importance of incentives to promote economic efficiency,<sup>8</sup> and balance the risks of under and over investment.<sup>9</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. This is a similar approach to that taken by the Australian Energy Market Commission (AEMC) when considering pass through event rule changes.<sup>10</sup>

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

<sup>5</sup> NER, cl. 6.5.10(b), 6.6.1.

<sup>6</sup> NEL, ss. 7 and 7A.

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

<sup>8</sup> NEL, s. 7A(3).

<sup>9</sup> NEL, s. 7A(6).

<sup>10</sup> AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 6.

<sup>11</sup> NER, Chapter 10, definition of nominated pass through event considerations.

- 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);
- whether the nature or type of event can be clearly identified at the time the determination is made for the service provider;
- 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;
- whether the relevant service provider could insure against the event, having regard to:
  - the availability (including the extent of availability in terms of liability limits) of insurance against the event on reasonable commercial terms; or
  - whether the event can be self-insured on the basis that:
    - it is possible to calculate the self-insurance premium; and
    - 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
- 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.<sup>12</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>13</sup>

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.<sup>14</sup> This promotes the efficient investment in, and efficient operation

---

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

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

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

and use of, network services for the long term interests of consumers with respect to price.<sup>15</sup>

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.<sup>16</sup>

## 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.<sup>17</sup> 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.<sup>18</sup>

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

---

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

<sup>16</sup> AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 18.

<sup>17</sup> NEL, s. 16(1)(c).

<sup>18</sup> AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, pp. 19–20.

mechanisms.<sup>19</sup> This is reflected in the materiality threshold that applies to cost pass through applications.<sup>20</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 Efficiency Benefit Sharing Scheme and Capital Expenditure Sharing Scheme.<sup>21</sup>

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.<sup>22</sup>

## 15.5 Reasons for draft decision

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

Consistent with our recent determinations for other network service providers,<sup>23</sup> we consider AusNet Services' proposed terrorism, natural disaster, insurer's credit risk, insurance coverage and retailer insolvency pass through events meet the nominated pass through event considerations set out in the NER:<sup>24</sup>

- 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 AusNet Services 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 AusNet Services and its customers is appropriate and more likely to be in the long-term interests of consumers with respect to price.

We have made some minor amendments to the definitions of these approved nominated pass through events (natural disaster and insurance coverage) to ensure consistency with recent AER decisions, as set out in Table 15.2. These changes are to

---

<sup>19</sup> AEMC 2012, *Economic Regulation of Network Service Providers, and Price and Revenue Regulation of Gas Services, Final Position Paper*, 29 November 2012, p. 186.

<sup>20</sup> NER, Chapter 10: Glossary, definition of 'materially'.

<sup>21</sup> AER, *Efficiency Benefit Sharing Scheme for Electricity Network Service Providers*, November 2013, p. 7; AER, *Capital Expenditure Incentive Guideline for Electricity Network Service Providers*, November 2013, p. 6.

<sup>22</sup> NER, cl. S6.2.1(e)(1)(ii).

<sup>23</sup> AER, *Final Decision, SA Power Networks Distribution Determination 2020–2025, Attachment 14 Pass through events*, June 2020, pp. 10–15, 13–15; AER, *Final Decision, Ergon Energy Distribution Determination 2020–2025, Attachment 14 Pass through events*, June 2020, pp. 9–10; AER, *Final Decision, Energex Distribution Determination 2020–2025, Attachment 14 Pass through events*, June 2020, pp. 9–10.

<sup>24</sup> NER, cl. 6.5.10(b); Chapter 10: Glossary, definition of 'nominated pass through event considerations'.

provide greater drafting consistency between AusNet Services and other network service providers.

### 15.5.1.1 Definition of insurance coverage event

We accept the insurance coverage pass through event proposed by AusNet Services, subject to the amendment discussed below. The new definition is consistent with our recent determinations for SA Power Networks, Ergon Energy and Energex.<sup>25</sup>

AusNet Services (similar to other network operators) often have more than one policy, particularly for bushfire liability insurance. We consider it appropriate to amend this pass through event to reflect the use of multiple insurance policies. Our amended wording is slightly more generic (and therefore more flexible) than that proposed by AusNet Services, in that we have made reference to a 'set of insurance policies' instead of 'program of policies'. We consider this change reflects that insurance market conditions are changing following significant bushfire events in Australia and overseas. The changes are making bushfire coverage more expensive and difficult to procure.

