



# **Directlink transmission determination 2015-2020**

April 2015

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# Table of contents

Table of contents .....	1
Shortened forms .....	2
Summary.....	3
1 Revenue.....	4
1.1 Method for calculating estimated total revenue cap.....	5
1.2 Annual building block revenue requirement .....	5
1.3 Method for calculating maximum allowed revenue .....	6
1.4 Regulatory asset base.....	8
1.5 Method for indexation of the regulatory asset base .....	8
1.6 Performance incentive scheme parameters .....	8
1.7 Efficiency benefit sharing scheme parameters.....	9
1.8 Application of the capital expenditure sharing scheme.....	10
1.9 Commencement and length of the regulatory control period.....	10
1.10 Depreciation for establishing the regulatory asset base as at the commencement of the next regulatory control period .....	10
2 Negotiating framework.....	11
3 Negotiated transmission service criteria.....	12
4 Pricing methodology .....	15
5 Pass through events .....	16

# Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
AR	Annual revenue
CESS	Capital expenditure sharing scheme
EBSS	Efficiency benefit sharing scheme
MAR	Maximum allowed revenue
NER	National Electricity Rules
NSP	Network service provider
NTSC	Negotiated transmission service criteria
opex	operating expenditure
PTRM	Post tax revenue model
RAB	Regulatory asset base
STPIS	Service target performance incentive scheme
TNSP	Transmission network service provider

# Summary

The Australian Energy Regulator (AER) must make a transmission determination for each transmission network service provider (TNSP) in accordance with chapter 6A of the National Electricity Rules (NER).<sup>1</sup>

This document is our transmission determination for Directlink for the regulatory control period 1 July 2015 to 30 June 2020. Our reasons are included in the AER's final decision on Directlink's transmission determination (April 2015) which is to be read in conjunction with this document.

Our transmission determination for Directlink consists of:<sup>2</sup>

- A revenue determination in respect of the provision by Directlink of prescribed transmission services (section 1)
- A determination relating to Directlink's negotiating framework (section 2)
- A determination that specifies the negotiated transmission service criteria (NTSC) that apply to Directlink (section 3)
- A determination that specifies the pricing methodology that applies to Directlink (section 4)
- A determination that specifies pass through events that will apply to this determination in addition to those specified in the NER (section 5).

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<sup>1</sup> NER, clause 6A.2.1.

<sup>2</sup> NER, clause 6A.2.2; 6A.7.3(a1).

# 1 Revenue

We are required to calculate the amount of revenue that Directlink requires each year of the regulatory control period in accordance with a building block approach.<sup>3</sup> This is referred to as the *annual building block revenue requirement*. The annual building block revenue is then used to calculate the expected *maximum allowed revenue* (MAR) for each year of the 2015–20 regulatory control period. The annual MAR that Directlink may earn from providing prescribed transmission services is subject to adjustments to account for factors such as inflation, approved pass through costs and annual performance rewards or penalties.

Our revenue determination specifies the following matters:<sup>4</sup>

- The amount of the estimated total revenue cap for the regulatory control period or the method of calculating that amount.
- The annual building block revenue requirement for each regulatory year of the regulatory control period.
- The amount of the MAR for each regulatory year of the regulatory control period or the method of calculating that amount.
- The regulatory asset base (RAB) as at the commencement of the regulatory control period.
- Appropriate methodology for the indexation of the RAB.
- The values that are to be attributed to the performance incentive scheme parameters for the purposes of the application to Directlink of the service target performance incentive scheme (STPIS) that applies in respect of the regulatory control period.
- The values that are to be attributed to the efficiency benefit sharing scheme parameters for the purposes of the application to Directlink of the efficiency benefit sharing scheme (EBSS) that applies in respect of the regulatory control period.
- How any capital expenditure sharing scheme or small-scale incentive scheme is to apply to Directlink.
- The commencement and length of the regulatory control period.
- Whether depreciation for establishing the regulatory asset base as at the commencement of the following regulatory control period is to be based on actual or forecast capital expenditure.

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<sup>3</sup> NER, clause 6A.5.4.

