



FINAL DECISION

Amadeus Gas Pipeline

Access Arrangement

2016 to 2021

Attachment 11 – Reference tariff variation mechanism

May 2016

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Note

This attachment forms part of the AER's final decision on the access arrangement for the Amadeus Gas Pipeline for 2016–21. It should be read with all other parts of the final decision.

The final 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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Shortened forms

Shortened form	Extended form
AA	Access Arrangement
AAI	Access Arrangement Information
APTNT	APT Pipelines (NT) Pty Limited (APTNT)
AER	Australian Energy Regulator
AGP	Amadeus Gas Pipeline
ATO	Australian Tax Office
capex	capital expenditure
CAPM	capital asset pricing model
CPI	consumer price index
DRP	debt risk premium
ECM	Efficiency carryover mechanism
ERP	equity risk premium
Expenditure Guideline	Expenditure Forecast Assessment Guideline
gamma	value of imputation credits
GTA	Gas Transport Services Agreement
MRP	market risk premium
NGP	Northern Gas Pipeline (formerly North East Gas Interconnector/NEGI)
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
TAB	tax asset base
UAFG	unaccounted for gas

Shortened form	Extended form
WACC	weighted average cost of capital
WPI	Wage Price Index

11 Reference tariff variation mechanism

This attachment sets out our final decision on the reference tariff variation mechanism in APTNT's revised access arrangement proposal for the Amadeus Gas Pipeline for the 2016–21 access arrangement period.

The proposed reference tariff variation mechanism includes:

- an annual reference tariff variation mechanism, and
- a cost pass through mechanism, including a series of cost pass through events.

11.1 Final decision

We accept some, but not all elements of the reference tariff variation mechanism in APTNT's revised access arrangement proposal.

We have revised the access arrangement having regard to our reasons for refusing to approve APTNT's proposal and the further matters identified in rule 64(2) of the NGR.

Our revisions are reflected in clauses 4.7.1 and 4.7.3 of the *Approved Access Arrangement for the Amadeus Gas Pipeline for the period 1 July 2016 to 30 June 2021*, which gives effect to this decision.¹

11.1.1 Annual reference tariff variation mechanism

We accept all but one aspect of APTNT's revised proposed annual reference tariff mechanism. The aspect we do not accept is the proposed cost pass through adjustment factor formula. Our final decision also makes a change to the cost pass through adjustment factor formula so that it is consistent with APTNT's reference tariff variation mechanism and satisfies rule 92(2) in regards to equalisation of the present values.

Consequently, our final decision is that amendments to the following elements of the reference tariff variation mechanism are preferable to APTNT's proposal and comply with the National Gas Law (NGL) and National Gas Rules (NGR):

- Amend clause 4.7.1 in the Amadeus Gas Pipeline (AGP) access arrangement to be consistent with Figure 11.2 in Attachment 11 of our Final Decision.

Our reasons for this decision are set out in section 11.4.1.

¹ AER, *Approved Access Arrangement for the Amadeus Gas Pipeline - 1 July 2016 to 30 June 2021*, May 2016

11.1.2 Cost pass through events

We approve the seven pass through events in APTNT's revised access arrangement proposal, with the definitions set out in Table 11.1. We have amended five of the definitions for the reasons set out in section 11.4.2 of this attachment.

Table 11.1 Approved pass through events

Cost pass through event	Definition
Regulatory change event	<p>A change in a regulatory obligation or requirement that:</p> <ul style="list-style-type: none">(a) falls within no other category of 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 the Firm Service; and(d) materially increases or materially decreases the costs of providing those services.
Service standard event	<p>A legislative or administrative act or decision that:</p> <ul style="list-style-type: none">(a) has the effect of:<ul style="list-style-type: none">(i) substantially varying, during the course of an access arrangement period, the manner in which a Service Provider is required to provide the Firm Service; or(ii) imposing, removing or varying, during the course of an access arrangement period, minimum service standards applicable to the Firm Service; or(iii) altering, during the course of an access arrangement period, the nature or scope of the Firm Service, provided by the Service Provider; and(b) materially increases or materially decreases the costs to the Service Provider of providing the Firm Service.
Tax change event	<p>A tax change event occurs if any of the following occurs during the course of the access arrangement period for Service Provider:</p> <ul style="list-style-type: none">(a) a change in a relevant tax, in the application or official interpretation of a relevant tax, in the rate of a relevant tax, or in the way a relevant tax is calculated;(b) the removal of a relevant tax;(c) the imposition of a relevant tax; and <p>in consequence, the costs to Service Provider of providing the Reference Service are materially increased or decreased.</p>
Terrorism event	<p>Terrorism event means an act (including, but not limited to, the use of force or violence or the threat of force or violence) of any person or group of persons (whether acting alone or on behalf of or in</p>

Cost pass through event	Definition
	<p>connection with any organisation or government), which:</p> <p>(a) from its nature or context is done for, or in connection with, political, religious, ideological, ethnic or similar purposes or reasons (including the intention to influence or intimidate any government and/or put the public, or any section of the public, in fear), and</p> <p>(b) increases the cost to the Service Provider in providing a Reference Service.</p> <p>Note for the avoidance of doubt, in making a determination on a Terrorism Event, the AER will have regard to, amongst other things:</p> <p>(i) whether the Service Provider has insurance against the event;</p> <p>(ii) the level of insurance that an efficient and prudent service provider would obtain in respect of the event; and</p> <p>(iii) whether a declaration has been made by a relevant government authority that an act of terrorism has occurred.</p>
	<p>Insurer Credit Risk Event means an event where:</p> <p>(a) An insurer of the Service Provider becomes insolvent, and</p> <p>(b) As a result, in respect of an existing, or potential, claim for a risk that was insured by the insolvent insurer, the Service Provider:</p> <p>(i) is subject to a higher or lower claim limit or higher or lower deductible than would have otherwise applied under the insolvent insurer's policy; or</p> <p>(ii) incurs additional costs associated with self-funding an insurance claim, which would otherwise have been covered by the insolvent insurer.</p>
Insurer credit risk event	<p>Note for the avoidance of doubt, in making a determination on an Insurer Credit Risk Event, the AER will have regard to, amongst other things:</p> <p>(i) 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, and</p> <p>(ii) in the event that a claim would have been made after the insurance provider became insolvent, whether the Service Provider had reasonable opportunity to insure the risk with a different provider.</p>
Insurance cap event	<p>Insurance Cap Event means an event where:</p> <p>(a) the Service Provider makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy;</p>