Gaps in a network operator's insurance coverage may occur if AusNet Services is unable to find suitable insurance providers to fill withdrawn capacity or cannot economically justify higher premiums.

We have refined the pass through definition to allow for unfavourable changes to AusNet Services' insurance policy, but only under what we have defined as 'changed circumstances'. While AusNet Services' proposal included a different definition which proposed to cover those costs which fall 'outside the scope of cover', we consider our definition of 'changed circumstances' addresses the same core issues with a balanced approach. The definition of 'changed circumstances' is as follows:

'changed circumstances' means movements in the relevant insurance liability market that are beyond the control of AusNet Services, where those movements mean that it is no longer possible for AusNet Services 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<sup>26</sup> within the scope of that insurance policy or set of insurance policies.

Our draft decision recognises the possibility of future coverage gaps, negative impact on deductible schedules or reinstatement rights, but also seeks to preserve appropriate pass through event incentives under a normal operating environment.

AusNet Services proposed that we should, when assessing the pass through event application, have regard to a non-exhaustive list of factors. We have instead amended the definition to allow the AER to have regard to any information provided by AusNet Services about its actions and processes. We believe this will provide a greater

---

<sup>25</sup> AER, *Final Decision, SA Power Networks Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 13–14; AER, *Final Decision, Ergon Energy Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 9–10; AER, *Final Decision, Energex Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 9–10.

<sup>26</sup> See Table 15.2 of this Attachment, paragraph 2, under the insurance coverage pass through event definition.

breadth of relevant information when considering an insurance coverage cost pass through event application.

As part of the draft decision consultation, Jemena proposed a number of minor amendments to the definition of the insurance coverage pass through event.<sup>27</sup> Jemena's proposed amendments are set out in Appendix A. We did not consider them for the draft decision but will consider them in the final decision for all the Victorian distribution businesses. We welcome AusNet Services' views on the relevance and merits of those proposed amendments.

As foreshadowed in our recent decisions, we intend to provide AusNet Services and the broader industry with greater clarity and guidance around the matters we are likely to have regard to in assessing any insurance coverage pass through event that occurs. We released a consultation paper<sup>28</sup> on 28 August 2020 seeking stakeholder views on the key elements that will guide our assessment of an insurance coverage pass through event application. This will be used to assist us to develop a draft and final guidance note. We welcome submissions by 30 October 2020.

### 15.5.1.2 Definition of natural disaster event

In our definition of 'natural disaster' event we have included additional factors which we will have regard to when assessing whether a natural disaster event occurred as a consequence as an act or omission of AusNet Services. The definition now states that:

Natural disaster event means any natural disaster including but not limited to cyclone, fire, flood or earthquake that occurs during the 2021–26 regulatory control period that increases the costs to AusNet Services in providing direct control services, provided the fire, flood or other event was:

- 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
- b) not a consequence of any other act or omission of the service provider.

This change was a result of other network service providers raising issues where compliance with regulations could prevent those network service providers from meeting pass through requirements.<sup>29</sup>

We have also removed the additional reference to 'cyclone' in the 'in providing direct control services, provided the cyclone, fire, flood or other event'. We believe that this decision will have no effect on AusNet Services as 'cyclone' would be included on the 'other event' classification.

---

<sup>27</sup> Jemena, *Information request 48*, 22 July 2020, pp. 9–11.

<sup>28</sup> See <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/insurance-coverage-pass-through-event-%E2%80%93-guidance-note>.

<sup>29</sup> SA Power Networks, *2020–25 Revised Regulatory Proposal, Attachment 13, Pass through events*, pp. 18–22.

### 15.5.1.3 Definition of retailer insolvency event

We have amended the retailer insolvency pass through definition in order to clarify that the meaning of the terms 'retailer insolvency costs', 'failed retailer' and 'billed but unpaid charges' are consistent with the NER. These changes should have no material impact on the operation of the pass through event.

This change was a result of other service providers raising that these terms have been incorporated into the NER as a result of the National Electricity Amendment (Retailer-Distributor Credit Support Requirements) Rule 2017.<sup>30</sup>

## 15.5.2 Insurance premium and electric vehicle uptake events

### 15.5.2.1 Insurance premium event

We do not accept AusNet Services' proposed insurance premium event because we are not satisfied that it met the nominated pass through considerations under the NER.

