DRAFT DECISION
Multinet Gas
Access arrangement
2018 to 2022

Attachment 11 – Reference tariff variation mechanism

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Note

This attachment forms part of the AER's draft decision on the access arrangement for Multinet Gas for 2018-22. It should be read with all other parts of the draft decision.

The draft decision includes the following documents:

Overview

Attachment 1 - Services covered by the access arrangement

Attachment 2 - Capital 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 carryover mechanism

Attachment 10 - Reference tariff setting

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Attachment 12 - Non-tariff components

Attachment 13 - Demand

Attachment 14 - Other incentive schemes

Contents

Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
ATO	Australian Tax Office
capex	capital expenditure
CAPM	capital asset pricing model
CESS	Capital Expenditure Sharing Scheme
CPI	consumer price index
DRP	debt risk premium
ECM	(Opex) Efficiency Carryover Mechanism
ERP	equity risk premium
Expenditure Guideline	Expenditure Forecast Assessment Guideline
gamma	Value of Imputation Credits
MRP	market risk premium
NGL	National Gas Law
NGO	national gas objective
NGR	National Gas Rules
NPV	net present value
opex	operating expenditure
PTRM	post-tax revenue model
RBA	Reserve Bank of Australia
RFM	roll forward model
RIN	regulatory information notice
RPP	revenue and pricing principles
SLCAPM	Sharpe-Lintner capital asset pricing model
STTM	Short Term Trading Market
TAB	Tax asset base
UAFG	Unaccounted for gas
WACC	weighted average cost of capital
WPI	Wage Price Index

11 Reference tariff variation mechanism

This attachment sets out our consideration of the reference tariff variation mechanism proposed by Multinet. The reference tariff variation mechanism:

- permits building block revenues to be recovered smoothly over the access arrangement period subject to any differences between forecast and actual demand
- accounts for actual inflation
- accommodates other reference tariff adjustments that may be required, such as for an approved cost pass through event
- sets administrative procedures for the approval of any proposed changes to reference tariffs—that is updating tariffs each year.

11.1 Annual reference tariff variation mechanism

11.1.1 Draft decision

We do not approve Multinet's proposed reference tariff variation mechanism for the 2018–22 access arrangement period. We consider some elements of Multinet's proposed reference tariff variation mechanism are not consistent with the National Gas Rules (NGR):

- we do not accept Multinet's proposal to replace its current weighed average price cap reference tariff variation mechanism with a revenue cap
- we do not accept all of Multinet's proposed pass through events
- the proposed initial reference tariffs and X factors must be revised to reflect the changes to the forecast total revenue identified in the overview of this draft decision.

Our draft decision weighted average price cap formula is different to that applied in Multinet's current access arrangement. We have made amendments to the formula to reflect our draft decision on revenue adjustment mechanisms and we have made minor modifications for consistency with this mechanism as applied by other gas distributors.

We discuss our reasons for our draft decision below.

11.1.2 Multinet's proposal

Multinet proposed to change its reference tariff variation mechanism from the current price cap to a revenue cap.[1] In support of its proposal Multinet cited:

- consistency with its related electricity network service provider United Energy which was shifted to a revenue cap in the 2015 Victorian electricity distribution reset

[1] Multinet Gas, *2018–22 Access Arrangement Information*, December 2016, p. 48.

- declining demand and consequential volume forecasting risk to Multinet under the current price cap
- its incentive to promote gas consumption, regardless of the type of reference tariff variation mechanism because gas is a fuel of choice.

Multinet placed most weight on the second factor listed above because that forecasting risk gives rise to the possibility of Multinet failing to recover its efficient costs. Multinet characterised this risk as relating to the AER making errors in forecasting demand. After submitting its proposal Multinet advised that, given the submissions received and further consideration internally, it would not object if in our draft decision we rejected this aspect of its initial proposal and sought to apply a price cap mechanism.[2]

For ancillary reference tariffs, Multinet proposed to maintain its current Schedule of Tariffs subject to annual CPI adjustments.[3] This is the same approach as applied in the 2013–17 access arrangement.[4]

11.1.3 Assessment approach

Under the NGR, a reference tariff variation mechanism for an access arrangement:

- must be designed to equalise (in present value terms):
  - forecast revenue from reference services over the access arrangement period, and
  - the portion of total revenue allocated to reference services for the access arrangement period.
- may provide for variation of a reference tariff:
  - in accordance with a schedule of fixed tariffs or
  - in accordance with a formula set out in the access arrangement or
  - as a result of a cost pass through for a defined event or
  - by the combination of two or more of these operations.

A formula for varying reference tariffs may (for example) provide for variable caps on the revenue to be derived from a particular combination of reference services; or tariff basket price control; or revenue yield control; or a combination of all or any of these factors. However, the reference tariff variation mechanism must give us adequate oversight and powers to approve reference tariff variations.

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2 Multinet, email to AER staff, *Price control mechanism*, 8 June 2017.

3 Multinet, *2018-22 Access Arrangement Information*, December 2016, p. 48.

4 Ancillary services are individually sought by customers on an ad-hoc or as needed basis (rather than universally by all customers) and so are not included in the total revenue requirement.

We must have regard to various factors in deciding whether an access arrangement's reference tariff variation mechanism is appropriate. These are:

- the need for efficient reference tariff structures
- the possible effects of the reference tariff variation mechanism on administrative costs
- the regulatory arrangements (if any) applicable to the relevant reference services before the commencement of the proposed reference tariff variation mechanism
- the desirability of consistency between regulatory arrangements for similar services
- any other relevant factor.

Having regard to these, we considered the implications of the proposed reference tariff variation mechanism for efficient tariff structures and administrative costs on natural gas consumers, potential users and Multinet. In doing so we took into account the nature and scope of pipeline reference services to which reference tariffs are applicable. Our assessment also included a comparison of:

- the proposed reference tariff variation mechanism arrangements with those in Multinet's current access arrangement
- other recent gas distribution access arrangement decisions (and electricity determinations under the NER)
- consistency in approach across the provision of similar services.

We assessed the potential impact of Multinet's proposal for meeting the national gas objectives and the revenue and pricing principles. We also assessed the implications of Multinet's proposed reference tariff variation mechanism for effective risk management that would be in the long term interests of consumers of natural gas.

We have taken into account the expected changes in gas demand over the 2018–22 access arrangement, the impact this can have on price stability over the period and incentives on the service provider to develop efficient tariffs.

We have also taken into account submissions provided to us by stakeholders, including our Consumer Challenge Panel (CCP11).

11.1.4 Interrelationships

The haulage reference tariff variation mechanism has interrelationships with the total revenue Multinet can earn, the services Multinet provides to its customers to recover those revenues and the tariffs it charges for the use of those services.

Multinet's haulage reference tariffs are adjusted annually by the application of a weighted average price cap formula. The X factor in the weighted average price cap formula is revised annually to reflect the updates to the return on debt as a result of the adoption of a trailing average approach to determining the cost of debt.

Multinet's haulage reference tariffs are derived from the total revenue requirement after consideration of demand for each tariff category. This means the tariffs we determine (including the means of varying the tariffs from year to year) are the binding constraint across the 2018–22 access arrangement period, rather than the total revenue requirement set out in our decision.

Our draft decision on:

- Multinet's total revenue requirement is set out in the Overview of this draft decision
- the WACC annual adjustment is set out in attachment 3—Rate of return and X factors are discussed in the Overview attachment
- the services Multinet will offer to customers over the 2018–22 access arrangement period are set out in attachment 1—Services covered by the access arrangement
- the tariffs Multinet will charge for the provision of these services are set out in attachment 10—Reference tariff setting.

11.1.5 Reasons for draft decision

We do not approve Multinet's proposed revenue cap reference tariff variation mechanism for the 2018-22 access arrangement period.

Multinet's revenue cap proposal relied in part on the application of revenue caps to electricity distributors. However, the gas and electricity distribution sectors face very different circumstances justifying different tariff variation (or control) mechanisms. In this context, we discuss

- volume forecasting risk
- incentives between price caps and revenue caps.

In doing so, we contrast the circumstances facing Multinet to those facing electricity distribution service providers, and take into account the stakeholder feedback received by Multinet in respect of this issue, as set out by Multinet in its access arrangement proposal and in submissions.