Cost pass through event	Definition
	<p>(b) the Service Provider incurs costs beyond the policy limit; and</p> <p>(c) the costs beyond the policy limit increase the costs to the Service Provider of proving the Reference Service.</p> <p>For this Insurance Cap Event:</p> <p>(d) a relevant insurance policy is an insurance policy held during the Access Arrangement Period or a previous period in which access to the pipeline services was regulated; and</p> <p>(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 Network or the Service Provider's business.</p> <p>Note in making a determination on an Insurance Cap Event, the AER will have regard to, amongst other things:</p> <p>(i) the insurance policy for the event</p> <p>(ii) the level of insurance that an efficient and prudent Service Provider would obtain in respect of the event, and</p> <p>(iii) any assessment by the AER of the Service Provider's insurance in approving the access arrangement for the AGP for the relevant period.</p>
	<p>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 Firm Service, provided the fire, flood or other event was not a consequence of the acts or omissions of the Service Provider.</p>
Natural disaster event	<p>Note for the avoidance of doubt, in making a determination on a Natural Disaster Event, the AER will have regard to, amongst other things:</p> <p>(a) whether the Service Provider has insurance against the event, and</p> <p>(b) the level of insurance that an efficient and prudent service provider would obtain in respect of the event.</p>

11.2 APTNT's revised proposal

Our draft decision indicated the nature of the amendments required to make APTNT's proposal acceptable to us.² Under the NGR, such amendments must be limited to

² NGR, r. 59(2).

those necessary to address matters raised in our draft decision unless we approve further amendments.³ APTNT submitted its revised proposal on 6 January 2016.⁴

11.2.1 Annual reference tariff variation mechanism

Our draft decision required APTNT to revise its proposed access arrangement to:

- Amend clause 4.7.1 in the Amadeus Gas Pipeline access arrangement to be consistent with figure 11.1 and figure 11.2 of attachment 11 of the draft decision, as well as appendix I of attachment 3 of the draft decision regarding annual updates for the return on debt.⁵
- Amend clause 4.7.2 to reflect our draft decision that the tariff variation notification submitted 50 business days before the date of implementation will be the final notification and not a draft notification which is to be updated.⁶

In its revised proposal, APTNT made revisions to the Amadeus Gas Pipeline access arrangement generally consistent with our draft decision revisions.⁷ However, it also proposed a number of new revisions to the access arrangement which it considered were required as a consequence of our draft decision.⁸

APTNT also raised concerns that our draft decision pass through adjustment factor may not satisfy rule 92(2) in regards to equalisation of the present values.⁹

11.2.2 Cost pass through events

Our draft decision accepted APTNT's proposed tax change event, but required APTNT to revise its proposed access arrangement, to replace the definitions of the following cost pass through events with those set out in Attachment 11 of the draft decision: regulatory change event, service standard event, terrorism event, natural disaster event, insurer credit risk event and insurance cap event.¹⁰

In its revised proposal, APTNT revised the definitions of tax change event and insurer credit risk event in accordance with our draft decision. It also revised the definitions of

³ NGR, r. 60(2).

⁴ NGR, rr. 59(3), 60(1).

⁵ AER, *Draft decision: Amadeus Gas Pipeline Access Arrangement 2016 to 2021, Attachment 11 – Reference tariff variation mechanism*, November 2015, p. 11-25 (Revision 11.1).

⁶ AER, *Draft decision: Amadeus Gas Pipeline Access Arrangement 2016 to 2021, Attachment 11 – Reference tariff variation mechanism*, November 2015, p. 11-25 (Revision 11.2).

⁷ APTNT, *Amadeus Gas Pipeline access arrangement revised proposal: Response to draft decision submission*, January 2016, pp. 104–108, 112; APTNT, *Access arrangement for the Amadeus Gas Pipeline: 1 July 2016 to 30 June 2021*, January 2016, cl. 4.7.1, 4.7.2.

⁸ APTNT, *Amadeus Gas Pipeline access arrangement revised proposal: Response to draft decision submission*, January 2016, pp. 107–108.

⁹ APTNT, *Amadeus Gas Pipeline access arrangement revised proposal: Response to draft decision submission*, January 2016, p. 108.

¹⁰ AER, *Draft decision: Amadeus Gas Pipeline Access Arrangement 2016 to 2021, Attachment 11 – Reference tariff variation mechanism*, November 2015, p. 11-25 (Revision 11.3).

the other cost pass through events, but with some amendments that differed from those specified in our draft decision.

11.3 AER's assessment approach

The reference tariff variation mechanism must be designed to equalise (in terms of present values):¹¹

- 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.

It may provide for variation of a reference tariff:¹²

- in accordance with a schedule of fixed tariffs,
- in accordance with a formula set out in the access arrangement,
- as a result of a cost pass through for a defined event, or
- by the combined operation of two or more of these.

A formula for variation of a reference tariff may (for example) provide for variable caps on the revenue to be derived from a particular combination of reference services, a tariff basket price control, a revenue yield control or a combination of all or any of these.¹³

In deciding whether a particular reference tariff variation mechanism is appropriate to a particular access arrangement, the NGR require us to have regard to:¹⁴

- (a) the need for efficient tariff structures; and
- (b) the possible effects of the reference tariff variation mechanism on administrative costs of the AER, the service provider, and users or potential users; and
- (c) the regulatory arrangements (if any) applicable to the relevant reference services before the commencement of the proposed reference tariff variation mechanism; and
- (d) the desirability of consistency between regulatory arrangements for similar services (both within and beyond the relevant jurisdiction); and
- (e) any other relevant factor.

A reference tariff variation mechanism must give us adequate oversight or powers of approval over variation of the reference tariff.¹⁵

¹¹ NGR, r. 92(2).

¹² NGR, r. 97(1).

¹³ NGR, r. 97(2).

¹⁴ NGR, r. 97(3).

¹⁵ NGR, r. 97(4).

