



**DRAFT DECISION**  
**Powerlink transmission**  
**determination**  
**2017–18 to 2021–22**

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

September 2016

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## Note

This attachment forms part of the AER's draft decision on Powerlink's transmission determination for 2017–22. It should be read with all other parts of the draft decision.

The draft decision includes the following documents:

Overview

Attachment 1 – Maximum allowed revenue

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Value of imputation credits

Attachment 5 – Regulatory depreciation

Attachment 6 – Capital expenditure

Attachment 7 – Operating expenditure

Attachment 8 – Corporate income tax

Attachment 9 – Efficiency benefit sharing scheme

Attachment 10 – Capital expenditure sharing scheme

Attachment 11 – Service target performance incentive scheme

Attachment 12 – Pricing methodology

Attachment 13 – Pass through events

Attachment 14 – Negotiated services

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## Shortened forms

Shortened form	Extended form
AARR	aggregate annual revenue requirement
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
ASRR	annual service revenue requirement
augex	augmentation expenditure
capex	capital expenditure
CCP	Consumer Challenge Panel
CESS	capital expenditure sharing scheme
CPI	consumer price index
DMIA	demand management innovation allowance
DRP	debt risk premium
EBSS	efficiency benefit sharing scheme
ERP	equity risk premium
MAR	maximum allowed revenue
MRP	market risk premium
NEL	national electricity law
NEM	national electricity market
NEO	national electricity objective
NER	national electricity rules
NSP	network service provider
NTSC	negotiated transmission service criteria
opex	operating expenditure
PPI	partial performance indicators
PTRM	post-tax revenue model
RAB	regulatory asset base
RBA	Reserve Bank of Australia
repex	replacement expenditure
RFM	roll forward model
RIN	regulatory information notice

Shortened form	Extended form
RPP	revenue and pricing principles
SLCAPM	Sharpe-Lintner capital asset pricing model
STPIS	service target performance incentive scheme
TNSP	transmission network service provider
TUoS	transmission use of system
WACC	weighted average cost of capital

## 13 Pass through events

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

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

- a regulatory change event
- a service standard event
- a tax change event
- an insurance event

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

This attachment sets out our draft decision on the nominated pass through events that will apply to Powerlink for the 2017-22 regulatory control period.

### 13.1 Draft decision

We accept the Insurer Credit Risk event proposed by Powerlink.

We also accept the following nominated pass through events, with minor modifications to the definitions as set out in section 13.4 of this attachment:

- Insurance cap event
- Terrorism event.

The reasons for our draft decision are set out in section 13.4 of this attachment.

### 13.2 Powerlink's proposal

Powerlink has proposed three nominated pass through events, with the definitions set out in Table 13-1.

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

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

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

**Table 13-1 Powerlink's proposed pass through events**

Proposed event	Proposed definition
Insurance cap event	<p>An insurance cap event occurs if:</p> <ol style="list-style-type: none"> <li>1. Powerlink makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy;</li> <li>2. Powerlink incurs costs beyond the relevant policy limit; and</li> <li>3. The costs beyond the relevant policy limit materially increase the costs to Powerlink of providing prescribed transmission services.</li> </ol> <p>For this Insurance Cap Event:</p> <ol style="list-style-type: none"> <li>4. The relevant policy limit is the greater of:               <ol style="list-style-type: none"> <li>(a) Powerlink's actual policy limit at the time of the event that gives, or would have given rise to a claim, and</li> <li>(b) the policy limit that is explicitly or implicitly commensurate with the allowance for insurance premiums that is included in the forecast operating expenditure allowance approved in the AER's final decision for the regulatory period in which the insurance policy is issued.</li> </ol> </li> <li>5. A relevant insurance policy is an insurance policy held during the 2017/18 to 2021/22 regulatory period or a previous regulatory period in which Powerlink was regulated.</li> </ol> <p>Note: For the avoidance of doubt, in assessing an insurance cap event cost pass through application under rule 6A.7.3, the AER will have regard to:</p> <ol style="list-style-type: none"> <li>i. i. the insurance policy for the event;</li> <li>ii. ii. the level of insurance that an efficient and prudent NSP would obtain in respect of the event; and</li> <li>iii. iii. the extent to which a prudent provider could reasonably mitigate the impact of the event</li> </ol>
Terrorism event	<p>A terrorism event is:</p> <p>An act (including, but not limited to, the use of force or violence or the threat of force or violence) of any person or group of persons (whether acting alone or on behalf of or in connection with any organisation or government), which from its nature or context is done for, or in connection with, political, religious, ideological, ethnic or similar purposes or reasons (including the intention to influence or intimidate any government and/or put the public, or any section of the public, in fear) and which materially increases the costs to Powerlink in providing prescribed transmission services.</p> <p>Note: In assessing a terrorism event pass through application, the AER will have regard to, amongst other things:</p> <ol style="list-style-type: none"> <li>(a) whether Powerlink has insurance against the event;</li> <li>(b) the level of insurance that an efficient and prudent NSP would obtain in respect of the event;</li> <li>(c) whether a declaration has been made by a relevant government authority that a terrorism event has occurred; and</li> <li>(d) the extent to which a prudent provider could reasonably mitigate the impact of the event.</li> </ol>
Insurer credit risk event	<p>An insurer credit risk event occurs if:</p> <p>A nominated insurer of Powerlink becomes insolvent, and as a result, in respect of an existing, or potential, claim for a risk that was insured by the insolvent insurer, Powerlink:</p>