Volume forecasting risk and incentives

Notwithstanding that for the current access arrangement period we accepted Multinet's forecasts Multinet appears to be placing an emphasis on removing the risk to it that the demand forecasts during 2018–22 are not realised.

Multinet set out in its access arrangement proposal details of its stakeholder engagement activities and described, at a high level, stakeholder feedback on specific issues. In respect of Multinet's proposed reference tariff variation mechanism, it indicated stakeholders provided:[5]

[5] Multinet, *2018 to 2022 Access Arrangement Information*, December 2016, p.22.

> General support for moving to a revenue cap given the difficulty in the AER accurately forecasting future demand, although retailers questioned whether a revenue cap provides appropriate incentives to grow demand.

In response to Multinet's access arrangement proposal, Origin Energy submitted that, while it understood the views articulated by Multinet, it was not convinced about changing to a revenue cap.[6] AGL also submitted its support for retaining a price cap because it provides greater customer certainty, aligns incentives for expenditure with network utilisation and is consistent with AGN and AusNet's approaches.[7]

We consider this retailer feedback raises a significant drawback with Multinet's proposal. Multinet set out its response to the above stakeholder feedback in its access arrangement proposal:[8]

> We propose changing our reference tariff variation mechanism for our Haulage Reference Services from a weighted average price cap to a revenue cap given the risk of the AER not accurately forecasting demand and therefore of us not recovering our efficient costs, consistent with the Revenue and Pricing Principles. We have a strong incentive to price our services as competitively as possible and to grow demand given that gas is a fuel of choice.

As explained below, we consider Multinet's statement that it would have a strong incentive to grow gas demand even under a revenue cap is problematic. In addition, while we accept that volume risk is a feature of price cap regulation, we have not identified that there is currently a problem with volume forecasting for Multinet. Multinet's assertion of the risks of the approved demand forecasts being inaccurate ignores that its demand forecasts have tended to be accepted and actual demand has been very close to forecast levels. By way of illustration, in its access arrangement proposal Multinet noted it expects less than a one per cent difference between its forecasts for the current period (which we accepted during the last reset) and its actual volumes.[9]

Multinet's statement above may have more foundation if considered only in the context of long term market trends relevant to multiple access arrangement periods, but it is not accurate in the short to medium term such as the upcoming access arrangement period. That is, gas network service providers such as Multinet would benefit from higher volumes in future so long as these were accurately forecast at the time of each successive reset. However, within the upcoming access arrangement period, Multinet would not, under a revenue cap, have an incentive to grow demand because it could not capture the revenue benefits attributable to increased volumes.

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6 Origin Energy, *Victorian Gas Access Arrangement Review 2018–22 - Response to Gas Distribution Business' proposals*, February 2017, p. 1.

7 AGL, *Re. Victorian GAAR proposals*, March 2017, p. 1.

8 Multinet, *2018 to 2022 Access Arrangement Information*, December 2016, p.23.

9 Multinet, *2018 to 2022 Access Arrangement Information*, December 2016, p.49.

The AER's Challenge Panel (CCP11) submitted the following in respect of Multinet's proposed revenue cap:[10]

> "The AER should consider consistency, as well as the risk assignment between the business and consumers when deciding whether Multinet's request for a revenue cap form of price control should be accepted."

We agree with CCP11 that the balance of risks between Multinet and consumers is a key factor in our decision on the type of control mechanism to apply during the access arrangement. To the extent that volume forecasting risk exists, we consider it should sit with the entity best able to manage that risk. Multinet is better able to address its volume forecasting risk than customers. Price cap regulation leaves forecasting risk with Multinet.

Under Multinet's proposed revenue cap, forecasting risk would sit with customers. That is, should actual volumes be lower than forecast, under a revenue cap customers would face higher per unit tariffs through which Multinet would recover its regulated revenues. Under a price cap, the risk of actual volumes being lower than forecast sits with Multinet which, we consider, has greater opportunity to address this risk by ensuring its forecasting approach is as robust as possible. Multinet is in a better position to do so than its customers.

Comparing Multinet's circumstances with the electricity distribution sector, gas consumption per customer at the distribution network level is in decline while electricity demand is driving increasing network costs. Multinet forecasts further declines in gas consumption over the upcoming access arrangement period. This contrasts with electricity consumption where demand management is a priority, particularly to ease peak demand pressures on network assets and therefore on network investment.

The revenue cap regulation applied to electricity distribution network service providers elicits greater incentives for demand management activities to be undertaken to manage peak demand. At this time, the gas distribution sector does not face equivalent demand pressures on assets. Rather, with steadily declining gas consumption the sector faces challenges to maintain and expand its customer base. A price cap approach provides greater incentives to gas distributors to maintain or expand gas consumption and thereby achieve scale efficiencies (reduce unit costs).

11.2 Changes to the weighted average price cap formula

11.2.1 Draft decision

Our draft decision is to make changes to the weighted average price cap formula within Multinet's current access arrangement.

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10 Consumer Challenge Panel (CCP11), *Response to proposals from AGN, AusNet and Multinet for the 2018-2022 Access Arrangements*, 3 March 2017, p. 85.

11.2.2 Multinet's proposal

Multinet did not propose a weighted average price cap formula because it proposed to switch to a revenue cap.

11.2.3 Assessment approach

We assess compliance with the price cap control formulae as part of the annual tariff variation mechanism and apply the assessment approach set out in section 11.1.3 above.

11.2.4 Reasons for draft decision

Our changes to Multinet’s proposed formula:

- reduce administrative burden
- remove adjustment mechanisms where provision for proposed costs has been made in Multinet's operating expenditure forecast
- make minor modifications to the mechanism to reflect those applied by other gas distributors.

Consumer price index

We have changed the timing of the CPI escalation adjustment from September quarter to June quarter to reduce the administrative burden that occurred by applying the approach as set out in Multinet's current access arrangement. The draft decision approach also allows greater transparency in the annual tariff variation proposal. We consider this approach is supported by Multinet as it proposed the same CPI escalation approach for its proposed revenue cap formula.[11]

Multinet's current access arrangement CPI escalation approach is calculated based on movements between annual September quarter CPI published by the Australian Bureau of Statistics (ABS). However, the September quarter CPI is typically released after Multinet is required to submit its annual tariff variation proposal—50 business days before the tariffs commence. Therefore, Multinet has had to either delay the submission of its proposal or submit a proposal with a 'placeholder' CPI until the actual CPI is known and then submit a supplementary proposal. This process is administratively inefficient.

To address this issue, our draft decision adopts a CPI calculation based on the movement between annual June quarter CPI movements. This approach allows the actual CPI escalation to be known prior to the submission of the annual tariff variation proposal. Therefore, Multinet can submit a completed proposal compliant with the timelines of its access arrangement which reduces the administrative burden of the current approach. Without the need to provide a placeholder or supplementary proposal will also allow greater

[11] Multinet, *2018 to 2022 Access Arrangement Information*, December 2016, p. 52.

transparency in the annual tariff variation proposal. Our draft decision approach to calculating CPI escalation is consistent with the approach undertaken by other gas and electricity distributors.

We are also aware that gas retailers require approximately six weeks to incorporate network tariff changes into their billing systems and to give adequate notice to stakeholders.[12] Our draft decision approach to calculating CPI escalation will ensure this can occur before the tariffs commence.

X factor adjustment

We accept Multinet's proposed X factor adjustment definition which has been revised to include annual revisions to reflect the updates to the return on debt as a result of the adoption of a trailing average approach to determining the cost of debt.[13] The annual update to the X factor in this manner is consistent with the X factor application by other gas and electricity distributors across jurisdictions.[14] Further discussion on this adjustment can be found in attachment 3—rate of return—which discusses the WACC annual adjustment and the Overview attachment—which details issues relating to X factors.

Licence fee factor adjustment

We do not accept provision in the weighted average price cap formula to adjust for annual costs relating to the annual license fees charged by the Essential Services Commission of Victoria. Multinet's current access arrangement included a licence fee factor to allow the pass through of these costs.[15]

Our draft decision has included in the operating expenditure forecast the annual costs relating to these licence fees. Therefore, our draft decision weighted average price cap formula has not included an adjustment for these costs as they are already provided for. Discussion on these cost elements can be found in attachment 7—operating expenditure.