In deciding whether a particular reference tariff variation mechanism is appropriate to a particular access arrangement, other factors we have regard to include:¹⁶

- the nature and scope of the reference services to which the reference tariffs are applicable
- how the proposed mechanism compares to that which applied under the current access arrangement, and to those that apply to other network service providers under our recent decisions
- 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 National Gas Objective (NGO) and Revenue and Pricing Principles (RPPs)
- in the case of cost pass through events, the considerations discussed in section 11.3.1 below.

The reference tariff variation mechanism is an area of our decision over which we have full discretion. This means that we may withhold our approval of a proposed reference tariff variation mechanism if—in our opinion—a preferable alternative exists that complies with the applicable requirements of the NGL and is consistent with any applicable criteria prescribed by the NGL.¹⁷

11.3.1 Cost pass through events

Our forecast revenue requirement includes forecasts of the capital and operating expenditure (capex and opex) a service provider will require over the access arrangement period to operate and maintain its network and meet its regulatory obligations (see attachments 6 and 7 to this decision). During the access arrangement period, a service provider can apply to us to pass material changes in its costs arising from pre-defined exogenous events through to customers, in the form of higher or lower reference tariffs. These events are called cost pass through events.

Our decision on the reference tariff variation mechanism for an access arrangement includes decisions on the cost pass through events that will apply during the access arrangement period, how an application to pass through costs will be assessed and how approved amounts will be passed through under the reference tariff variation mechanism.

Assessment of proposed events

Our decision on the reference tariff variation mechanism includes a decision on the pass through events that are to apply for the access arrangement period.¹⁸

¹⁶ NGR, r. 97(3)(e).

¹⁷ NGR, rr. 40(3), 92, 97.

¹⁸ NGR, r. 97(1)(c).

Our assessment approach is guided by the NGO and the RPPs. These provide that the service provider should be provided with a reasonable opportunity to recover at least the efficient costs incurred in providing services and complying with a regulatory obligation or requirement.¹⁹ They also provide incentives to promote economic efficiency.²⁰ 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.²¹ In the context of pass through events, we 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.²²

In determining whether we accept a proposed pass through event as part of the reference tariff variation mechanism, we also take into account the following considerations:²³

(a) whether the event proposed is an event covered by another pass through event under the access arrangement or the NGR²⁴;

(b) whether the nature or type of event can be clearly identified at the time the access arrangement is approved 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*.

These considerations serve the same purpose under the National Electricity Rules (NER), and are referred to in the NER as the nominated pass through event

¹⁹ NGL, s. 24(2).

²⁰ NGL, s. 24(3).

²¹ NGL, s. 24(6).

²² NGL, s. 23; See also AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, Sydney, p. 6.

²³ NGR, r. 97(3)(e).

²⁴ For example, rule 531 of the NGR provides for pass through of unpaid distribution service charges if a retailer insolvency event occurs.

considerations.²⁵ We consider these considerations are relevant to help determine whether a proposed cost pass through event under an access arrangement is consistent with the NGO.²⁶ In adding the nominated pass through event considerations to the NER, the Australian Energy Market Commission (AEMC) described their purpose 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.²⁷
- 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.²⁸

In turn, this limits the erosion of incentives on service providers to use market based mechanisms to mitigate the cost impacts that would arise.²⁹ 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.³⁰

As a matter of good regulatory practice, one additional matter³¹ we take into account is consistency in our approach to assessing pass through events across our electricity determinations and gas access arrangements.³²

Another additional matter we take into account³³ is how an application to pass through costs after an event occurs will be assessed, and the workability of the nominated pass through event in the context of the reference tariff variation mechanism. This is discussed below.

Assessment of pass through applications

²⁵ NER, cll. 6.5.10(b), 6A.6.9(b); NER Chapter 10: Glossary, definition of 'nominated pass through event considerations'.

²⁶ NGR, r. 100(1).

²⁷ AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, Sydney, p. 19.

²⁸ AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, Sydney, p. 20.

²⁹ NGL, s. 24(3); AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, Sydney, p. 8.

³⁰ NGL, s. 23; AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, Sydney, p. 8.

³¹ NGR, r. 97(3)(e).

³² AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, Sydney, p. 18.

³³ NGR, r. 97(3)(e).

Our decision on the reference tariff variation mechanism also includes a decision on the provisions of the access arrangement that set out how an application to pass through costs after a pass through event occurs will be made.

Typically, a pass through event is triggered when a defined event occurs, and entails the service provider incurring materially higher (or lower) costs than it would have occurred but for that event. When the change in costs is positive (that is, costs increase), the service provider may seek our approval to pass through an increase in the costs that it has incurred and is likely to incur over the access arrangement period to its users. When the change in costs is negative (and costs decrease), the service provider must provide us with a statement of the amount to be passed through back to customers, which leads to lower charges.

The pass through mechanism should not allow a service provider to pass through any change in its actual costs resulting from an event. As the AEMC has noted in the context of the NER pass through provisions:³⁴

The natural incentive properties of cost pass throughs are very weak. There is no direct financial benefit to the [service provider] from not performing in relation to those events that are covered by cost pass throughs, unlike the incentive arrangements for operating expenditure captured in the building blocks.

...the NER allow the AER to take into account the efficiency of the provider's decisions and actions in relation to the risk, as an attempt to impose some incentives to not overspend in relation to cost pass throughs. However, the incentives to find cost efficiencies on matters that can be claimed as cost pass through events are very poor.

We manage these incentives in our decisions in a number of ways.

First, a materiality threshold is typically applied so that an application to pass through costs (whether positive or negative) can only be made where the total change in costs resulting from the event is material. We consider the threshold prescribed in the NER is a suitable benchmark for a materiality threshold for cost pass through events under the NGR. This threshold requires the change in costs to be more than one per cent of the forecast revenue requirement for the service provider for the relevant regulatory year.³⁵

Second, where a pass through event has occurred the access arrangement should set out factors relevant to our determination on the amount to be passed through. Again, we consider the relevant factors in the NER are also useful for the pass through mechanism under the NGR. These include:³⁶

- the information provided to us by the service provider

³⁴ AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, Sydney, p. 3.

³⁵ NER, Chapter 10: Glossary, definition of 'materially'.

³⁶ NER, cl. 6A.7.3(j) / 6.6.1(j).