<sup>4</sup> NER, clause 6A.4.2

## 1.1 Method for calculating estimated total revenue cap

We determine an estimated total MAR of \$68.7 million (\$ nominal) for Directlink for the 2015–20 regulatory control period as shown in Table 1. The estimated total MAR is also known as the total revenue cap. It is the sum of the expected MAR for each regulatory year.<sup>5</sup>

**Table 1 AER's final determination on Directlink's annual expected maximum allowed revenue (\$ million, nominal)**

	2015–16	2016–17	2017–18	2018–19	2019–20	Total
Annual expected MAR (smoothed)	13.1	13.4	13.7	14.1	14.4	68.7
X factor (%)	n/a <sup>a</sup>	0.0% <sup>b</sup>	0.0% <sup>b</sup>	0.0% <sup>b</sup>	0.0% <sup>b</sup>	n/a

Source: AER analysis.

- (a) Directlink is not required to apply an X factor for 2015–16 because the MAR is set in this decision. The MAR for 2015–16 is around 10.1 per cent lower than the approved MAR (\$14.2 million, nominal) in the final year of the 2005–15 regulatory control period (2014–15) in nominal terms, or 7.8 per cent lower in nominal terms.
- (b) The X factor will be revised to reflect the annual return on debt update.

We determine the annual expected MAR by using the X factors to smooth the annual building block revenue requirement as set out below.

## 1.2 Annual building block revenue requirement

We determine the annual building block revenue requirement for Directlink as shown in Table 2.

**Table 2 AER's final determination on Directlink's annual building block revenue requirement (\$ million, nominal)**

	2015–16	2016–17	2017–18	2018–19	2019–20	Total
Return on capital	7.1	7.4	7.4	7.3	7.4	36.5
Regulatory depreciation	1.7	1.9	2.1	2.4	2.6	10.7
Operating expenditure	4.3	3.6	3.8	3.8	4.0	19.5
Net tax allowance	0.3	0.4	0.4	0.4	0.5	2.1
Annual building block revenue requirement (unsmoothed)	13.3	13.3	13.7	14.0	14.4	68.7

Source: AER analysis.

<sup>5</sup> NER, clause 6A.5.3.

### 1.3 Method for calculating maximum allowed revenue

We use a forecast inflation rate in our post-tax revenue model (PTRM) to calculate the expected MAR in nominal dollar terms. Therefore, the calculation of the actual annual MAR will require an adjustment for actual inflation. The MAR is also subject to adjustments for updating the return on debt annually, revenue increment or decrement determined in accordance with the STPIS, and any approved pass through amounts. This section sets out the method of this annual adjustment process.

We determine that the method for calculating Directlink's MAR for each year of the 2015–20 regulatory control period will be the sum of its allowed revenue (AR) for that year and adjustments arising from the STPIS and any approved pass through amounts.

We determine AR of \$13.1 million for Directlink for 2015–16. Directlink then applies an annual adjustment to determine its AR for each subsequent year of the 2015–20 regulatory control period, based on the previous year's AR and using the CPI–X methodology. That is, the subsequent year's AR is determined by adjusting the previous year's AR for actual inflation and the X factor determined after the annual return on debt update:

$$AR_t = AR_{t-1} \times (1 + \Delta CPI) \times (1 - X_t)$$

where:

AR = the allowed revenue

t = time period/financial year (for t = 2 (2016–17), 3 (2017–18), 4 (2018–19), 5 (2019–20))

$\Delta$ CPI = the annual percentage change in the Australian Bureau of Statistics' (ABS) consumer price index (CPI) all groups, weighted average of eight capital cities from December in year t – 2 to December in year t – 1<sup>6</sup>

X = the smoothing factor determined in accordance with the PTRM as approved in the AER's final decision, and annually revised for the return

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<sup>6</sup> In the revenue cap determination for Directlink's 2005–15 regulatory control period, the CPI required for the annual MAR adjustment process reflects the March quarter CPI, which is typically published by the ABS in late April each year. For this transmission determination we require Directlink to use the December quarter of the previous calendar year CPI for the annual MAR adjustment for its next regulatory control period. December quarter CPI is typically released by the ABS towards the end of January of the following year. As the same set of CPI will be used for the RAB roll forward at the next reset for Directlink in 2020, this change will allow us to update the actual CPI for RAB roll forward purposes well before the publication date of the AER's final decision at the next reset. We note that there will be an overlapping issue of the March quarter CPI when the transition to the December quarter CPI occurs (this will be in the year 2015–16 for the TNSP). This is because the CPI for March quarter 2015 will be reflected in both 2014–15 and 2015–16. However, we consider this is only a transitional issue and does not have a material impact on the revenue to be recovered by the TNSP.



on debt update in accordance with the formula specified in the return on debt appendix B of attachment 3 calculated for the relevant year.