Minor modifications

Our draft decision has also made minor modifications to the weighted average price cap formula to be consistent with the presentation of this formula as applied by other gas distribution networks. These amendments do not alter the application of the tariff variation mechanism. We consider consistency across distributors will assist stakeholder understanding of annual tariff variation mechanisms.

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12 For example, see: Origin Energy, *Submission on Australian Gas Networks (South Australia) access arrangement proposal 2016–21*, 10 August 2015, p. 7.

13 Multinet*, 2018 to 2022 Access Arrangement Information*, December 2016, p. 52.

14 NGR, r. 97(3)(d).

15 Multinet, 2013–17 access arrangement, Part B: Appendix 1, p. 38.

New proposed adjustments

We do not accept Multinet's proposed annual adjustments relating to incentive schemes and carbon emissions costs.

Incentive scheme adjustment

We do not accept inclusion in the tariff variation mechanism to adjust for additional incentive scheme payments as proposed by Multinet.[16] We do not consider Multinet will receive any of these type of payments over the 2018–22 access arrangement. Therefore, our draft decision weighted average price cap formula does not include an adjustment for these payments.

Carbon Emissions Costs

We do not accept provision in the tariff variation mechanism to adjust for currently unknown costs in connection with a carbon emission scheme.

Multinet seeks recovery of 'carbon emission costs', which it describes as 'costs paid by Multinet Gas in the financial year ending in June of regulatory year t-1 being costs incurred by the Service Provider under (including costs of purchasing Australian Carbon Credit Units) the "Carbon Safeguard Mechanism" applying under the National Greenhouse and Energy Reporting Act 2007 and any other costs incurred under Regulatory Instruments relating to carbon emissions.[17]

The safeguard mechanism requires the operators of certain facilities to keep carbon emissions below a baseline level. An emitter has a range of options for keeping their emissions down, including purchasing carbon credits and surrendering them to offset their emissions, or generating carbon credits by carrying out a project under the Emission Reduction Fund (ERF). Alternatively, an emitter can apply for their baseline to be changed (e.g. in response to increased demand), or seek a longer monitoring period to allow additional time to reduce emissions. An emitter can also seek an exemption in the case of a natural disaster or criminal activity.[18]

Multinet is subject to the NGER Act in respect of its Victorian distribution system. If it appears that emissions are likely to exceed the threshold, Multinet would need to decide whether to purchase and surrender carbon credits, generate carbon credits under the ERF, or pursue one of the additional options in the NGER Act.

Multinet has not established that the alternatives to purchasing carbon credits are unavailable or inapplicable to Multinet. Aside from carbon credits, the safeguard mechanism incentivises carbon emitters to reduce emissions through operational measures. Carbon emitters may also seek a lower emission benchmark or a longer reporting period to prevent an excess emission situation from arising. The service provider is far better placed than its

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16 Multinet, *2018 to 2022 Access Arrangement Information*, December 2016, p. 51.

17 Multinet, *2018 to 2022 Access Arrangement Information*, December 2016, p. 52.

18 http://www.cleanenergyregulator.gov.au/NGER/The-safeguard-mechanism, accessed 23 May 2017.

customers to identify the least cost option (or combination of options) to ensure compliance with the NGER Act safeguard mechanism. It would have little incentive to seek out the least cost option if we approved its proposed NGER pass through as it could simply pass these costs through to customers.

Our draft decision for Multinet's annual reference tariff variation mechanism is set out in figure 11.1.

Figure 11.1 Annual haulage reference tariff variation formula

$$(1+\Delta CPI_t)(1-X_t)(1+PT_t) \geq \frac{\sum_{i=1}^{n}\sum_{j=1}^{m} p_t^{ij} q_{t-2}^{ij}}{\sum_{i=1}^{n}\sum_{j=1}^{m} p_{t-1}^{ij} q_{t-2}^{ij}}$$

where:

ΔCPI_t is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities from the June quarter in year t-2 to the June quarter in year t-1, calculated using the following method:

> The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the June quarter in year t-1
>
> divided by
>
> The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the June quarter in year t-2
>
> minus one.

If the ABS does not, or ceases to, publish the index, then CPI will mean an index which the AER considers is the best available alternative index.

t is the year for which tariffs are being set.

X_t is the X factor for each year of the 2018–22 access arrangement period as determined in the PTRM as approved in the AER's final decision, and annually revised for the return on debt update calculated for the relevant year during the access arrangement period in accordance with that approved in the AER's final decision

PT_t is the cost pass through factor for year t calculated as outlined in figure 11.3

n is the number of different reference tariffs

m is the different components, elements or variables ("components") comprised within a reference tariff

p_t^{ij} is the proposed component j of reference tariff i in year t

p_{t-1}^{ij} is the prevailing component j of reference tariff i in year t-1

q_{t-2}^{ij} is the audited quantity of component j of reference tariff i that was sold in year t-2 (expressed in the units in which that component is expressed (e.g. GJ)).

Rebalancing control formula

We do not accept Multinet's proposal to increase the rebalancing constraint from two per cent to ten per cent.[19] Multinet provided no justification for the proposed increase.

Red Energy and Lumo Energy submitted that proposed rebalancing constraint increases may lead to significant price increases.[20]

We agree that the proposed increase in the rebalancing constraint could lead to increased price volatility and potential price shocks to consumers during the access arrangement period. Allowing for such outcomes is not consistent with the national gas objective (NGO).[21] Such volatility and price shocks would create uncertainty for downstream users. That in turn, may be detrimental to the efficient investment in, and utilisation of pipeline assets, which would be contrary to the revenue and pricing principles (RPP).[22] A reference tariff control should preferably result in a price path with a reasonable degree of certainty and predictability.

We also note the proposed increase in the rebalancing constraint is inconsistent with Multinet's current arrangements, the arrangements for the other Victorian gas distributors, and our recent decisions for the Queensland and South Australia gas distributors. We consider consistency in regulatory approaches across distributors and jurisdictions to be desirable.[23] Consistency leads to reduced complexity and administrative burden for us and other stakeholders and assists customers and other interest groups to understand the operation of tariff variation mechanisms.

We therefore consider that a rebalancing constraint of two per cent is appropriate for the 2018–22 access arrangement period.

We have also made the two per cent explicit in the rebalancing control formula rather than the current access arrangement's Y factor. We have done this to be consistent with the presentation of this adjustment in the rebalancing control mechanisms applied by other gas distributors. Consistent approaches across distributors will assist stakeholder understanding of annual tariff variation mechanisms.

Our draft decision formula for rebalancing control is set out in figure 11.2.

19 Multinet, *2018 to 2022 Access Arrangement Information*, December 2016, p. 53.

20 Red Energy and Lumo Energy, *Australian Gas Networks Access Arrangement*, 6 March 2017, p. 3.

21 NGL, s. 23.

22 NGL, s. 24(3)(c).

23 NGR, r. 97(3)(d).

Figure 11.2 Rebalancing control formula

$$(1+\Delta CPI_t)(1-X_t)(1+PT_t)(1+0.02) \geq \frac{\sum_{i=1}^{n}\sum_{j=1}^{m} p_t^{ij} q_{t-2}^{ij}}{\sum_{i=1}^{n}\sum_{j=1}^{m} p_{t-1}^{ij} q_{t-2}^{ij}} \qquad i=1,...n.$$

ΔCPI_t is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities from the June quarter in year t-2 to the June quarter in year t-1, calculated using the following method:

> The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the June quarter in year t-1
>
> divided by
>
> The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the June quarter in year t-2
>
> minus one.

If the ABS does not, or ceases to, publish the index, then CPI will mean an index which the AER considers is the best available alternative index.

t is the year for which tariffs are being set.

X_t is the X factor for each year of the 2018–22 access arrangement period as determined in the PTRM as approved in the AER's final decision, and annually revised for the return on debt update calculated for the relevant year during the access arrangement period in accordance with that approved in the AER's final decision.