- the increase in the costs of providing reference services that the service provider has incurred and is likely to incur (or the costs in the provision of reference services the service provider has saved and is likely to save) until:
 - the end of the access arrangement period in which the event occurred; or
 - if the access arrangement for the access arrangement period following that in which the event occurred does not make any allowance for the recovery of that increase in costs (or the pass through of those cost savings) – the end of the access arrangement period following that in which the event occurred;
- for an increase in costs, the efficiency of the service provider's decisions and actions in relation to the risk of the event, including whether the service provider has failed to take any action that could reasonably be taken to reduce the magnitude of the pass through amount in respect of that event and whether the service provider has taken or omitted to take any action where such action or omission has increased the magnitude of the amount in respect of that event;
- the time cost of money based on the allowed rate of return for the service provider for the regulatory control period in which the pass through event occurred;
- the need to ensure that the service provider only recovers any actual or likely increment in costs to the extent that such increment is solely as a consequence of a pass through event;
- whether the costs of the pass through event have already been factored into the calculation of the service forecast revenue requirement for the access arrangement period in which the pass through event occurred or will be factored into the calculation of the provider's forecast revenue requirement for a subsequent access arrangement period;
- the extent to which the costs that the service provider has incurred and is likely to incur are the subject of a previous determination we have made on a cost pass through application; and
- any other factors we consider relevant.

What other factors may be relevant to a particular pass through event must—to some extent—be determined on a case by case basis. However, for some events there may be additional factors that can be identified in advance. We include these factors in the approved definitions of those events as part of the access arrangement. This is good regulatory practice for two reasons:

1. It provides transparency and predictability to service providers and users, and allows service providers to address these factors directly in cost pass through applications.
2. It allows us, service providers and users to consider and engage on how a pass through event will operate during the regulatory control period, and therefore to better take into account the considerations discussed above when defining an approved event.

11.3.2 Interrelationships

Tariffs are derived from the total revenue requirement *after* consideration of demand for each tariff category. APTNT operates 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 2016–21 access arrangement period, rather than the total revenue requirement set in our decision.³⁷ Except as provided by a reference tariff variation mechanism, a reference tariff is not to vary during the course of an access arrangement period.³⁸

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.³⁹

The pass through component of the reference tariff variation mechanism is also interrelated with other parts of this decision, in particular with the forecast opex⁴⁰ and capex⁴¹ and rate of return⁴² 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, commercial insurance and self-insurance under approved

³⁷ Where actual demand across the 2016–21 access arrangement period varies from the demand forecast in the access arrangement, APTNT's actual revenue will vary from the revenue allowance determined in our decision. In general, if actual demand is above forecast demand, APTNT's actual revenue will be above forecast revenue, and vice versa.

³⁸ NGR, r. 97(5).

³⁹ NGL, ss. 23, 24.

⁴⁰ See Attachment 7 (Operating expenditure) to this final decision.

⁴¹ See Attachment 6 (Capital expenditure) to this final decision.

⁴² See Attachment 3 (Rate of return) to this final decision.

forecasts of prudent and efficient opex and capex are either unavailable or inappropriate.⁴³

For smaller projects a service provider should generally utilise its existing expenditure allowance or reprioritise its work program rather than seeking approval of a pass through.⁴⁴ This is reflected in the materiality threshold that applies to applications for cost pass through under the approved access arrangement.⁴⁵

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.⁴⁶

11.4 Reasons for final decision

11.4.1 Annual reference tariff variation mechanism

In this section we set out the reasons for our final decision on APTNT's annual reference tariff variation mechanism.

Revenue equalisation

The annual reference tariff variation mechanism must be designed to equalise (in present value terms) the building block costs associated with reference services and the portion of total revenue requirement allocated to reference services. We consider our final decision annual reference tariff variation formula complies with rule 92(2) regarding revenue equalisation.

APTNT raised concerns that our draft decision pass through adjustment factor may not satisfy rule 92(2).⁴⁷ Our final decision discussion on the pass through adjustment factor formula and its compliance with rule 92(2) is set out below.

Further, the quantum of APTNT's revised proposal reference tariff has been revised to reflect the final decision total revenue requirement and forecast demand. The total revenue requirement and forecast demand are outlined in their respective sections of this final decision.

⁴³ 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.

⁴⁴ 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.

⁴⁵ 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'.

⁴⁶ 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 final decision.

⁴⁷ APTNT, *Amadeus Gas Pipeline access arrangement revised proposal: Response to draft decision submission*, January 2016, p. 108.

Reference tariff variation mechanism

APTNT accepted our draft decision reference tariff variation mechanism.⁴⁸ However, APTNT proposed a number revisions to our draft decision pass through factor formula.⁴⁹ These proposed revisions and our final decision on the pass through factor formula are discussed below. Our final decision reference tariff variation mechanism formula is set out in Figure 11.1.

Figure 11.1 Reference tariff variation mechanism formula

$$\text{Reference Tariff}_t = \text{Reference Tariff}_b \times \frac{\text{CPI}_t}{\text{CPI}_b} \times \prod_{j=1}^t (1 - X_j) \times (1 + PT_t)$$

where:

Reference Tariff_t is the Reference Tariff for the year *t*

t is the year in which the adjusted Reference Tariff is to be applied

Reference Tariff_b is the Reference Tariff for the Firm Service for the year 2016–17

CPI is the ABS CPI All Groups, Weighted Average of Eight Capital Cities. 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.

CPI_t is the ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in financial year *t*–1

CPI_b is the ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in financial year 2015–16

X is the X factor for each financial year of the 2016–21 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 financial year during the access arrangement period in accordance with that approved in the AER's final decision.

$\prod_{j=1}^n (1 - X_j)$ is the product of X factors calculated as follows:

where

n is the number of X factors

⁴⁸ APTNT, *Amadeus Gas Pipeline access arrangement revised proposal: Response to draft decision submission*, January 2016, pp. 104–108.

⁴⁹ APTNT, *Amadeus Gas Pipeline access arrangement revised proposal: Response to draft decision submission*, January 2016, pp. 107–108.