Proposed event	Proposed definition
	<ul style="list-style-type: none"> <li>i. is subject to a materially higher or lower claim limit or a materially higher or lower deductible than would have otherwise applied under the insolvent insurer's policy; or</li> <li>ii. Incurs additional costs associated with self-funding an insurance claim, which would otherwise have been covered by the insolvent insurer.</li> </ul>
	<p>Note: In assessing an insurer's credit risk event pass through application, the AER will have regard to, amongst other things:</p>
	<ul style="list-style-type: none"> <li>(a) Powerlink's attempts to mitigate and prevent the event from occurring by reviewing and considering the insurer's track record, size, credit rating and reputation, and</li> <li>(b) In the event that a claim would have been made after the insurance provider became insolvent, whether Powerlink had reasonable opportunity to insure the risk with a different provider.</li> </ul>

Powerlink's regulatory proposal noted the provision in NER rule 6A.7.2 for a TNSP to seek a pass through of any difference between forecast and actual efficient costs associated with network support events. Powerlink further noted that it has proposed a forecast allowance for network support payments of \$0 for the 2018-22 regulatory period.<sup>4</sup> We consider Powerlink's operating expenditure (opex) forecast in Attachment 7 of this draft decision. We have accepted Powerlink's total opex forecast, which includes zero network support costs.<sup>5</sup>

### 13.3 Assessment approach

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

In this decision, our task is to determine whether to accept the nominated pass through events.

The NER include the following pass through events for all transmission determinations:<sup>6</sup>

- a regulatory change event
- a service standard event
- a tax change event
- an insurance event

They also allow a service provider to propose other events be specified in a determination as a pass through event for that determination.<sup>7</sup> Our draft decision must

<sup>4</sup> Powerlink, *2018–22 Powerlink Queensland Revenue Proposal*, January 2016, pp. 76, 108.

<sup>5</sup> Powerlink, *2018–22 Powerlink Queensland Revenue Proposal*, January 2016, p. 27.

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

include a decision on the additional (nominated) pass through events that are to apply for the regulatory control period.<sup>8</sup>

Our assessment approach is guided by the National Electricity Objective (NEO) and the Revenue and Pricing Principles. These provide the service provider with a reasonable opportunity to recover at least the efficient costs incurred in providing services and complying with its obligations.<sup>9</sup> They also provide incentives to promote economic efficiency.<sup>10</sup> Together, they promote a balance between the economic costs and risks of the potential for under and over investment by a service provider, to promote efficient investment.<sup>11</sup> In the context of pass through events, we have particular regard to the impact on price, quality, reliability and security of supply that may arise as a result of any change in the efficient operation of, and ability and incentive of, a service provider to invest in its network.<sup>12</sup>

In determining whether we accept a nominated pass through event, we must take into account the nominated pass through event considerations:<sup>13</sup>

The *nominated pass through event considerations* are:

- (a) whether the event proposed is an event covered by a category of *pass through event* specified in clause 6A.7.3(a1)(1) to (4);
- (b) whether the nature or type of event can be clearly identified at the time the determination is made for the service provider;
- (c) whether a prudent service provider could reasonably prevent an event of that nature or type from occurring or substantially mitigate the cost impact of such an event;
- (d) whether the relevant service provider could insure against the event, having regard to:
  - (1) the availability (including the extent of availability in terms of liability limits) of insurance against the event on reasonable commercial terms; or
  - (2) whether the event can be self-insured on the basis that:
    - (i) it is possible to calculate the self-insurance premium; and
    - (ii) the potential cost to the relevant service provider would not have a significant impact on the service provider's ability to provide *network services*; and.