PT_t is the cost pass through factor for year t calculated as outlined in figure 11.3

n is the number of different reference tariffs

m is the different components, elements or variables ("components") comprised within a reference tariff

p_t^{ij} is the proposed component j of reference tariff i in year t

p_{t-1}^{ij} is the prevailing component j of reference tariff i in year t-1

q_{t-2}^{ij} is the audited quantity of component j of reference tariff i that was sold in year t-2 (expressed in the units in which that component is expressed (e.g. GJ)).

Pass through factor formula

We have included in the reference tariff variation mechanism formula a pass through adjustment factor consistent with that applied to other gas distribution networks.

Inclusion of an adjustment factor to accommodate AER approved cost pass through events enables a simple and transparent method for cost recovery and pass through of these costs to customers. The pass through adjustment factor formula is set out in figure 11.3.

Figure 11.3 Pass through adjustment factor formula

$$PT_t = \frac{(1+PT'_t)}{(1+PT'_{t-1})} - 1$$

where:

t is the year for which tariffs are being set

PT_t is:

(a) zero when financial year t–1 refers to year 2018

(b) the value of PT'_t determined in the year t-1 for all other years in the access arrangement period

and

$$PT'_t = \frac{AP_t}{(1+\Delta CPI_t)(1-X_t)\sum_{i=1}^{n}\sum_{j=1}^{m} p_{t-1}^{ij} q_{t-2}^{ij}}$$

where

AP_t is:

(a) any determined pass through amount that the AER approves in whole or part in year t; and/or

(b) any pass through amounts arising from pass through events (as that term is defined in the access arrangement applying to Multinet in the immediately prior access arrangement period) occurring in the immediately prior access arrangement period that Multinet proposes to pass through in whole or in part in year t,

that includes an amount to reflect the time value of money between incurring the costs and recovering the costs, and excludes any amounts already passed through in reference tariffs.

ΔCPI_t is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities from the June quarter in year t-2 to the June quarter in year t-1, calculated using the following method:

The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the June quarter in year t-1

divided by

The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the June quarter in year t-2

minus one.

If the ABS does not, or ceases to, publish the index, then CPI will mean an index which the AER considers is the best available alternative index.

X_t means the X factor for each year of the 2018–22 access arrangement period as determined in the PTRM as approved in the AER's final decision, and annually revised for the return on debt update calculated for the relevant year during the access arrangement period in accordance with that approved in the AER's final decision.

p_{t-1}^{ij} is the prevailing component j of reference tariff i in year t-1

q_{t-2}^{ij} is the audited quantity of component j of reference tariff i that was sold in year t-2 (expressed in the units in which that component is expressed (e.g. GJ).

Ancillary reference tariff variation formula

We accept the proposed annual ancillary reference tariff variation formula which is consistent with that of the current access arrangement. These tariffs will be adjusted each year by the movement in CPI. Our draft decision ancillary reference tariff variation formula is set out in figure 11.4.

Figure 11.4 Ancillary reference tariff variation formula

$$ART_t = ART_{t-1} \times (1 + \Delta CPI_t)$$

where:

t is the year for which tariffs are being set

ART_t is the reference tariff that will apply to an ancillary reference service in year t

ART_{t-1} is the reference tariff applicable to an ancillary reference service in year t-1

ΔCPI_t is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities from the June quarter in year t-2 to the June quarter in year t-1, calculated using the following method:

The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the June quarter in year t-1

divided by

The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the June quarter in year t-2

minus one.

If the ABS does not, or ceases to, publish the index, then CPI will mean an index which the AER considers is the best available alternative index.

11.3 Cost pass through mechanism

The cost pass through mechanism allows us to vary reference tariffs following the occurrence of a specified event which materially increases or decreases the cost of providing the reference service. The inclusion of a pass through mechanism recognises a service provider can be exposed to risks beyond its control, which may have a material impact on costs.

11.3.1 Draft decision

We accept:

- Multinet’s proposed process for notifying and seeking approval of a pass through amount
- the Change in Taxes Event
- deletion of the Mains Replacement Event
- the Disaster Event, Insurance Cap Event, Insurer Credit Risk Event, Regulatory Change Event, Retailer Insolvency Event, Service Standard Event, and Terrorism Event, but require Multinet to amend the definitions as set out in Table 11.1

We do not approve the Major Upstream Failure Event or the National Energy Customer Framework (NECF) Event.

11.3.2 Multinet's proposal

Under its proposal Multinet has 90 days from the occurrence of a pass through event to submit a pass through application. Notification is mandatory for events that decrease costs and optional for events that increase costs. The costs of the event must be notified as soon as they are known or can reasonably be estimated. The access arrangement provides that we will notify Multinet of our decision within 90 days, though we may extend assessment period for complex applications[24].

Multinet proposed the following pass through events:

- Change in Taxes Event
- Disaster Event
- Insurance Cap Event
- Insurer Credit Risk Event
- Major Upstream Failure Event
- NECF Event
- Regulatory Change Event
- Retailer Insolvency Event
- Service Standard Event
- Terrorism Event.

All of these events are in the current access arrangement except for the Retailer Insolvency Event and the Major Upstream Failure Event. Multinet also proposed to delete the Mains Replacement Event which is in the current access arrangement.

Multinet proposed a materiality threshold of one per cent of annual revenue for all events except the NECF Event and the Retailer Insolvency Event, for which it proposed no materiality threshold. Multinet also proposed that for the Change in Taxes Event and the Major Upstream Failure Event, reductions in revenue are to be counted as costs for the purposes of applying the definition of materiality.[25]

11.3.3 Assessment approach

The NGR state that a reference tariff variation mechanism may provide for the variation of a reference tariff:[26]

> as a result of a cost pass through for a defined event (such as a cost pass through for a particular tax).

As a component of the reference tariff variation mechanism, a cost pass through mechanism must be assessed having regard to the matters in rule 97(3)[27] of the NGR and must give us adequate oversight and power to approve reference tariff variations.[28]

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[24] Multinet, 2018-22 Access Arrangement Part B, December 2016, clause 8.

[25] Multinet Gas, *2018 to 2022 Access Arrangement Information*, December 2016, p. 145.

[26] NGR, r. 97(1)(c)

[27] In summary: efficient reference tariff structures; administrative costs; prior regulatory arrangements; consistency between regulatory arrangements; any other relevant factor.

We must approach this assessment in a manner likely to contribute to the achievement of the National Gas Objective (NGO),[29] which states that the purpose of the NGL is to promote efficient investment, operation and use of natural gas services for the long term interest of consumers with regard to price, quality, safety and security of supply.[30]

In addition, we must take into account the Revenue and Pricing Principles (RPPs) whenever we exercise discretion in approving or making those parts of an access arrangement relating to a reference tariff.[31] The RPPs state that the service provider should be provided with a reasonable opportunity to recover at least the efficient costs incurred in providing reference services and complying with a regulatory obligation or requirement.[32] They also provide incentives to promote economic efficiency.[33] Together, the RPPs 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.[34]

In the context of pass through events, the RPPs require us to have particular regard to the impact on price, quality, safety, 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.[35]

Our decision on the cost pass through mechanism includes a decision on what categories of event to approve.[36] In approaching this part of our task we also take into account the following considerations:[37]

- whether the type of event is covered by another category of pass through event;
- whether the nature or type of event can be clearly identified at the time the access arrangement is approved 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

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28 NGR, r. 97(4).

29 NGL, s. 28(1)(a).

30 NGL, s. 23.

31 NGL, s. 28(2)(a).

32 NGL, s. 24(2).

33 NGL, s. 24(3).

34 NGL, s. 24(6).

35 NGL, s. 23; See also AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination,* 2 August 2012, Sydney, p. 6.

36 NGR, r. 97(1)(c).

37 NGR, r. 97(3)(e).

- 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.