The MAR is determined annually in accordance with the NER by adding to (or deducting from) the AR:

- the service target performance incentive scheme revenue increment (or revenue decrement)<sup>7</sup>
- any approved pass through amounts.<sup>8</sup>

Table 3 sets out the timing of the annual calculation of the AR and performance incentive:

$MAR_t = (\text{allowed revenue}) + (\text{performance incentive}) + (\text{pass through})$

$$= AR_t + \left( \frac{(AR_{t-1} + AR_{t-2})}{2} \times S_{ct} \right) + P_t$$

where:

MAR = the maximum allowed revenue

AR = the allowed revenue

S = the revenue increment or decrement determined in accordance with the STPIS

P = the pass through amount (positive or negative) that the AER has determined in accordance with clauses 6A.7.2 and 6A.7.3 of the NER

t = time period/financial year (for t = 2 (2016–17), 3 (2017–18), 4 (2018–19), 5 (2019–20))

ct = time period/calendar year (for t = 2 (2015), 3 (2016), 4 (2017), 5 (2018)).

Under the NER, a TNSP may also adjust the MAR for under or over recovery amounts.<sup>9</sup> That is, the revenue amounts recovered higher or lower than the approved MAR for each year would be included in the subsequent year's MAR. In the case of an under-recovery, the amount would be added to the future year's MAR. In the case of an over-recovery, the amount would be subtracted from the future year's MAR.

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<sup>7</sup> NER, clauses 6A.7.4.

<sup>8</sup> NER, clauses 6A.7.2 and 6A.7.3.

<sup>9</sup> NER, clauses 6A.23.3(c)(2)(iii) and 6A.24.4(c).

**Table 3 Timing of the calculation of allowed revenues and the performance incentive for Directlink**

<i>f</i>	Allowed revenue (financial year)	<i>ct</i>	Performance incentive (calendar year)
2	1 July 2016–30 June 2017	2	1 January 2015–31 December 2015
3	1 July 2017–30 June 2018	3	1 January 2016–31 December 2016
4	1 July 2018–30 June 2019	4	1 January 2017–31 December 2018
5	1 July 2019–30 June 2020	5	1 January 2018–31 December 2019

Note: The performance incentive for 1 January 2014–31 December 2014 is to be applied to the AR determined for 2015–16.

## 1.4 Regulatory asset base

We determine an opening RAB value of \$129.4 million as at the commencement of the 2015–20 regulatory control period for Directlink.

## 1.5 Method for indexation of the regulatory asset base

We determine that the method for indexing Directlink's RAB for each year of the 2015–20 regulatory control period will be the same as that used to escalate its AR for that relevant year—that is, to apply the annual percentage change in the published ABS CPI all groups, weighted average of eight capital cities.<sup>10</sup> For Directlink, this will be the December quarter CPI. This method will be used as part of the roll forward of Directlink's opening RAB for the purposes of the AER's transmission revenue determination for the regulatory control period commencing on 1 July 2020.

## 1.6 Performance incentive scheme parameters

The AER has determined the values for the performance targets, caps, collars and weightings for each of the parameters for the service component of the service target performance incentive scheme (STPIS) applicable to Directlink for the 2015–20 regulatory control period.<sup>11</sup> These are shown in Table 4.

<sup>10</sup> ABS, *Catalogue number 6401.0, Consumer price index*, Australia.

<sup>11</sup> AER, *Final – Service target performance incentive scheme*, December 2012.