AusNet Services proposed an insurance premium event to recover costs if it incurs costs above the insurance premium estimates included in the forecast operating expenditure allowance approved by us for the 2021–26 regulatory control period.<sup>31</sup> AusNet Services stated the main reason for seeking this pass through event was the recent unfavourable developments in the international liability insurance market.<sup>32</sup> AusNet Services considers this proposed insurance premium event is consistent with the nominated pass through event considerations,<sup>33</sup> but did not provide much supporting information in its proposal.

In our recent determinations<sup>34</sup>, we are aware of the recent volatility in the insurance liability market and took account of this impact on network providers by including an insurance coverage event. Similarly, we have accepted the insurance coverage event (section 15.5.1.1) and are of the view that it addresses key aspects of the unusual and uncontrollable risks faced by AusNet Services in the prevailing insurance liability market.

Where a network provider has sought a separate step change for the increasing insurance premiums, we have also considered its merits and decided accordingly. AusNet Services did not seek a step change for increasing insurance premiums in its proposal but sought an insurance premium pass through event. AusNet Services has not provided sufficient details for us to understand the specific impacts it would face

---

<sup>30</sup> Powercor, *2021–26 Regulatory proposal – Appendix 4 – Uncertainty appendix*, January 2020, pp. 16–19; CitiPower, *2021–26 Regulatory proposal – Appendix 4 – Uncertainty appendix*, January 2020, pp. 16–19; United Energy, *2021–26 Regulatory proposal – Appendix 4 – Uncertainty appendix*, January 2020, p. 18.

<sup>31</sup> AusNet Services, *2022–26 Regulatory proposal – EDPR – Part III*, 31 January 2020, p. 257.

<sup>32</sup> AusNet Services, *2022–26 Regulatory proposal – EDPR – Part III*, 31 January 2020, p. 257.

<sup>33</sup> AusNet Services, *2022–26 Regulatory proposal – EDPR – Part III*, 31 January 2020, p. 257.

<sup>34</sup> AER, *Final Decision, SA Power Networks Distribution Determination 2020–2025, Attachment 14 Pass through events*, June 2020, pp. 13–14; AER, *Final Decision, Ergon Energy Distribution Determination 2020–2025, Attachment 14 Pass through events*, June 2020, pp. 9–10; AER, *Final Decision, Energex Distribution Determination 2020–2025, Attachment 14 Pass through events*, June 2020, pp. 9–10.



due to the unusual insurance liability market conditions over the 2021–26 regulatory control period. We are not in a position to form a considered view whether the proposed event meets the NER considerations for a pass through event and, whether the issue is best addressed via a nominated pass through event or a step change.

We agree that the basic proposition is that network providers are provided with a reasonable opportunity to recover efficient costs incurred in providing direct control network services. However, the appropriate regulatory mechanisms used to allow a service provider to recover costs is important in order to not duplicate recovery for the same set of risks as well as placing maximum incentives for that service provider to address the identified risks and incur efficient costs. As noted by AEMC, nominated pass throughs should be “the last option available to network service providers with respect to risk management relating to recovery of costs associated with provision of direct control services. This is to protect the incentive mechanisms that operate under the building block approach to revenue determination. The incentive mechanisms help ensure that prices for consumers are no more than necessary to provide an appropriate level of service”.<sup>35</sup> Pass through events should be limited to unpredictable, infrequent and high cost events that are beyond the control of the service provider- we are not able to form this conclusion based on the information provided by AusNet Services on the need for an insurance premium pass through event.

Accordingly, we do not accept the insurance premium pass through nominated by AusNet Services in its proposal.

### 15.5.2.2 Electric vehicle uptake event

We do not accept AusNet Services' proposed electric vehicle (EV) uptake event because we are not satisfied that it met the nominated pass through considerations under the NER.

AusNet Services proposed an EV uptake pass through event to manage the uncertainty regarding the content and timing of EV-specific policies and relevant legislation required to give effect to those policies.<sup>36</sup> It claimed this uncertainty was not conducive for them to reliably forecast the likely impacts on its network demand and hence, incorporate them in the expenditure forecasts.<sup>37</sup> It further stated that the possibility of using a prescribed “regulatory obligation” pass through event might be averted in the circumstances where the regulatory obligations fall short of the National Electricity Law (NEL) definition, or when such policies were announced but not accompanied by a change in the law or regulatory instrument.<sup>38</sup>

Stakeholder submissions did not agree with AusNet Services' views on the uncertainty of increased EV uptake and how to manage it. For example, the Victorian Community Organisations considered that the distributors will have more than adequate time to

---

<sup>35</sup> Australian Energy Market Commission, *Rule Determination – National Electricity Amendment (Cost pass through arrangements for Network Service Providers) Rule 2012*, 2 August 2012, p. Summary i.