These considerations appear in the National Electricity Rules (NER), where they guide the regulator's decision on whether to approve additional categories of pass through event beyond those already included in the NER.[38] We consider they are consistent with the factors referred to in NGR (r. 97(3)), and pertinent to our examination of the degree to which a proposed category of event is likely to contribute to the achievement of the NGO.[39]

The Australian Energy Market Commission (AEMC) described the purpose of these considerations as:

> to incorporate and reflect the essential components of a cost pass through regime. 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.[40]
>
> 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.[41]

We consider that viewing pass throughs as a 'last resort' and accepting them only when event avoidance, mitigation and avoidance are unavailable, is consistent with the RPPs and will contribute to the achievement of the NGO. This approach maintains the incentives on service providers to use market based mechanisms to mitigate the cost impacts that would arise if the event is triggered.[42] In turn, this promotes the efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers with respect to price.[43]

We also look to promote consistency in our approach to pass through categories across our electricity determinations and gas access arrangements.[44]

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[38] NER, cll. 6.5.10(b), 6A.6.9(b); NER Chapter 10: Glossary, definition of 'nominated pass through event considerations'.

[39] NGR, r. 100(1).

[40] AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination,* 2 August 2012, Sydney, p. 19.

[41] AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination,* 2 August 2012, Sydney, p. 20.

[42] NGL, s. 24(3); AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination,* 2 August 2012, Sydney, p. 8.

[43] NGL, s. 23; AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination,* 2 August 2012, Sydney, p. 8.

[44] See NGR r. 97(3)(d).

11.3.4 Interrelationships

Tariffs are derived from the total revenue requirement after consideration of demand for each tariff category. Our draft decision is that Multinet will continue to operate under a weighted average tariff cap. This means the tariffs we determine (including the means of varying the tariffs from year to year) are the binding constraint across the 2018–22 access arrangement period, rather than the total revenue requirement set in our decision.[45] Except as provided by a reference tariff variation mechanism, a reference tariff is not to vary during the course of an access arrangement period.[46]

In assessing and approving a reference tariff variation mechanism, we consider the potential impact of the proposed mechanism on the service provider's incentives under the access arrangement to operate its network—and manage its risks—in a manner consistent with the NGO and RPPs.[47]

The pass through component of the reference tariff variation mechanism is also interrelated with other parts of this decision, in particular with the forecast opex[48] and capex[49] and rate of return[50] included in our forecast revenue requirement. These interrelationships require us to balance the incentives in the various parts of our decision.

Pass through events are one way, but not the only way, in which service providers can manage their risks under an access arrangement. 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 forecast revenue requirement 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 an access arrangement, we only accept pass through events where we are satisfied that event avoidance, mitigation,

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45 Where actual demand across the 2018–22 access arrangement period varies from the demand forecast in the access arrangement, Multinet's actual revenue will vary from the revenue allowance determined in our decision. In general, if actual demand is above forecast demand, Multinet's actual revenue will be above forecast revenue, and vice versa.

46 NGR, r. 97(5).

47 NGL, ss. 23, 24.

48 See Attachment 7 (Operating expenditure) to this draft decision.

49 See Attachment 6 (Capital expenditure) to this draft decision.

50 See Attachment 3 (Rate of return) to this draft decision.

commercial insurance and self-insurance under approved forecasts of prudent and efficient opex and capex are either unavailable or inappropriate.[51]

For smaller expenditure a service provider should generally utilise its existing expenditure allowance or reprioritise its work program rather than seeking approval of a pass through.[52] This is reflected in the materiality threshold that applies to applications for cost pass through under the approved access arrangement.[53]

Cost pass through amounts approved in an access arrangement period are added to forecast opex for the purpose of calculating efficiency carryover amounts under the efficiency carryover mechanism in the approved access arrangement.[54]

11.3.5 Reasons for draft decision

Pass through process

Our draft decision is to approve Multinet's process for notifying and seeking approval of a cost pass through.

The proposal is substantially identical to the process in Multinet's current access arrangement. We remain satisfied that it provides us sufficient capacity to oversee and decide on a pass through proposal in light of the NGO, RPPs and the considerations identified above.

Change in taxes event

Our draft decision is to accept the proposed Change in Taxes Event.

The Change in Taxes Event was proposed to allow pass through of cost changes resulting from the change, removal or imposition of a relevant tax applying to its distribution network.[55] The proposed definition is consistent with the definitions approved in our recent decisions[56] and with the equivalent prescribed event that applies to electricity distributors under the NER.[57] We consider it meets the criteria in our assessment approach. It would not be

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51 This is consistent with the AEMC's conclusions in its review of the NER pass through arrangements. See: AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination,* 2 August 2012, Sydney, pp. 19–20.

52 This is consistent with the AEMC's conclusions in its review of the NER pass through arrangements. See: AEMC 2012, *Economic Regulation of Network Service Providers, and Price and Revenue Regulation of Gas Services, Final Rule Determination*, 29 November 2012, Sydney, p. 186.

53 AER, *Approved Access Arrangement for the Amadeus Gas Pipeline - 1 July 2016 to 30 June 2021*, May 2016, cl. 4.7.3, Definition of 'materiality threshold'.

54 AER, *Approved Access Arrangement for the Amadeus Gas Pipeline - 1 July 2016 to 30 June 2021*, May 2016, cl. 8.1(i); See Attachment 9 (Efficiency carryover mechanism) to this draft decision.

55 Multinet Gas, *2018–22 Access Arrangement Part A*, December 2016, p. 17.

56 See AER, *Final Decision for Amadeus Gas Pipeline Access Arrangement 2016 to 2021, Attachment 11 –Reference tariff variation mechanism*, May 2016, p. 11–19. AER, *Final Decision for Australian Gas Networks Access Arrangement 2016 to 2021, Attachment 11 –Reference tariff variation mechanism*, May 2016, p.11-33.

57 NER, cl. 6.6.1(a1)(3).

covered by another category, the nature or type of event can be clearly identified and Multinet Gas often has limited ability to prevent or mitigate the event.

However, we require Multinet to remove the associated clause in its access arrangement that extends the operation of this event by providing that references to costs in its definition of the event will be read as references to the reduced revenue due to that Change in Taxes Event.[58] While we accepted this clause in Multinet's current 2013–17 access arrangement, on further review, we consider there is no longer a basis for treating Multinet differently to other network service providers in respect of this event. Rather, we consider common treatment of common risks to be preferable to individual variations between access arrangements.

Disaster event

Our draft decision is to accept this event in part, but we require Multinet to revise the definition as set out in Table 1.1 below, and to change the name to 'Natural Disaster Event', which is in keeping with these changes.

While Multinet's submission stated that its Disaster Event is consistent with its current access arrangement,[59] the new definition added three additional classes of disaster that considerably extend its scope, namely:[60]

- pandemic or plague
- major civil disturbances
- acts of war (but excluding any terrorism event).

Multinet's proposal does not provide any argument in support of these changes.

In other decisions we have approved Natural Disaster Events consistent with the Disaster event in Multinet's current (2013–17) access arrangement. [61] We remain satisfied that this is appropriate and our draft decision approves the inclusion of an equivalent Natural Disaster event for Multinet for its 2018–22 access arrangement.

Our draft decision does not approve the three extensions Multinet has proposed to this event. We consider they are not defined and are uncertain as to scope. On the information before us it is not clear what are the defined risks. Nor has the case been made that those risks cannot be mitigated or insured against.

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58 Multinet Gas - 22.3 - Access Arrangement Part B Reference Tariff and Reference Tariff Policy - Clean - 20161215 – PUBLIC, page. 25.

59 Multinet Gas, *2013–17 access arrangement for the Multinet Gas Distribution System*, 29 April 2013, p.18.

60 Multinet Gas, *2018–22 Access Arrangement Part A*, December 2016, p. 19.

61 See AER, *Final Decision for ActewAGL Distribution Access Arrangement 2016 to 2021, Attachment 11 –Reference tariff variation mechanism*, May 2016, p. 11-40. AER, *Final Decision for Amadeus Gas Pipeline Access Arrangement 2016 to 2021, Attachment 11 –Reference tariff variation mechanism*, May 2016, p.28. AER, *Final Decision for Australian Gas Networks Access Arrangement 2016 to 2021, Attachment 11 –Reference tariff variation mechanism*, May 2016, p.11-33.

Accordingly we require Multinet to amend this event name and definition as set out in Table 1.1, to align with the Natural Disaster Event approved in our recent decisions.

Insurance cap event

Our draft decision is to approve the Insurance Cap Event, amended as set out in Table 1.1 below.