- for 2017–18, n=1, and

$$\prod_{j=1}^n (1 - X_j) = 1 - X_{2017-18}$$

where $X_{2017-18}$ is the X factor for 2017–18 as determined in the PTRM as approved in the AER's final decision after revision for the return on debt for 2017–18

- for 2018–19, n=2, and

$$\prod_{j=1}^n (1 - X_j) = (1 - X_{2017-18})(1 - X_{2018-19})$$

where $X_{2017-18}$ is the X factor for 2017–18 as determined in the PTRM as approved in the AER's final decision after revision for the return on debt for 2017–18, and $X_{2018-19}$ is the X factor for 2018–19 as determined in the PTRM as approved in the AER's final decision after revision for the return on debt for 2018–19

- for 2019–20, n=3, and

$$\prod_{j=1}^n (1 - X_j) = (1 - X_{2017-18})(1 - X_{2018-19})(1 - X_{2019-20})$$

where $X_{2017-18}$ is the X factor for 2017–18 as determined in the PTRM as approved in the AER's final decision after revision for the return on debt for 2017–18, and $X_{2018-19}$ is the X factor for 2018–19 as determined in the PTRM as approved in the AER's final decision after revision for the return on debt for 2018–19, and $X_{2019-20}$ is the X factor for 2019–20 as determined in the PTRM as approved in the AER's final decision after revision for the return on debt for 2019–20

- for 2020–21, n=4, and

$$\prod_{j=1}^n (1 - X_j) = (1 - X_{2017-18})(1 - X_{2018-19})(1 - X_{2019-20})(1 - X_{2020-21})$$

where $X_{2017-18}$ is the X factor for 2017–18 as determined in the PTRM as approved in the AER's final decision after revision for the return on debt for 2017–18, and $X_{2018-19}$ is the X factor for 2018–19 as determined in the PTRM as approved in the AER's final decision after revision for the return on debt for 2018–19, and $X_{2019-20}$ is the X factor for 2019–20 as determined in the PTRM as approved in the AER's final decision after revision for the return on debt for 2019–20, and $X_{2020-21}$ is the X factor for 2020–21 as determined in the PTRM as approved in the AER's final decision after revision for the return on debt for 2020–21

PT_t is the cost pass through factor for financial year t calculated as outlined below.

Pass through adjustment factor

APTNT accepted our draft decision to include a pass through adjustment factor in the reference tariff variation mechanism.⁵⁰ However, in response to our draft decision it proposed:

- a number of revisions to the access arrangement due to the inclusion of the pass through adjustment factor
- to remove the word 'audited' from the formula definition for quantities in year t–2
- that our final decision demonstrate that the pass through adjustment factor as presented in our draft decision satisfies rule 92(2).⁵¹

Our discussion on these issues is set out below.

Revisions to the access arrangement

We generally accept APTNT's proposed revisions to the AGP access arrangement due to the inclusion of the pass through adjustment factor. We agree that the revisions will provide transparency on the application of the pass through adjustment factor and allow a consistent use of terms within the access arrangement. However, we do not accept APTNT's proposed change to the timing of the tariff variation notification it submits to the AER for approval.⁵² We maintain our draft decision timing of at least 50 business days before the tariff implementation.

APTNT considered in its revised proposal that the following revisions were required to the AGP access arrangement as a consequence of the inclusion of the pass through adjustment factor:

- revision to the definition of AP_t to refer to the decision of the AER in respect of a pass through amount under section 4.7.4 of the access arrangement, and to refer to 'costs' as opposed to 'pass through amounts' consistent with the drafting of the clause 4.7.2
- inclusion of a new clause in 4.7.2 referring to costs of the cost pass through events previously approved by the AER

⁵⁰ APTNT, *Amadeus Gas Pipeline access arrangement revised proposal: Response to draft decision submission*, January 2016, p. 107.

⁵¹ APTNT, *Amadeus Gas Pipeline access arrangement revised proposal: Response to draft decision submission*, January 2016, pp. 107–108.

⁵² APTNT, *RE: 040316 AER Information request - AER Amadeus 014 - Tariff Variation Mechanism* [email to AER], 24 March 2016.

- revision to clause 4.7.4 to refer to the notified costs of a cost pass through event as well as to refer to the costs of a cost pass through event as required under clause 4.7.2; and
- inclusion of a new provision under clause 4.7.4 to link the costs of the cost pass through event approved by the AER under clause 4.7.4 to the variation to the reference tariff undertaken in accordance with the scheduled reference tariff variation process set out in clause 4.7.2.⁵³

Our final decision accepts these proposed changes.

While APTNT stated it had made these changes to the AGP revised access arrangement,⁵⁴ we note these changes were not made. We raised these omissions with APTNT who agreed this was an oversight and provided an updated revised access arrangement to include these proposed changes.⁵⁵

However, in its response to the omissions, APTNT also included a proposed change to the timing of the submission of its tariff variation notification.⁵⁶ It proposed that tariff variation notifications be made at least 30 business days before the date of tariff implementation. We do not accept this change.

We note APTNT initially proposed a time period of at least 50 business days.⁵⁷ However, it considered the notification submitted at this time should be a 'draft' as the Australian Bureau of Statistics (ABS) March quarter consumer price index—a key input into tariff variations—would not be available at this time. As such, a 'final' tariff variation notification would be submitted once the March quarter CPI was known.

However, our draft decision adopted the December quarter CPI in place of the March quarter, meaning a 50 business day's submission works without the administrative burden.⁵⁸ Therefore only one 'final' tariff variation notification would be required.

APTNT's revised proposal accepted our draft decision.⁵⁹ However, it has since proposed that as only one notification is required that the timing of submitting the tariff variation notification should be at least 30 business days before implementation.⁶⁰

⁵³ APTNT, *Amadeus Gas Pipeline access arrangement revised proposal: Response to draft decision submission*, January 2016, pp. 107–108.

⁵⁴ APTNT, *Amadeus Gas Pipeline access arrangement revised proposal: Response to draft decision submission*, January 2016, p. 108.

⁵⁵ APTNT, *RE: 220216 AER Information request - AER Amadeus 012 - Tariff Variation Mechanism* [email to AER], 24 February 2016; *RE: 040316 AER Information request - AER Amadeus 014 - Tariff Variation Mechanism* [email to AER], 24 March 2016.

⁵⁶ APTNT, *RE: 040316 AER Information request - AER Amadeus 014 - Tariff Variation Mechanism* [email to AER], 24 March 2016.

⁵⁷ APTNT, *Access arrangement for the Amadeus Gas Pipeline: 1 July 2016 to 30 June 2021*, August 2015, cl. 4.7.2; APTNT, *Amadeus Gas Pipeline access arrangement revision proposal submission*, August 2015, p. 173.