**Table 4 AER's final decision on Directlink's parameter values and weightings for the service component of the STPIS**

	Collar	Target	Cap	Weighting (% of MAR)
<b>Average circuit outage rate</b>				
Circuit outage – fault	500%	333%	167%	1.0
Circuit outage – forced outage	383.31%	180%	35.19%	0.0
<b>Proper operation of equipment<sup>12</sup></b>				
Failure of protection system	8	4	1	0.0
Material failure of SCADA	n/a	n/a	n/a	0.0
Incorrect operational isolation of primary or secondary equipment	n/a	n/a	n/a	0.0

Sources: AER analysis.

Directlink's market impact parameter performance targets that will apply within the 2015–20 regulatory control period will be published annually as part of our service standards compliance reporting process. Directlink's market impact performance target for 2015 is 1409 dispatch intervals.<sup>13</sup>

## 1.7 Efficiency benefit sharing scheme parameters

The AER has determined the values for the efficiency benefit sharing scheme (EBSS) parameters that are to apply to Directlink in the 2015–20 regulatory control period, subject to adjustments required by the EBSS. These values are set out in Table 5.

**Table 5 Final decision on Directlink's forecast opex for the EBSS (\$ million, 2014–15)**

	2015–16	2016–17	2017–18	2018–19	2019–20	Total
Forecast opex for EBSS (excluding debt raising costs)	4.09	3.37	3.45	3.41	3.42	17.73

Note: Numbers may not add due to rounding.

<sup>12</sup> Directlink noted the STPIS applies weight to only the "circuit outage fault" parameter, therefore Directlink only proposed values for the "failure of protection system" sub-parameter under the proper operation of equipment section. It did not have historical data for other "proper operation of equipment" sub-parameters and will commence collecting data to report against those sub-parameters in the future. As the scheme requires the provision of values for parameters unless there is no data, we accept the approach proposed by Directlink.

<sup>13</sup> Regarding the performance measure for the last half of 2015, we calculate the performance using the method set out in Appendix F of the STPIS, with the incentive payment pro-rated in accordance with clause 4.2(i) and Appendix D.

We will exclude debt raising costs from the calculation of EBSS carryover amounts.

We will also:

- adjust forecast opex to add (subtract) any approved revenue increments (decrements) made after the initial regulatory determination. This may include approved pass through amounts.
- adjust actual opex to add capitalised opex that has been excluded from the RAB
- exclude categories of opex not forecast using a single year revealed cost approach for the regulatory control period beginning in 2020 where doing so better achieves the requirements of clause 6A.6.5 of the NER.

When calculating actual opex under the EBSS we will adjust reported actual opex for the 2015–20 period to reverse any movements in provisions.

## **1.8 Application of the capital expenditure sharing scheme**

We will apply the CESS as set out in version 1 of the capital expenditure incentives guideline to Directlink in the 2015–20 regulatory control period.<sup>14</sup>

## **1.9 Commencement and length of the regulatory control period**

The regulatory control period will be five years, commencing on 1 July 2015 and ending on 30 June 2020.

## **1.10 Depreciation for establishing the regulatory asset base as at the commencement of the next regulatory control period**

We determine that the forecast depreciation approach (that is, based on forecast capex) will apply to the 2015–20 regulatory control period and is to be used to establish the RAB at the commencement of the regulatory control period from 1 July 2020 for Directlink.

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<sup>14</sup> AER, *Capex incentive guideline*, November 2013, pp. 5–9.

## 2 Negotiating framework

Our determination on Directlink's negotiating framework accepts in full the framework prepared by Directlink.

Directlink must comply with its negotiating framework and its NTSC (see section 3 of this determination) when it is negotiating the terms and conditions of access for negotiated transmission services to be provided to a person.<sup>15</sup>

Directlink's negotiating framework sets out the procedure to be followed during negotiations between Directlink and any person who wishes to receive a negotiated transmission service from Directlink, as to the terms and conditions of access for provision of the service.<sup>16</sup>

The negotiating framework in Attachment A to this determination must be adopted by Directlink for the regulatory control period covered by this determination.

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<sup>15</sup> NER, clause 6A.9.2(a); 6A.9.3. Directlink must also comply with chapters 4, 5 and 6A of the NER.