Multinet's proposed Insurance Cap Event is identical to the event in its current access arrangement. It is intended to allow pass through of costs incurred where the service provider makes a claim on an insurance policy for costs beyond the relevant policy limit.[62]

We remain satisfied it is appropriate to include an Insurance Cap Event in Multinet's access arrangement for 2018–22. However we require Multinet to amend the definition as set out in Table 1.1, to delete subclause (d) from the definition – this was not included in our recent decisions as it does not align with the determination of the opex forecast. Our amendments also align the definition with the corresponding event approved in our recent determinations.

Insurer credit risk event

Our draft decision is to approve the Insurer Credit Risk Event, with the amendments set out in Table 1.1 below.

Multinet's proposed definition covers the following costs incurred as a result of its insurer becoming insolvent:

- materially higher or lower insurance premiums
- materially higher or lower claim limit or deductible
- additional costs associated with self-funding an insurance claim.[63]

Generally, we consider it appropriate to include an event of this nature in the access arrangement. Despite a service provider's efforts to take precautions to mitigate an insurer credit risk event,[64] it may be exposed to circumstances beyond its control. We accept the options available to service providers to manage these risks are limited, and given the rarity of such events, may in fact result in greater expenditure on insurance than is prudent or efficient. Where a pass through event is approved for multiple service providers to address the same risk, we also consider it preferable that the event be defined consistently.[65]

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[62] Multinet Gas, *2018–22 Access Arrangement Part A*, December 2016, pp. 24–25.

[63] Multinet Gas, *2018–22 Access Arrangement Part A*, December 2016, p. 25.

[64] For example by investigating market development, insurer reputation and credit rating and financial stabilities of potential insuring entities.

[65] NGR, r. 97(3)(d).

However, Multinet's proposed definition, though consistent with that in its current access arrangement[66] is, in two respects, broader than the corresponding event that we have approved in our recent gas decisions.[67]

First, Multinet's definition would allow pass through of costs associated with changes to insurance premiums as a result of an insurer becoming insolvent. After further review, we no longer consider this appropriate. Insurance premiums are a typical business expense, subject to ordinary market factors in the economy. This is a risk businesses are best placed to manage, rather than customers. This view is consistent with our approach in recent decisions.[68]

Second, our recent decisions have confined the scope of this event to costs that are specific to an existing or potential claim against a failed insurer.[69] Multinet's proposed definition does not include that limitation. Without this limitation there may be an incentive for service providers to delay the purchase of alternative insurance, thereby transferring the risk of insurable events to customers.

We therefore require that Multinet amend its definition to reflect the above.

Major upstream failure event

Our draft decision is not to accept the Major Upstream Failure Event.

The proposed event is as follows:[70]

66 Multinet Gas, *Access Arrangement 2013–2017, Part A of the Access Arrangement for the Distribution System*, 29 April 2013, p.21.

67 See AER, *Draft decision for ActewAGL Distribution Access Arrangement 2016 to 2021, Attachment 11 –Reference tariff variation mechanism*, November 2015, p.11–29. AER, *Final Decision for ActewAGL Distribution Access Arrangement 2016 to 2021, Attachment 11 –Reference tariff variation mechanism*, May 2016, pp. 11-38 and 11-39. AER, *Draft Decision for Amadeus Gas Pipeline Access Arrangement 2016–21, Attachment 11–Reference tariff variation mechanism*, November 2015, *p*. 11–22. AER, *Final Decision for Amadeus Gas Pipeline Access Arrangement 2016 to 2021, Attachment 11 –Reference tariff variation mechanism*, May 2016, p.26. AER, *Draft Decision for Australian Gas Networks Access Arrangement 2016 to 2021, Attachment 11 –Reference tariff variation mechanism*, November 2015, p.11-29. AER, *Final Decision for Australian Gas Networks Access Arrangement 2016 to 2021, Attachment 11 –Reference tariff variation mechanism*, May 2016, p.11-32.

68 See AER, *Draft decision for ActewAGL Distribution Access Arrangement 2016 to 2021, Attachment 11 –Reference tariff variation mechanism*, November 2015, p.11–29. AER, *Draft Decision for Amadeus Gas Pipeline Access Arrangement 2016–21, Attachment 11–Reference tariff variation mechanism*, November 2015, *p*. 11–22. AER, *Draft Decision for Australian Gas Networks Access Arrangement 2016 to 2021, Attachment 11 –Reference tariff variation mechanism*, November 2015, p.11-29.

69 See AER, *Final Decision for ActewAGL Distribution Access Arrangement 2016 to 2021, Attachment 11–Reference tariff variation mechanism*, May 2016, pp. 11-38 and 11-39. AER, *Final Decision for Amadeus Gas Pipeline Access Arrangement 2016 to 2021, Attachment 11–Reference tariff variation mechanism*, May 2016, p.26. AER, *Final Decision for Australian Gas Networks Access Arrangement 2016 to 2021, Attachment 11 –Reference tariff variation mechanism*, May 2016, p.11-32.

70 Multinet Gas, *2018 to 2022 Access Arrangement Part A*, December 2016, p. 25.

> **Major Upstream Failure Event** means a failure of, or event affecting (including without limitation fire, explosion or major mechanical failure), the Transmission System or any production facility upstream of the Transmission System which:
>
> (a) results in or necessitates a material curtailment in the quantities of Gas able to be Supplied by the Service Provider to Customers; or
>
> (b) would have resulted in or necessitated such a material curtailment but for steps taken by the Service Provider to overcome or mitigate the impact on Customers (for example the trucking or injection into the Distribution System of CNG or LNG),
>
> (but excluding those events for which external insurance or self-insurance has been included within the Service Provider's forecast operating expenditure for the relevant Access Arrangement period) that occurs during the Access Arrangement period and that causes an inability for the Service Provider to recover the building block costs which make up its total revenue allowance or which Materially increases the costs to the Service Provider of providing Reference Services (including without limitation because of the need to undertake repairs to the Distribution System or because the Service Provider incurs costs in sourcing replacement supplies of Gas or substitute supplies for Gas).

Multinet submitted the Major Upstream Failure Event should be included because:

- it is not covered by another category of event
- it is beyond Multinet's capacity to control such rare and potentially catastrophic events
- the event is not covered under Multinet's self-insurance allowance
- the cost of insuring or including in forecasts such events would be prohibitive and would not be consistent with the pricing principles in the NGL
- this event results in material increases in costs incurred by Multinet in providing haulage reference services.

Multinet also submitted this event is consistent with the natural disaster event and the terrorism event.[71]

We consider the proposed Major Upstream Failure Event is too broadly defined and is uncertain in its scope of operation. It is unknown what type of events might be covered. Accordingly we cannot assess whether the cost impacts of such occurrences are better managed by a service provider or its customers, nor the degree to which those costs can be prevented or mitigated.

Moreover, the Major Upstream Failure Event would allow recovery of a revenue shortfall caused by curtailment in the quantities of gas available for Multinet to deliver to customers.

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[71] Multinet Gas, *2018 to 2022 Access Arrangement Information*, December 2016, pp. 144–145.

In our recent decisions we have not accepted pass through events of this nature.[72] Accepting this pass through event would weaken a service provider's incentives to mitigate the risk, and minimise the costs, of a gas shortfall. The service provider is best placed to manage this risk. Adequate gas supply is fundamental to a service provider's business. Properly managing the risk of low supply is vital for the service provider to be an effective gas distributor. Therefore, we consider managing this risk is a typical business expense, and should not be passed through to consumers

National Energy Customer Framework event

Our draft decision is not to approve the NECF Event.

The NECF Event covers certain costs associated with the introduction of the NECF in Victoria.[73] Multinet proposed that the materiality threshold not apply to the NECF Event.[74]

We approved a NECF Event in Multinet's current access arrangement. However, on further review, we consider any cost adjustments caused by a future implementation of the NECF in Victoria would likely be covered by the Regulatory Change Event and/or the Service Standard Event.

This is consistent with our recent electricity distribution determination for United Energy.[75] It also puts Multinet in the same position regarding any future transition to the NECF as network businesses in other jurisdictions that have adopted the NECF, where that transition was managed in the same way as other regulatory changes, including as to the operation of the materiality threshold.[76]

Regulatory change event and service standard event

Our draft decision is to approve these events with the amendments set out in Table 1.1 below.