<sup>36</sup> AusNet Services, *2022–26 Regulatory proposal – EDPR – Part III*, 31 January 2020, p. 264.

<sup>37</sup> AusNet Services, *2022–26 Regulatory proposal – EDPR – Part III*, 31 January 2020, p. 264.

<sup>38</sup> AusNet Services, *2022–26 Regulatory proposal – EDPR – Part III*, 31 January 2020, pp. 264–265.

respond to any increase in demand caused by the EV uptake as “any introduction of policies leading to an increase in EVs is not going to cause an instantaneous increase in demand and it is likely to occur over a considerable period of time”.<sup>39</sup> Energy Consumer Australia’s (ECA) submission saw this as an opportunity for Victorian network service providers to design EV tariffs that encourage charging at times that will mitigate the impact on demand growth.<sup>40</sup> ECA viewed that both the level of capital investment and emphasis on digitalisation of the network by the Victorian networks in their current proposal allow for the scope to mitigate any higher than expected EV uptake.<sup>41</sup> Relevantly, ECA’s submission pointed out that a pass through mechanism for EV could act as a disincentive to progress tariff strategy.<sup>42</sup>

AusNet Services also noted in its proposal the Federal Government’s National Strategy for Electric Vehicles promises to “coordinate action across governments, industry and urban and regional communities” to “ensure the transition to electric vehicle technology and infrastructure is planned and managed, so that all Australians can access the benefits of the latest vehicle technology.”<sup>43</sup> AusNet Services did not give clear reasons why such a major policy initiative could not be planned and managed as foreshadowed. As affected service providers are key stakeholders in this process, they are in an effective position to ensure that policy makers understand major costs impacts and that supporting legislation and processes should be in place to allow for recovery of efficient costs stemming from this new initiative. Further, AusNet Services did not cite any similar past incidents or substantiate with examples of future events where it is conceivable that service providers could incur material cost impacts as a result of potential policy developments.

We are therefore not persuaded that AusNet Services has demonstrated sufficiently that:

- the risks that it outlines related to EV policy introduction are likely to occur, and/or
- the range of any such cost impacts is likely to be material,

to satisfy the considerations for a nominated pass through event under the NER.

Table 15.2 summarises the nominated pass through events accepted by us in the draft decision.

---

<sup>39</sup> Victorian Community Organisations, *EDPR 2021–26 Submission to Initial Proposals*, 29 May 2020, p. 76.

<sup>40</sup> Energy Consumers Australia, *Victorian Electricity Distributors Regulatory Proposals 2021–26, Attachment 1: A review of Victorian Distribution Networks*, p. 36.

<sup>41</sup> Energy Consumers Australia, *Victorian Electricity Distributors Regulatory Proposals 2021–26, Attachment 1: A review of Victorian Distribution Networks*, p. 36.

<sup>42</sup> Energy Consumers Australia, *Victorian Electricity Distributors Regulatory Proposals 2021–26, Attachment 1: A review of Victorian Distribution Networks*, p. 36.

<sup>43</sup> AusNet Services, *2022–26 Regulatory proposal – EDPR – Part III*, 31 January 2020, p. 264; Department of the Environment and Energy, *A National Strategy for Electric Vehicles*, February 2019, <https://www.environment.gov.au/climate-change/publications/national-strategy-electric-vehicles>; The Senate, *Select Committee on Electric Vehicles Report*, January 2019, pp. xi and xii.

**Table 15.2 AER pass through event definitions**

Pass through event	Approved definition
Insurance coverage	<p>An insurance coverage event occurs if:</p> <ol style="list-style-type: none"> <li>1. AusNet Services:               <ol style="list-style-type: none"> <li>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</li> <li>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</li> </ol> </li> <li>2. AusNet Services incurs costs:               <ol style="list-style-type: none"> <li>a) beyond a relevant policy limit for that policy or set of insurance policies; or</li> <li>b) that are unrecoverable under that policy or set of insurance policies due to changed circumstances; and</li> </ol> </li> <li>3. The costs referred to in paragraph 2 above materially increase the costs to AusNet Services in providing direct control services.</li> </ol> <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 AusNet Services, where those movements mean that it is no longer possible for AusNet Services 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"> <li>i. the limit not been exhausted; or</li> <li>ii. those costs not been unrecoverable due to changed circumstances.</li> </ol> <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 AusNet Services was regulated; and</p> <p>AusNet Services 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 AusNet Services in relation to any aspect of AusNet Services' network or business; and</p>