⁵⁸ AER, *Draft decision: Amadeus Gas Pipeline Access Arrangement 2016 to 2021, Attachment 11 – Reference tariff variation mechanism*, November 2015, p. 13.

⁵⁹ APTNT, *Amadeus Gas Pipeline access arrangement revised proposal: Response to draft decision submission*, January 2016, p. 112.

We do not accept APTNT's approach of at least 30 business days. We note the earlier timing of the CPI was to negate the reduced time of APTNT submitting its 'final' annual tariff variation proposal.

We also note that APTNT's proposed timing is inconsistent with the timing of tariff variation notification submissions by other gas distributors. We note gas distributors such as ActewAGL, Australian Gas Networks (South Australia) and Jemena Gas Networks (New South Wales) submit notifications at least 50 business days before tariff implementation.⁶¹ We consider consistent approaches across gas distributors and jurisdictions is desirable as it enables regulators, retailers, policy makers and end users greater transparency in tariff variation processes.⁶²

Therefore, our final decision maintains the tariff variation notification must be submitted at least 50 business days before the date of the tariffs implementation as per our draft decision.⁶³

Requirement for audited quantities

Our final decision accepts APTNT's proposal to remove the word 'audited' from the definition of q_{t-2} in the pass through adjustment factor formula. However, we note that APTNT will still need to provide assurances to us that the quantities used in calculating the pass through adjustment factor are reliable. As part of these assurances, we may require APTNT to provide audited data. However, rather than make this a standing requirement in the formula, we consider this requirement should be assessed on a case-by-case basis.

We note APTNT proposed the removal of the requirement for audited quantities on the basis that the majority of the Amadeus Gas Pipeline services are provided through negotiated services.⁶⁴ It noted the reference tariff is used as a 'stake in the ground' for negotiation. Therefore, APTNT considered the requirement to audit the quantity of reference services provided in year $t-2$ may not provide value to the AER as it is not an accurate measure of the utilisation of the pipeline.

⁶⁰ APTNT, *RE: 040316 AER Information request - AER Amadeus 014 - Tariff Variation Mechanism* [email to AER], 24 March 2016.

⁶¹ ActewAGL Distribution (proposed), *Access arrangement for the ACT, Queanbeyan and Palerang gas distribution network 1 July 2016–30 June 2021: Incorporating revisions that address matters raised in the AER draft decision*, 6 January 2016, p. 25, clause 7.18; Australian Gas Networks (proposed), *Access arrangement for AGN's South Australian Gas Distribution Network 1 July 2016–30 June 2021*, January 2016, clause 4.4.2; Jemena Gas Networks, *Access arrangement JGN's NSW gas distribution networks 1 July 2015 – 30 June 2020 (Incorporating revisions required by AER Final Decision 3 June 2015)*, June 2015, p. 10, clause 3.6.

⁶² NGR, r. 97(3)(d).

⁶³ AER, *Draft decision: Amadeus Gas Pipeline Access Arrangement 2016 to 2021, Attachment 11 – Reference tariff variation mechanism*, November 2015, p. 13.

⁶⁴ APTNT, *Amadeus Gas Pipeline access arrangement revised proposal: Response to draft decision submission*, January 2016, p. 108.

While we acknowledge the particular circumstances of the Amadeus Gas Pipeline, we note the reference tariff remains a key aspect in its access arrangement. Therefore, we consider any adjustments to the reference tariff should be performed through a prudent process. Thus where we consider it necessary, we will request APTNT to submit audited data to calculate the pass through adjustment factor.

Compliance with revenue equalisation

Our final decision has made changes to our draft decision pass through adjustment factor formula (pass through formula). These changes are required so that our final decision pass through formula is consistent with APTNT's reference tariff variation mechanism and satisfies rule 92(2) in regards to equalisation of the present values.

We agree with APTNT that the application of our draft decision method to calculate the pass through adjustment factor may not have satisfied rule 92(2) in regards to equalisation of the present values.⁶⁵ We consider our final decision adjustment factor formula has addressed APTNT's concerns and is now compliant with rule 92(2).

Our draft decision pass through formula—although consistent with the formula applied by other gas distribution networks⁶⁶—did not take into account the specific circumstances of APTNT's tariff variation mechanism. Our draft decision formula is better suited for a distributor applying a weighted average price cap tariff variation mechanism. However, this formula is not accurate for APTNT's tariff variation mechanism.

In the draft decision formula, the pass through amounts for the forthcoming year (year t) takes into account the pass through amounts in the preceding year (year $t-1$). This approach is required under a weighted average price cap because the establishment of reference tariffs for year t use the year $t-1$ tariffs as the basis for adjustments. Therefore, any pass through amounts reflected in the year $t-1$ tariffs need to be accounted for when establishing the year t tariffs so that the pass through amounts allowed for in year $t-1$ are not double counted. However, this approach is inconsistent with APTNT's reference tariff variation mechanism.

For APTNT's reference tariff variation mechanism, the reference tariff for the forthcoming year (year t) always uses the reference tariff approved in our final decision for 2016–17 (year b) as the basis for adjustments. As the 2016–17 reference tariff does not include any pass through amounts there is no need to adjust for pass through amounts approved in year $t-1$. Therefore, our final decision has removed the year $t-1$ component as set out in our draft decision pass through formula.

⁶⁵ APTNT, *Amadeus Gas Pipeline access arrangement revised proposal: Response to draft decision submission*, January 2016, p. 108.

⁶⁶ For example, see: Jemena Gas Networks (NSW), *Access arrangement: JGN's NSW gas distribution networks 1 July 2015 – 30 June 2020 — Incorporating revisions required by AER Final Decision 3 June 2015*, June 2015, Schedule 3; Australian Gas Networks (proposed), *Access arrangement for AGN's South Australian Gas Distribution Network 1 July 2016 – 30 June 2021*, January 2016, Annexure E.

Similarly, our final decision has changed the denominator in the method to calculate the pass through adjustment factor to be consistent with APTNT's reference tariff variation mechanism and to satisfy rule 92(2). The draft decision method applied a denominator that would be consistent with a weighted average price cap reference tariff variation mechanism.

Our final decision pass through adjustment factor formula is set out in Figure 11.2.