The Regulatory Change Event is intended to cover the costs associated with unforeseen changes in regulatory obligations in the 2018–22 access arrangement period.[77] The Service Standard Event covers cost increases and decreases caused by legislative or administrative changes affecting service standards and other aspects of reference services. The definition of both events is unchanged from Multinet's current access arrangement.

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[72] AER, *Draft decision: ActewAGL Distribution Access Arrangement 2016-21, Attachment 11 – Reference tariff variation mechanism,* p. 37; AER, *Final decision: Jemena Gas Networks 2015–20, Attachment 11 – Reference tariff variation mechanism*, pp. 24–25.

[73] Multinet Gas, *2018 to 2022 Access Arrangement Part A*, December 2016, p. 26.

[74] Multinet Gas, *2018 to 2022 Access Arrangement Information*, December 2016, p.143.

[75] AER, *Preliminary decision: United Energy distribution determination 2016-2020,* pp. 18-19.

[76] See AER, *Final Decision for AusNet Services distribution determination 2016 to 2020, Attachment 15–Pass Through Events,* May 2016, p.15–10.

[77] Multinet Gas, *2018 to 2022 Access Arrangement Information*, December 2016, p.140.

Both of these events meet the criteria in our assessment approach. They would not be covered by another category, the nature or type of event can be clearly identified and Multinet often has limited ability to prevent or mitigate the event.

However, we require the following amendments to bring the definitions into line with our recent decisions[78] and the equivalent prescribed events that applies to electricity distribution networks under the NER:[79]

- For Regulatory Change Event - add the word 'substantially' before the phrase 'affects the manner in which the Service Provider provides Reference Services'
- For Service Standard Event - add the word 'substantially' before the phrase 'altering […] the manner in which the service provider is required to provide a reference service'.

Retailer insolvency event

Our draft decision is to approve the Retailer Insolvency Event, amended as set out in Table 1.1 below, and to require deletion of the redundant Financial Failure of Retailer Event.

Multinet proposed this event to pass through additional costs it incurs or is unable to recover from a retailer due to the retailer becoming insolvent. It also covers certain costs arising from a Retailer of Last Resort Event, upon the NERL applying in Victoria.[80] Multinet proposed that no materiality threshold to apply to this event.[81]

Including an event of this type in the access arrangement for the 2018–22 period will place Multinet in a similar position to gas distributors in NECF jurisdictions. Rule 520 of the NGR, which does not apply in Victoria because the NECF has not taken effect in Victoria, provides for the pass through of certain costs incurred by a distributor when a retailer becomes insolvent.

We approved an event dealing with retailer insolvency in the recent determinations for the five Victorian electricity distribution network service providers. In those determinations we defined the pass through event to refer directly to the equivalent pass through event applying in the NECF jurisdictions.[82]

Referring directly to the NECF pass through event is also appropriate for the Victorian gas distributors' access arrangements. It ensures close alignment with the risk allocation in NECF jurisdictions, including as to the scope of the event. It is also drafted to ensure any

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78 See AER, *Draft decision for ActewAGL Distribution Access Arrangement 2016 to 2021, Attachment 11 –Reference tariff variation mechanism*, November 2015, p.11–24. AER, *Draft Decision for Amadeus Gas Pipeline Access Arrangement 2016–21, Attachment 11–Reference tariff variation mechanism*, November 2015, *p.* 11–18. AER, *Draft Decision for Australian Gas Networks Access Arrangement 2016 to 2021, Attachment 11 –Reference tariff variation mechanism*, November 2015, p.11-23.

79 NER, cl. 6.6.1(a1) (1), (2).

80 Multinet Gas, *2018 to 2022 Access Arrangement Information*, December 2016, p.143.

81 Multinet Gas, *2018 to 2022 Access Arrangement Information*, December 2016, p. 145.

82 E.g. AER, Final Decision for United Energy Distribution Determination 2016 to 2020, Attachment 15–Pass Through Events, May 2016, p.15–09.

changes to the NGR prescribed retailer insolvency event during the access arrangement period will apply consistently to Victorian gas distributors as they take effect.

Multinet's proposed access arrangement includes a definition for 'Financial Failure of a Retailer Event', dealing with similar subject matter to the Retailer Insolvency Event.[83] The Financial Failure of a Retailer Event is not a 'relevant pass through event' according to the definition in the access arrangement, and the term is not used anywhere in the access arrangement.[84] Accordingly we require Multinet to delete the definition of 'Financial Failure of a Retailer Event'.

Terrorism event

Our draft decision is to approve the Terrorism Event, amended as set out in Table 1.1.

Multinet's proposed definition is unchanged from the current access arrangement. We remain satisfied that this is appropriate, although we require the amendment in Table 1.1 to align it more closely with the event approved in our recent decisions.[85]

11.4 Revisions

We require the following revisions to make the access arrangement proposal acceptable:

Revision 11.1: Amend Part B - Reference Tariffs and Reference Tariff Policy of Multinet's proposed access arrangement to be consistent with the current weighted average price cap reference tariff variation mechanism.

Revision 11.2: Replace the definitions of the following cost pass through events with those set out in section 11.2.5 of this attachment: disaster event, credit risk event, regulatory change event, retailer insolvency event, terrorism event.

Revision 11.3: Remove the term "financial failure of a retailer event" from Part A of the proposed 2018–22 access arrangement as this term is not referred to elsewhere in the proposed access arrangement.

Revision 11.4: Amend the pass through events as set out in Table 11.1

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[83] Multinet, *Access Arrangement Part A – Principal Arrangements,* p. 21.

[84] Multinet, *Response to AER Information Request 25,* 12 May 2017.

[85] See AER, *Draft decision for ActewAGL Distribution Access Arrangement 2016 to 2021, Attachment 11 –Reference tariff variation mechanism*, November 2015, p.11–30. AER, *Draft Decision for Amadeus Gas Pipeline Access Arrangement 2016–21, Attachment 11– Reference tariff variation mechanism*, November 2015, *p.* 11–19. AER, *Draft Decision for Australian Gas Networks Access Arrangement 2016 to 2021, Attachment 11 –Reference tariff variation mechanism*, November 2015, p.11-26.

Table 1.1 – Pass through amendments

Reference	AER required amendment
Part A – Principal Arrangements Schedule 2 – Access Arrangement Glossary	
	~~**Disaster Event** means any:~~ ~~(a) major fire, flood, earthquake or other natural disaster;~~ ~~(b) pandemic or plague;~~ ~~(c) major civil disturbances;~~ ~~(d) acts of war (but excluding any Terrorism Event),~~ ~~(but excluding those events for which external insurance or self-insurance has been included within the Service Provider's forecast operating expenditure for the relevant Access Arrangement period) that occurs during the Access Arrangement period and Materially increases the costs to the Service Provider of providing Reference Services (including without limitation because of the need to undertake repairs to the Distribution System).~~ **Natural Disaster Event** means: Any natural disaster including but not limited to fire, flood or earthquake that occurs during the access arrangement period and increases the costs to the Service Provider in providing the Reference Service, provided the fire, flood or other event was not a consequence of the acts or omissions of Multinet Gas. Note for the avoidance of doubt, in making a determination on a Natural Disaster Event, the AER will have regard to, amongst other things: (a) whether the Service Provider has insurance against the event, and

Reference	AER required amendment
	(b) the level of insurance that an efficient and prudent service provider would obtain in respect of the event.
	~~**Financial Failure of a Retailer Event means the occurrence of an event whereby a User is subject to an Insolvency Event, and as a consequence the Service Provider does not receive revenue which it was otherwise entitled to for the provision of References Services;**~~
	Insurance Cap Event means an event whereby: (a) the Service Provider makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy; (b) the Service Provider incurs costs beyond the relevant policy limit of that insurance policy; and (c) the costs beyond the relevant insurance policy limit Materially increase the costs to the Service Provider of providing Reference Services~~;~~ For the purposes of this Insurance Cap Event: ~~(d) the relevant policy limit is the greater of Multinet Gas' actual policy limit at the time of the event that gives rise to the claim and its policy limit at the time the AER made its Final Decision on Multinet Gas' access arrangement proposal for the period 2018-22, with reference to the forecast operating expenditure allowance approved in the AER's Final Decision and the reasons for that decision~~; and (~~e~~) (d)A relevant insurance policy is an insurance policy held during the 2018-22 Access Arrangement Period or a previous period in which access to the pipeline services was regulated (e) the Service Provider will be deemed to have made a claim on a relevant insurance policy if the claim is made by a related party of the Service Provider in relation to any aspect of the Distribution System or the Service Provider's business. Note in making a determination in making a determination on an Insurance Cap Event, the Regulator will have regard to, amongst other things: (1) the insurance policy for the event;