<sup>16</sup> NER, clause 6A.9.5(a).

### 3 Negotiated transmission service criteria

Directlink must comply with its negotiating framework (see section 2 of this determination) and its NTSC when it is negotiating the terms and conditions of access for negotiated transmission services to be provided to a person.<sup>17</sup>

Directlink's NTSC sets out the criteria that are to be applied:<sup>18</sup>

- by Directlink in negotiating:
  - the terms and conditions of access for negotiated transmission services, including the prices that are to be charged for the provision of those services by Directlink for the regulatory control period
  - any access charges which are negotiated by Directlink during the regulatory control period
- by a commercial arbitrator in resolving any dispute, between Directlink and a person who wishes to receive a negotiated transmission service, in relation to:
  - the terms and conditions of access for the negotiated transmission service, including the price that is to be charged for the provision of that service by Directlink
  - any access charges that are to be paid to or by Directlink.

The following NTSC will apply to Directlink for the regulatory control period covered by this determination.

#### National Electricity Objective

1. The terms and conditions of access for a negotiated transmission service, including the price that is to be charged for the provision of that service and any access charges, should promote the achievement of the National Electricity Objective.

#### Criteria for terms and conditions of access

##### *Terms and conditions of access*

2. The terms and conditions of access for a negotiated transmission service must be fair, reasonable and consistent with the safe and reliable operation of the power system in accordance with the NER.
3. The terms and conditions of access for negotiated transmission services, particularly any exclusions and limitations of liability and indemnities, must not be unreasonably onerous. Relevant considerations include the allocation of risk

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<sup>17</sup> NER, clause 6A.9.2(a); 6A.9.3. Directlink must also comply with chapters 4, 5 and 6A of the NER.

<sup>18</sup> NER, clause 6A.9.4

between the TNSP and the other party, the price for the negotiated transmission service and the cost to the TNSP of providing the negotiated service.

4. The terms and conditions of access for a negotiated transmission service must take into account the need for the service to be provided in a manner that does not adversely affect the safe and reliable operation of the power system in accordance with the NER.

### ***Price of services***

5. The price of a negotiated transmission service must reflect the cost that the TNSP has incurred or incurs in providing that service, and must be determined in accordance with the principles and policies set out in the Cost Allocation Methodology.
6. Subject to criteria 7 and 8, the price for a negotiated transmission service must be at least equal to the avoided cost of providing that service but no more than the cost of providing it on a stand-alone basis.
7. If the negotiated transmission service is a shared transmission service that:
  - (a) exceeds any network performance requirements which it is required to meet under any relevant electricity legislation; or
  - (b) exceeds the network performance requirements set out in schedule 5.1a and 5.1 of the NER
8. then the difference between the price for that service and the price for the shared transmission service which meets network performance requirements must reflect the TNSP's incremental cost of providing that service (as appropriate).
9. For shared transmission services, the difference in price between a negotiated transmission service that does not meet or exceed network performance requirements and a service that meets those requirements should reflect the TNSP's avoided costs. Schedule 5.1a and 5.1 of the NER or any relevant electricity legislation must be considered in determining whether any network service performance requirements have not been met or exceeded.
10. The price for a negotiated transmission service must be the same for all Transmission Network Users. The exception is if there is a material difference in the costs of providing the negotiated transmission service to different Transmission Network Users or classes of Transmission Network Users.
11. The price for a negotiated transmission service must be subject to adjustment over time to the extent that the assets used to provide that service are subsequently used to provide services to another person. In such cases the adjustment must reflect the extent to which the costs of that asset are being recovered through charges to that other person.
12. The price for a negotiated transmission service must be such as to enable the TNSP to recover the efficient costs of complying with all regulatory obligations associated with the provision of the negotiated transmission service.

## Criteria for access charges

### *Access charges*

13. Any access charges must be based on the costs reasonably incurred by the TNSP in providing Transmission Network User access. This includes the compensation for forgone revenue referred to in clause 5.4A(h) to (j) of the NER and the costs that are likely to be incurred by a person referred to in clause 5.4A(h) to (j) of the NER (as appropriate).