Figure 11.2 Pass through adjustment factor formula

PT_t is:

- (a) zero when financial year t refers to financial year 2016–17
- (b) the value of PT'_t determined for the financial year t for all other financial years in the access arrangement period

and

$$PT'_t = \frac{AP_t}{\left(\frac{CPI_t}{CPI_b}\right) \times \prod_{j=1}^t (1 - X_j) \times \sum_{j=1}^n ReferenceTariff_b q_{t-2}}$$

where

AP_t is:

- (a) any determined costs that the AER approves in respect of a pass through amount under section 4.7.4 of the access arrangement for financial 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 APTNT in the immediately prior access arrangement period) occurring in the immediately prior access arrangement period that APTNT proposed to pass through in whole or in part for financial year t,

CPI is the ABS CPI All Groups, Weighted Average of Eight Capital Cities. 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.

CPI_t is the ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in financial year t–1

CPI_b is the ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in financial year 2015–16

X_t means the X factor for each financial year of the 2016–21 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 financial year

during the access arrangement period in accordance with that approved in the AER's final decision

$\prod_{j=1}^n (1 - X_j)$ is the product of X factors calculated as follows:

where

n is the number of X factors

- for 2017–18, $n=1$, and

$$\prod_{j=1}^n (1 - X_j) = 1 - X_{2017-18}$$

where $X_{2017-18}$ is the X factor for 2017–18 as determined in the PTRM as approved in the AER's final decision after revision for the return on debt for 2017–18

- for 2018–19, $n=2$, and

$$\prod_{j=1}^n (1 - X_j) = (1 - X_{2017-18})(1 - X_{2018-19})$$

where $X_{2017-18}$ is the X factor for 2017–18 as determined in the PTRM as approved in the AER's final decision after revision for the return on debt for 2017–18, and $X_{2018-19}$ is the X factor for 2018–19 as determined in the PTRM as approved in the AER's final decision after revision for the return on debt for 2018–19

- for 2019–20, $n=3$, and

$$\prod_{j=1}^n (1 - X_j) = (1 - X_{2017-18})(1 - X_{2018-19})(1 - X_{2019-20})$$

where $X_{2017-18}$ is the X factor for 2017–18 as determined in the PTRM as approved in the AER's final decision after revision for the return on debt for 2017–18, and $X_{2018-19}$ is the X factor for 2018–19 as determined in the PTRM as approved in the AER's final decision after revision for the return on debt for 2018–19, and $X_{2019-20}$ is the X factor for 2019–20 as determined in the PTRM as approved in the AER's final decision after revision for the return on debt for 2019–20

- for 2020–21, $n=4$, and

$$\prod_{j=1}^n (1 - X_j) = (1 - X_{2017-18})(1 - X_{2018-19})(1 - X_{2019-20})(1 - X_{2020-21})$$

where $X_{2017-18}$ is the X factor for 2017–18 as determined in the PTRM as approved in the AER's final decision after revision for the return on debt for 2017–18, and $X_{2018-19}$ is the X factor for 2018–19 as determined in the PTRM as approved in the AER's final decision after revision for the return on debt for 2018–19, and $X_{2019-20}$ is the X factor for 2019–20 as determined in the PTRM as approved in the AER's final decision after revision for the return on debt for 2019–20, and $X_{2020-21}$ is the X factor for 2020–21 as determined in the PTRM as approved in the AER's final decision after revision for the return on debt for 2020–21

Reference Tariff_t is the Reference Tariff for the Firm Service for the year 2016–17

q_{t-2} is the quantity of component reference tariff that was sold in year $t-2$ (expressed in the units in which that component is expressed, e.g. GJ)

t is the financial year for which the reference tariff is being set.

11.4.2 Cost pass through events

This section sets out the reasons for our final decisions on APTNT's proposed pass through events.

Tax change event and Insurer credit risk event

Our draft decision accepted APTNT's proposed tax change event. APTNT has made no further changes to the tax change event in its revised proposal. APTNT's revised proposal also included the revisions to the insurer credit risk event set out in our draft decision. For the reasons set out in our draft decision we accept these events,⁶⁷ although we have made a minor amendment to insurer credit risk event to remove a redundant word.⁶⁸

Regulatory change event and Service standard event

These events allow service providers to recover costs associated with legislative and regulatory changes. As set out in our draft decision, we agree to include these events, but do not accept the definitions in APTNT's revised access arrangement proposal. For the reasons in our draft decision,⁶⁹ we have amended the definitions to align with the corresponding definitions in the NER.⁷⁰

⁶⁷ AER - *Draft decision Amadeus Gas Pipeline access arrangement - Attachment 11 - Reference tariff variation mechanism*, November 2015, pp. 11-19, 11-21 - 11-22.

⁶⁸ Paragraph (a) of our definition now commences 'an insurer of the service provider becomes insolvent' instead of 'a nominated insurer of the service provider becomes insolvent'. The word 'nominated' was redundant.

⁶⁹ AER - *Draft decision Amadeus Gas Pipeline access arrangement - Attachment 11 - Reference tariff variation mechanism*, November 2015, pp. 11-18 – 11-19.

⁷⁰ NER, Part 10 Glossary.

The NER definitions of these events, which we adapted for APTNT's 2016–21 access arrangement in our draft decision, require the triggering occurrence to 'substantially affect' or 'substantially vary' how the reference service is to be provided.

Responding to our draft decision, APTNT argued the inclusion of 'substantially' in these events inappropriately increases our discretion in accepting that an event has occurred, which increases uncertainty in relation to the recovery of costs under the event.⁷¹ APTNT argued that the materiality threshold applies an appropriate test as to whether a regulatory change or change in service standard is substantial—that is, that a change will be substantial if it has a material impact on costs.⁷² It submitted that a decision on whether a change to obligations is substantial is not relevant to the consideration we must make under the revenue and pricing principles (RPPs). APTNT submitted that the RPPs require that a service provider be provided a reasonable opportunity to recover at least the efficient costs of providing reference services and complying with a regulatory obligation or making a regulatory payment, not just an obligation that is substantial.⁷³

We consider the AEMC's language in the corresponding NER definitions is clear, and unambiguously indicates a requirement for both a substantial effect on the manner of service provision *and* a material cost impact before costs can be recovered via the pass through mechanism. The RPPs under the NEL are substantively the same as those under the NGL.⁷⁴ In neither case do we consider the dual requirement reflected in the AEMC's prescribed, electricity regulatory change event is incompatible with the principle that a service provider should be able to recover at least its efficient costs.