Reference	AER required amendment
	(2) the level of insurance that an efficient and prudent Service Provider would obtain in respect of the event; and (3) any assessment by the Regulator of the Service Provider's insurance in making its access arrangement decision for the relevant period.
	Insurer Credit Risk Event means an event where the insolvency of ~~the nominated insurers~~ an insurer of the Service Provider occurs, as a result of which the Service Provider: ~~(a) incurs Materially higher or lower costs for insurance premiums than those incurred immediately prior to the insolvency; or~~ (~~b~~) (a) in respect of a claim for a risk that ~~would have been~~ was insured by the Service Provider's insolvent insurers, is under a new policy subject to a materially higher or lower claim limit or a materially higher or lower deductible than would have applied under the policy with the insolvent insurer; or ~~(c)~~ (b) incurs additional costs associated with self funding an insurance claim which would have otherwise been covered by the insolvent insurer; Note: In making its decision to approve or reject a proposed reference tariff variation arising from an Insurer Credit Risk Event, the Regulator will have regard to, amongst other things: (c) the Service Provider's attempts to mitigate and prevent the event from occurring by reviewing and considering the insurer's track record, size, credit rating and reputation. (d) in the event that a claim would have been made after the insurer became insolvent, whether the Service Provider had reasonable opportunity to insure the risk with a different insurer.
	~~**Major Upstream Failure Event** means:~~ ~~a failure of, or event affecting (including without limitation fire, explosion or major mechanical failure), the Transmission System or any production facility upstream of the Transmission System which:~~ ~~(a) results in or necessitates a material curtailment in the quantities of Gas able to be Supplied by the Service Provider to Customers; or~~ ~~(b) would have resulted in or necessitated such a material curtailment but for steps taken by the Service Provider to overcome or~~

Reference	AER required amendment
	~~mitigate the impact on Customers (for example the trucking or injection into the Distribution System of CNG or LNG),~~ ~~(but excluding those events for which external insurance or self-insurance has been included within the Service Provider's forecast operating expenditure for the relevant Access Arrangement period) that occurs during the Access Arrangement period and that causes an inability for the Service Provider to recover the building block costs which make up its total revenue allowance or which Materially increases the costs to the Service Provider of providing Reference Services (including without limitation because of the need to undertake repairs to the Distribution System or because the Service Provider incurs costs in sourcing replacement supplies of Gas or substitute supplies for Gas).~~
	~~**National Energy Customer Framework Event** means:~~ ~~a legislative act or decision that:~~ ~~(a) occurs during the Access Arrangement period;~~ ~~(b) has the effect of implementing in Victoria, either in part or in its entirety, the National Energy Customer Framework; and~~ ~~(c) increases the costs to the Service Provider of providing Reference Services.~~ ~~For the purposes of this definition, the "National Energy Customer Framework" means any legislation, regulations or rules that give effect, in Victoria, to any or all of the Schedule to the National Energy Retail Law (South Australia) Act 2011, the National Energy Retail Regulations (South Australia) and the National Energy Retail Rules (South Australia) as amended from time to time including any amendment, withdrawal or introduction of any associated Victorian legislation, regulations or rules.~~
	'**Regulatory Change Event'** means: the introduction of, or a change in, a regulatory obligation or requirement that: (a) falls within no other category of Relevant Pass Through Event; and (b) occurs during the course of an Access Arrangement Period; and (c) substantially affects the manner in which the Service Provider provides Reference Services; and (d) Materially increases or Materially decreases the costs of providing those Reference Services.

Reference	AER required amendment
	Relevant Pass Through Event means each of the following: (a) Change in Taxes Event; (b) Retailer Insolvency Event; (c) Insurer Credit Risk Event; (d) Insurance Cap Event; (e) Regulatory Change Event; (f) Service Standard Event; (g) Terrorism Event; (h) Natural Disaster Event; ~~(i) National Energy Customer Framework Event;~~ ~~(j) Major Upstream Failure Event~~
	Retailer Insolvency Event means: ~~that the Service Provider incurs additional costs or is unable to recover from a Retailer amounts billed to that Retailer or amounts accrued due but not yet billed due to:~~ ~~(a) the failure of a Retailer, who has had an Insolvency Official appointed to them, to pay an amount for Reference Services to the Service Provider which amount the Service Provider is entitled to under its contract with that Retailer but only to the extent the Service Provider is not entitled to recoup that amount under any Bank Guarantee provided in respect of that Retailer; and~~ ~~(b) from the time the National Energy Retail Law applies in Victoria,~~ the occurrence of an event where: ~~(1)~~ (a) a Retailer of Last Resort (RoLR) Event as described in section 122 of the National Energy Retail Law has occurred; and ~~(2)~~ (b)the Service Provider incurs costs in responding to the RoLR Event in accordance with its obligations under the National Energy Retail Law, National Energy Retail Rules, National Gas Law or National Gas Rules (including guidelines and procedures

Reference	AER required amendment
	that are binding under those instruments); and (3) those costs are not recoverable by the Service Provider under other provisions of the National Energy Retail Law, National Energy Retail Rules, National Gas Law or National Gas Rules as in force at the time of the RoLR Event or under other Relevant Pass-Through Events in this Access Arrangement. Note for the avoidance of doubt, in making a determination under this paragraph (b) in respect of a Retailer Insolvency Event, the Regulator will have regard to, amongst other things, the extent to which the Service Provider has taken steps to minimise the costs associated with its responsibilities in the ROLR Event, both prior to, and after the RoLR Event was triggered.
Service Standard Event	'**Service Standard Event'** means: a legislative or administrative act or decision that falls within no other category of Relevant Pass Through Event that: (a) has the effect of: (1) substantially varying, during the course of an access arrangement period, the manner in which the Service Provider is required to provide a Reference Service; (2) imposing, removing or varying, during the course of an access arrangement period, minimum service standards applicable to Reference Services; or (3) altering, during the course of an access arrangement period, the nature or scope of the Reference Services, provided by the Service Provider; and (b) Materially increases or Materially decreases the costs to the Service Provider of providing Haulage Reference Services.
	'**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), occurring during the Access Arrangement period, 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 or put the public, or any section of the public, in fear) and which ~~Materially~~ increases the costs to the Service Provider of providing a Reference Service.

Reference	AER required amendment
	Note for the avoidance of doubt, in making a determination on a Terrorism Event, the Regulator will have regard to, amongst other things: (c) whether the Service Provider has insurance against the event; (d) the level of insurance that an efficient and prudent service provider would obtain in respect of the event; and (e) whether a declaration has been made by a relevant government authority that an act of terrorism has occurred.
Part B – Reference Tariff and Reference Tariff Policy	
Clause 8	[…] In the case of ~~the following~~ all Relevant Pass Through Events: ~~a) Change in Taxes Event;~~ ~~b) Major Upstream Failure Event; ;~~ ~~c) Insurer Credit Risk Event;~~ ~~d) Insurance Cap Event;~~ ~~e) Regulatory Change Event;~~ ~~f) Service Standard Change Event;~~ ~~g) Terrorism Event; and~~ ~~h) Disaster Event,~~ ~~the relevant definitions require~~ there is required to be a Material increase or decrease in costs as a pre-condition to there being a Relevant Pass-Through Event.

Reference	AER required amendment
	[…]
Clause 8 (cont.)	[…] ~~In the case of a Change in Taxes Event or Major Upstream Failure Event which causes a reduction in the Service Provider's revenue, for the purposes of applying the definition of Material and the preceding paragraphs of this clause 8 references to costs will be read as references to the reduced revenue due to that Change in Taxes Event.~~ […]