## 4 Pricing methodology

Our determination on Directlink's pricing methodology accepts in full Directlink's proposed pricing methodology (Attachment B to this determination).

The role of Directlink's pricing methodology is to answer the question 'who should pay how much'<sup>19</sup> in order for Directlink to recover its costs. Directlink's pricing methodology provides a 'formula, process or approach'<sup>20</sup> that when applied:

- allocates the aggregate annual revenue requirement to the categories of prescribed transmission services that a transmission business provides and to the connection points of network users<sup>21</sup>
- determines the structure of prices that a transmission business may charge for each category of prescribed transmission services.<sup>22</sup>

Directlink's pricing methodology relates to prescribed transmission services only.

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<sup>19</sup> AEMC, *Rule determination: National Electricity Amendment (Pricing of Prescribed Transmission Services) Rule 2006 No. 22*, 21 December 2006, p. 1.

<sup>20</sup> NER, 6A.24.1(b).

<sup>21</sup> NER, clause 6A.24.1(b)(1).

<sup>22</sup> NER, clause 6A.24.1(b)(2).

## 5 Pass through events

Under the NER any of the following is a pass through event for this transmission determination:<sup>23</sup>

- a regulatory change event
- a service standard event
- a tax change event
- an insurance event
- any other event specified in this transmission determination as a pass through event for this determination.

The first four of these pass through events are prescribed by, and defined in, the NER.<sup>24</sup>

In addition, the nominated pass through events in Table 6 will apply to Directlink for the 2015–20 regulatory control period.<sup>25</sup>

**Table 6 Nominated pass through events**

Pass through event	Definition
Insurance cap event	<p>An insurance cap event occurs if:</p> <ol style="list-style-type: none"> <li>1. Directlink makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy,</li> <li>2. Directlink incurs costs beyond the relevant policy limit, and</li> <li>3. the costs beyond the relevant policy limit materially increase the costs to Directlink in 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. Directlink'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 control period in which the insurance policy is issued.</li> </ol> </li> <li>5. A relevant insurance policy is an insurance policy held during the 2015-20 regulatory control period or a previous regulatory control period in which Directlink 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>

<sup>23</sup> NER, clause 6A.7.3(1a).

<sup>24</sup> NER, Chapter 10 Glossary

<sup>25</sup> NER, clauses 6A.6.9, 6A.7.3(a1)(5).

Pass through event	Definition
	<ul style="list-style-type: none"> <li>i. the insurance policy for the event, and</li> <li>ii. the level of insurance that an efficient and prudent NSP would obtain in respect of the event.</li> </ul>
Terrorism event	<p>A terrorism event occurs if:</p> <p>An act (including, but not limited to, the use of force or violence or the threat of force or violence) of any person or group of persons (whether acting alone or on behalf of or in connection with any organisation or government), which from its nature or context is done for, or in connection with, political, religious, ideological, ethnic or similar purposes or reasons (including the intention to influence or intimidate any government and/or put the public, or any section of the public, in fear) and which materially increases the costs to Directlink in providing prescribed transmission services.</p> <p>In assessing a terrorism event pass through application, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> <li>i. whether Directlink has insurance against the event,</li> <li>ii. the level of insurance that an efficient and prudent NSP would obtain in respect of the event, and</li> <li>iii. whether a declaration has been made by a relevant government authority that a terrorism event has occurred.</li> </ul>
Natural disaster event	<p>A natural disaster event occurs if:</p> <p>Any major fire, flood, earthquake or other natural disaster occurs during the 2015-20 regulatory control period and materially increases the costs to Directlink in providing prescribed transmission services, provided the fire, flood or other event was not a consequence of the acts or omissions of the NSP.</p> <p>The term 'major' in the above paragraph means an event that is serious and significant. It does not mean material as that term is defined in the NER (that is 1 per cent of the TNSP's maximum allowed revenue for that regulatory year).</p> <p>In assessing a natural disaster event pass through application, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> <li>i. whether Directlink has insurance against the event,</li> <li>ii. the level of insurance that an efficient and prudent NSP would obtain in respect of the event, and</li> <li>iii. whether a relevant government authority has made a declaration that a natural disaster has occurred.</li> </ul>