Pass through event	Approved definition
	<p>AusNet Services 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 AusNet Services in relation to any aspect of AusNet Services' network or business.</p> <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"> <li>i. the relevant insurance policy or set of insurance policies for the event</li> <li>ii. the level of insurance that an efficient and prudent DNSP would obtain, or would have sought to obtain, in respect of the event; and</li> <li>iii. any information provided by AusNet Services to the AER about AusNet Services' actions and processes.</li> </ul>
Insurer credit risk	<p>An insurer credit risk event occurs if an 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> <ul style="list-style-type: none"> <li>(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</li> <li>(b) incurs additional costs associated with funding an insurance claim, which would otherwise have been covered by the insolvent insurer.</li> </ul> <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"> <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 covered by the insolvent insurer's policy, whether AusNet Services had reasonable opportunity to insure the risk with a different provider.</li> </ul>
Natural disaster	<p>Natural disaster event means any natural disaster including but not limited to cyclone, fire, flood or earthquake that occurs during the 2021–26 regulatory control period that increases the costs to AusNet Services in providing direct control services, provided the fire, flood or other event was:</p> <ul style="list-style-type: none"> <li>(a) a consequence of an act or omission that was necessary</li> </ul>

Pass through event	Approved definition
	<p>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>(1) whether AusNet Services has insurance against the event;</p> <p>(2) the level of insurance that an efficient and prudent NSP would obtain in respect of the event.</p>
Terrorism	<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> <p>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</p> <p>increases the costs to AusNet Services in providing direct control services.</p> <p>Note: In assessing a terrorism event pass through application, the AER will have regard to, amongst other things:</p> <p>i. whether AusNet Services 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>
Retailer insolvency	<p>Until such time as the National Energy Retail Law set out in the Schedule to the National Energy Retail Law (South Australia) Act 2011 of South Australia is applied as a law of Victoria, retailer insolvency event has the meaning set out in the NER as in force from time to time, except that:</p> <p>(a) where used in the definition of 'retailer insolvency event' in the NER, the term 'retailer' means the holder of a licence to sell electricity under the Electricity Industry Act 2000 (Vic); and</p>

Pass through event	Approved definition
	<p data-bbox="643 253 1361 499">(b) other terms used in the definition of retailer insolvency event in the Rules as a consequence of amendments made to that definition from time to time, which would otherwise take their meaning by reference to provisions of the NER or National Energy Retail Law not in force in Victoria, take their ordinary meaning and natural meaning, or their technical meaning (as the case may be).</p> <p data-bbox="643 521 1361 813">For the purposes of this definition, the terms 'eligible pass through amount' and 'positive change event' where they appear in the NER (as well as any subordinate terms including, without limitation, 'retailer insolvency costs', 'failed retailer' and 'billed but unpaid charges') are modified in respect of this retailer insolvency event in the same manner as those terms are modified in respect of the retailer insolvency event prescribed in the NER from time to time</p> <p data-bbox="643 835 1361 936">Note: This retailer insolvency event will cease to apply as a nominated pass through event on commencement of the National Energy Customer Framework in Victoria</p>

---

Source: AER analysis

# A Jemena proposed insurance coverage event amendments

## 3. AER Question 3

In light of the recent SA Power Network's final decision on the insurance coverage event pass through definition, can Jemena confirm if this addresses their concerns in relation potential gaps in liability coverage?

### 3.1 Jemena Response – Question 3

As identified in the SAPN final decision, the industry is experiencing new challenges with insurance in that there is a growing risk because of gaps in the coverage below the insurance cap. The insurance cap event—which applied in previous regulatory control periods—would not represent an adequate means of managing this risk, as this mechanism was predicated on there being no gaps in the insurance layers or coverage within a layer. As this is no longer the case, a transition to a coverage event represents an improvement to the management of this risk over the previous 'cap' event.