Terrorism event, natural disaster event and insurance cap event

We accept the inclusion of these events in APTNT's access arrangement, but have modified the definitions proposed by APTNT.

Our draft decision required APTNT to revise its definitions of the terrorism, insurance cap and natural disaster events to include a list of factors we would have regard to in assessing an application to pass through costs.⁷⁵ These go to how we would approach the pass through assessment contemplated in clause 4.7.3 of APTNT's proposed access arrangement.

⁷¹ APTNT, *Amadeus Gas Pipeline Access Arrangement Revised Proposal Response to Draft Decision - Submission*, January 2016, p. 111.

⁷² APTNT, *Amadeus Gas Pipeline Access Arrangement Revised Proposal Response to Draft Decision - Submission*, January 2016, p. 111.

⁷³ APTNT, *Amadeus Gas Pipeline Access Arrangement Revised Proposal Response to Draft Decision - Submission*, January 2016, p. 111.

⁷⁴ NEL, s. 7A ; NGL, s. 24.

⁷⁵ AER, *Draft decision Amadeus Gas Pipeline access arrangement - Attachment 11 - Reference tariff variation mechanism*, November 2015, pp. 11-19 – 11-21, 11-23.

A prudent and efficient service provider can, and should, take steps to manage the risk that a terrorism, natural disaster or insurance cap event may occur, and to mitigate the impact of the event should it occur, including through insurance or self-insurance. In allowing these three pass through events, we took this into account by requiring inclusion of the following factors as relevant to our assessment of an approved pass through amount:

- (ii) the level of insurance that an efficient and prudent service provider would obtain in respect of the event;

APTNT's revised proposal did not make this change to any of these three events.

For the terrorism and natural disaster events, we also required inclusion of:

- (i) whether the Service Provider has insurance against the event;

APTNT's revised proposal included this in the definition of the natural disaster event, but not the definition of the terrorism event.

APTNT argued that including an assessment of an efficient and prudent level of insurance for these pass through events creates a high level of uncertainty as to their application, and would create a perverse incentive to over-insure in order to avoid a negative decision on a pass through application.⁷⁶ It also considered our proposed revision would undermine our assessment of the prudence and efficiency of forecast opex, by allowing us to 're-determine' the efficient level of insurance after the fact to avoid a pass through claim.⁷⁷

Contrary to APTNT's arguments, we consider that absent such an assessment APTNT may have an incentive to *under-insure*. In this way, it could reduce expenditure below approved forecasts by spending less on insurance than the amount (implicitly or explicitly) included in its approved forecast opex, in the knowledge that any shortfalls could then be recovered from customers under the pass through mechanism. In such circumstances customers would pay APTNT twice for management of the same risk: first through the opex allowance for insurance, and again when a pass through claim was made. For the reasons set out in our draft decision,⁷⁸ we therefore require that this assessment be reflected in the definitions of these events as a relevant consideration.

For similar reasons, we consider the complementary question of whether APTNT has insured against the event is relevant to both the natural disaster and terrorism events, and should be reflected in both definitions.

⁷⁶ APTNT, *Amadeus Gas Pipeline Access Arrangement Revised Proposal Response to Draft Decision - Submission*, January 2016, p. 111.

⁷⁷ APTNT, *Amadeus Gas Pipeline Access Arrangement Revised Proposal Response to Draft Decision - Submission*, January 2016, pp. 111–112.

⁷⁸ AER, *Draft decision Amadeus Gas Pipeline access arrangement - Attachment 11 - Reference tariff variation mechanism*, November 2015, pp. 11-19 – 11-21, 11-23.

Other than the matters discussed in the foregoing paragraphs, APTNT's revised proposal incorporated our required revisions to these events. However, having considered recent submissions in concurrent regulatory proposals, we have departed in some cases from the definitions put to APTNT in our draft decision.

First, the draft decision (and APTNT's revised proposal) defined the relevant policy limit for the insurance cap event as the greater of (a) the regulated entity's actual⁷⁹ policy level, and (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 Access Arrangement Period. Our objective was to avoid a perverse incentive for a service provider to reduce its expenditure on insurance below prudent efficient levels, thereby reducing its operating expenditure relative to the approved forecast by transferring insurable risks to its customers instead of through genuine efficiencies.

We maintain that the insurance cap event should operate so as to dissuade a regulated firm from reducing its cover below prudent and efficient levels. However, we have considered recent submissions in concurrent regulatory proposals, and we accept that a firm's approved operating expenditure allowance may not unambiguously imply a particular level of insurance cover. However, it remains appropriate that we take into account where relevant, any assessments and analysis we have undertaken in relation to insurance when approving the access arrangement. We have added a note to this effect stating that, when making a determination on a pass through application, we will have regard to:

(iii) any assessment by the AER of APTNT's insurance in approving the access arrangement for the relevant period.

We have also amended the natural disaster event to:

- remove the adjectives 'major' and 'materially' to avoid any confusion with the materiality threshold that applies to all pass through events, and
- delete reference to whether a government authority has made a natural disaster declaration, following submissions that this may not be an appropriate matter for us to consider in the context of a claim under the natural disaster pass through event.

We likewise removed the adjective 'materially' from the definition of terrorism event to avoid any confusion with the pass through threshold.

We invited APTNT's comment on the modified definition of insurance cap event, natural disaster event and terrorism event. APTNT indicated general support for the changes but reiterated its concern about note (ii), which states we would have regard

⁷⁹ ActewAGL Distribution, *Response to AER's draft determination, 2016-21 ACT, Queanbeyan and Palerang Gas Network Access Arrangement*, January 2016, p. 125; CitiPower, *Revised Regulatory Proposal 2016-2020* pp. 420-421; Powercor, *Revised Regulatory Proposal 2016-2020*, pp. 412-413.

to efficient and prudent insurance levels when assessing an application under these pass through events.⁸⁰ However for the reasons set out above we believe it appropriate to consider the matters identified in note (ii) and have therefore included it in the definitions for these events.

⁸⁰ APTNT, *Response to AER information request 15* [email to AER], 4 April 2016.