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<sup>7</sup> NER, cl. 6A.7.3(a1)(5).

<sup>8</sup> NER, cl. 6A.14.1(9) .

<sup>9</sup> NEL, s. 7A(2).

<sup>10</sup> NEL, s. 7A(3).

<sup>11</sup> NEL, s. 7A(6).

<sup>12</sup> NEL, s. 7; AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, Sydney, p. 6.

<sup>13</sup> NER, cl. 6A.6.9(b); NER Chapter 10: Glossary, definition of 'nominated pass through event considerations'.

(e) any other matter the AER considers relevant and which the AER has notified *Network Service Providers* is a nominated pass through event consideration.

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

- to incorporate and reflect the essential components of a cost pass through regime in the NER. It was intended that in order for appropriate incentives to be maintained, any nominated pass through event should only be accepted when event avoidance, mitigation, commercial insurance and self-insurance are unavailable. That is, a cost pass through event is the least efficient option for managing the risk of unforeseen events.<sup>14</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>15</sup>

In turn, this protects the incentive regime under the NER by limiting the erosion of incentives on service providers to use market based mechanisms to mitigate the cost impacts that would arise.<sup>16</sup> This promotes the efficient investment in, and efficient operation and use of, network services for the long term interests of consumers with respect to price.<sup>17</sup>

### 13.3.1 Interrelationships

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

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

- prevention (avoiding the risk)

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<sup>14</sup> AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, Sydney, p. 19.

<sup>15</sup> AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, Sydney, p. 20.

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

<sup>17</sup> AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, Sydney, p.8.

- 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 smaller projects a service provider should be using up its existing expenditure allowance, or reprioritising or substituting its projects, to avoid seeking cost recovery through the pass through mechanisms.<sup>19</sup> This is reflected in the materiality threshold that applies to applications for cost pass through determinations.<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 EBSS and CESS.<sup>21</sup>

Cost pass through amounts that have already been recovered in a regulatory period cannot be recovered again in the roll-forward of the regulatory asset base (RAB) for the next regulatory period.<sup>22</sup>

## 13.4 Reasons for draft decision

We accept all three of the pass through events nominated in Powerlink's regulatory proposal, subject to the minor drafting amendments noted below. Having regard to the nominated pass through considerations, we consider:

- the nominated events are not already covered by the pass through events prescribed in the NER<sup>23</sup>
- the nature and type of each nominated event can be clearly identified at the time of our determination<sup>24</sup>

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

<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, Sydney, 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. 9; AER, *Capital Expenditure Incentive Guideline for Electricity Network Service Providers*, November 2013, p. 18.

<sup>22</sup> NER, cl. S6A.2.1(f)(1)(ii).

<sup>23</sup> NER, Chapter 10: Glossary, definition of 'nominated pass through event considerations', cl. (a).

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

- While a prudent service provider could take steps to reduce the likelihood of these events and the cost impacts should the event occur,<sup>25</sup> and could in principle insure or self-insure against them,<sup>26</sup> expenditure beyond a certain point is likely to be imprudent or inefficient. In these circumstances we consider risk sharing between Powerlink and its customers is appropriate and more likely to be in the long term interest of consumers.

Powerlink's proposed definitions are consistent with those in the final decisions we released for Queensland's distribution network service providers in October 2015, shortly before Powerlink submitted its proposal.<sup>27</sup>

We accept Powerlink's proposed Insurer Credit Risk Event as drafted.

However in more recent decisions we have made minor amendments to the definitions of Insurance Cap Event and Terrorism events.<sup>28</sup> We approached Powerlink to seek its views on these revised definitions, which we considered clarified the definitions of these events and better serve the nominated pass through considerations.<sup>29</sup>

With the benefit of Powerlink's response,<sup>30</sup> our draft decision is to approve the amendments to Powerlink's January proposal shown in Table 13-2.

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

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

<sup>27</sup> AER - Final decision Energex distribution determination - Attachment 15 - Pass through events - October 2015;  
AER - Final decision Ergon Energy distribution determination - Attachment 15 - Pass through events - October 2015

<sup>28</sup> See, for example, AER, *Final decision AusNet distribution determination - Attachment 15 - Pass through events*, May 2016, pp. 6–8

<sup>29</sup> AER Information Request IR#002 – Pass Through Events, 29 April 2016.

<sup>30</sup> Powerlink, Response to AER Information Request IR#002 – Pass Through Events, 11 May 2016.