For the most part, we consider the approach adopted in the SAPN final decision is a workable model to address the new challenges presented to distribution business through changes in the insurance market (although we have some residual concerns that we hope will be addressed in the AER's consultation paper as noted in the SAPN final decision<sup>33</sup>). Further, we consider that with a few minor drafting changes the SAPN insurance coverage event could be applied to JEN. These amendments are intended to clarify the circumstances in which this event is triggered or where insurance that is in place either:

- a) becomes unavailable,
- b) remains available, but the terms change so that they are not reasonable commercial terms (and therefore it is not appropriate to maintain that insurance coverage), or
- c) becomes only partly available, so that where insurance comprises various layers of coverage, one of those layers is not available, or where there is a gap within a layer – and an event occurs which results in JEN bearing costs that it would not otherwise have borne;

Using the SAPN insurance coverage event as a baseline, we have marked-up the recommended changes in the text below.<sup>34</sup> Within the text, we have also included some drafting notes highlighted in grey shading to outline our reasoning for the proposed changes.

\*\*\*\*\*

An insurance coverage event occurs if:

1. JEN:
  - 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. JEN incurs costs:
  - a) beyond a ~~relevant~~ policy limit for ~~that the relevant insurance~~ policy or set of insurance policies; or

<sup>33</sup> AER, *FINAL DECISION SA Power Networks Distribution Determination 2020 to 2025, Attachment 14 Pass through events*, June 2020, Pg. 14-14.

<sup>34</sup> We note that the changes from SAPN to JEN are not marked-up given then obvious reason for the change.

*[JEN Note: minor changes have been made to reflect defined terms – otherwise scope and intent unaltered.]*

- b) that are unrecoverable under ~~that~~ the relevant insurance policy or set of insurance policies (whether wholly or in part) due to changed circumstances; and

*[JEN Note: we think “unrecoverable” on its own could be interpreted as limiting (b) to the circumstance where insurance is not available at all. Since we are also trying to capture the circumstance where one layer is unavailable, or there is a gap within a layer, we have included some additional wording to make the intent clearer.]*

3. The costs referred to in paragraph 2 above materially increase the costs to JEN in providing direct control services.

For the purposes of this insurance coverage event:

- ‘changed circumstances’ means movements in the relevant insurance liability market that are beyond the reasonable control of JEN, where those movements result in ~~mean that it is~~ no longer being possible for JEN to take out with a reputable insurer:
  - i. ~~an~~ relevant insurance policy or,
  - ii. in the case of a set of insurance policies, one or more layers of insurance within that set (or there are otherwise one or more gaps within the set),
 either 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.~~

*[JEN Note: we have revised wording in the above definition to better deal with the unavailability of insurance layers within the set, and also to clarify it has to be insurance offered by a reputable insurer (see definition below). We have also deleted the last two lines of this definition which refer to costs, because it is unnecessary to include the wording here in this definition when it is already covered off in para 2 and below in separate definition.]*

- ‘costs’ means the ~~costs amount~~ that would have been recoverable ~~ed~~ under the relevant insurance policy or set of insurance policies had:
  - i. the limit not been exhausted; or
  - ii. those costs not been unrecoverable due to changed circumstances.

*[JEN Note: it is appropriate that this definition refer to amounts that are “recoverable” rather than “recovered”, consistent with the wording in para 2 above.]*

- ‘reputable insurer’ means an insurer with a current financial security rating of “A-” or better by Standard and Poor’s (or the equivalent rating with another reputable rating agency).

*[JEN Note: our understanding is that this is well-accepted as a means of determining whether an insurer is reputable – i.e. an entity to which a prudent DNSP would look to provide insurance coverage.]*

- 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 JEN was regulated.
- JEN 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 JEN in relation to any aspect of JEN’s network or business.
- JEN 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 JEN in relation to any aspect of JEN’s network or business.

Note for the avoidance of doubt, in assessing an insurance coverage event through application under rule 6.6.1(i), the AER will have regard to:

- The relevant insurance policy or set of insurance policies for the event;



- The level of insurance that an efficient and prudent DNSP would obtain, or would have sought to obtain, in respect of the event; and
- Any information provided by JEN to the AER about JEN's actions and processes.

\*\*\*\*\*

Source: Jemena, *Information request 48*, 22 July 2020, pp. 9–11.

## Shortened forms

Shortened form	Extended form
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
capex	capital expenditure
CCP 17	Consumer Challenge Panel, sub-panel 17
distributor / DNSP	distribution network service provider
ECA	Energy Consumers Australia
EV	electric vehicle
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