**Table 13-2 AER draft decision definitions – Insurance cap event and terrorism event**

Proposed event	AER draft decision definition
Insurance cap event	<p>An insurance cap event occurs if:</p> <ol style="list-style-type: none"> <li>1. Powerlink makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy;</li> <li>2. Powerlink incurs costs beyond the <del>relevant</del> <u>relevant policy limit of the relevant insurance policy at the time of the event that gives rise to the relevant claim</u>; and</li> <li>3. The costs beyond the relevant policy limit <del>materially</del> increase the costs to Powerlink of providing prescribed transmission services.</li> </ol> <p>For this Insurance Cap Event:</p> <ol style="list-style-type: none"> <li>4. <del>The relevant policy limit is the greater of:</del> <ol style="list-style-type: none"> <li><del>(c) Powerlink’s actual policy limit at the time of the event that gives, or would have given rise to a claim; and</del></li> <li><del>(d) the policy limit that is explicitly or implicitly commensurate with the allowance for insurance premiums that is included in the forecast operating expenditure allowance approved in the AER’s final decision for the regulatory period in which the insurance policy is issued.</del></li> </ol> </li> <li>4. A relevant insurance policy is an insurance policy held during the <u>2016/17 to 2021/22</u> regulatory control period or a previous regulatory control period in which Powerlink was regulated, and</li> <li>5. <u>Powerlink will be deemed to have made a claim on a relevant insurance policy if the claim is made by a related body corporate of Powerlink in relation to any aspects of Powerlink’s prescribed transmission services.</u></li> </ol> <p>Note: in making a determination on an Insurance Cap Event, the AER will have regard to, amongst other things:</p> <ol style="list-style-type: none"> <li>i. the insurance policy for the event;</li> <li>ii. the level of insurance that an efficient and prudent NSP would obtain in respect of the event; and</li> <li><u>iii. any assessment by the AER of Powerlink’s insurance documented in respect of its transmission determination for the relevant period.</u></li> <li><del>iii. the extent to which a prudent provider could reasonably mitigate the impact of the event</del></li> </ol>
Terrorism event	<p>A terrorism event is: An act (including, but not limited to, the use of force or violence or the threat of force or violence) of any person or group of persons (whether acting alone or on behalf of or in connection with any organisation or government), which from its nature or context is done for, or in connection with, political, religious, ideological, ethnic or similar purposes or reasons (including the intention to influence or intimidate any government and/or put the public, or any section of the public, in fear) and which <del>materially</del> increases the costs to Powerlink in providing prescribed transmission services.</p> <p>Note: In assessing a terrorism event pass through application, the AER will have regard to, amongst other things:</p> <ol style="list-style-type: none"> <li>(i) whether Powerlink has insurance against the event;</li> <li>(ii) the level of insurance that an efficient and prudent NSP would obtain in respect of the event; <u>and</u></li> <li>(iii) Whether a declaration has been made by a relevant government</li> </ol>

Proposed event	AER draft decision definition
	<p>authority that an act of terrorism event has occurred.</p> <p>d) <del>The extent to which a prudent provider could reasonably mitigate the impact of the event.</del></p>

In respect of the Insurance Cap Event, the effect of these amendments is to recognise that the approved operating expenditure in a transmission determination may not unambiguously imply a particular level of insurance cover. We have therefore removed this limb from the definition, and added a note that we will take into account, where relevant, any assessments or analysis we have undertaken in relation to insurance when making our final decision on total forecast opex. The revised definition also clarifies recognises the possibility of a claim by a related body corporate (as defined by the NER), and removes the reference to an event 'materially' increasing costs, to avoid any confusion with the materiality threshold applying to all pass through events.

In respect of the Terrorism Event, these amendments again remove the reference to an event 'materially' increasing costs, to avoid any confusion with the materiality threshold applying to all pass through events. They also remove circularity in the definition and notes on the factors we may have regard to in assessment of a pass through application. In commenting on the revised definition Powerlink suggested that we align the language of note (iii) with Commonwealth legislation, but also that we make clear that note (iii) is not limited to declarations under the *Terrorism Insurance Act 2003* (Cth).<sup>31</sup> We do not intend to limit our consideration of declarations by relevant authorities to that Act, and consider the generic term 'act of terrorism'—which is not tied to or deliberately aligned with that Act or with any particular instrument—is adequate to achieve that purpose.

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<sup>31</sup> Powerlink, Response to AER Information Request IR#002 – Pass Through Events, 11 May 2016.