



FINAL DECISION
Energex determination 2015–16
to 2019–20

Attachment 15 – Pass through
events

October 2015

© Commonwealth of Australia 2015

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

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

Requests and inquiries concerning reproduction and rights should be addressed to the Director, Corporate Communications, Australian Competition and Consumer Commission, GPO Box 4141, Canberra ACT 2601 or publishing.unit@acc.gov.au.

Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Tel: (03) 9290 1444
Fax: (03) 9290 1457

Email: AERInquiry@aer.gov.au

Note

This attachment forms part of the AER's final decision on Energex's 2015–20 distribution determination. It should be read with all other parts of the final decision.

The final decision includes the following documents:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Value of imputation credits

Attachment 5 – Regulatory depreciation

Attachment 6 – Capital expenditure

Attachment 7 – Operating expenditure

Attachment 8 – Corporate income tax

Attachment 9 – Efficiency benefit sharing scheme

Attachment 10 – Capital expenditure sharing scheme

Attachment 11 – Service target performance incentive scheme

Attachment 12 – Demand management incentive scheme

Attachment 13 – Classification of services

Attachment 14 – Control mechanism

Attachment 15 – Pass through events

Attachment 16 – Alternative control services

Attachment 17 – Negotiated services framework and criteria

Attachment 18 – Connection policy

Contents

| | |
|--|-------------|
| Note | 15-2 |
| Contents | 15-3 |
| Shortened forms | 15-4 |
| 15 Pass through events | 15-6 |
| 15.1 Final decision | 15-6 |
| 15.2 Energex's revised proposal | 15-8 |
| 15.3 AER's assessment approach | 15-8 |
| 15.3.1 Interrelationships..... | 15-9 |
| 15.4 Reasons for final decision | 15-9 |

Shortened forms

| Shortened form | Extended form |
|----------------------------------|--|
| AEMC | Australian Energy Market Commission |
| AEMO | Australian Energy Market Operator |
| AER | Australian Energy Regulator |
| augex | augmentation expenditure |
| capex | capital expenditure |
| CCP | Consumer Challenge Panel |
| CESS | capital expenditure sharing scheme |
| CPI | consumer price index |
| DRP | debt risk premium |
| DMIA | demand management innovation allowance |
| DMIS | demand management incentive scheme |
| distributor | distribution network service provider |
| DUoS | distribution use of system |
| EBSS | efficiency benefit sharing scheme |
| ERP | equity risk premium |
| Expenditure Assessment Guideline | Expenditure Forecast Assessment Guideline for electricity distribution |
| F&A | framework and approach |
| MRP | market risk premium |
| NEL | national electricity law |
| NEM | national electricity market |
| NEO | national electricity objective |
| NER | national electricity rules |
| NSP | network service provider |
| opex | operating expenditure |
| PPI | partial performance indicators |

| Shortened form | Extended form |
|----------------|---|
| PTRM | post-tax revenue model |
| RAB | regulatory asset base |
| RBA | Reserve Bank of Australia |
| repex | replacement expenditure |
| RFM | roll forward model |
| RIN | regulatory information notice |
| RPP | revenue and pricing principles |
| SAIDI | system average interruption duration index |
| SAIFI | system average interruption frequency index |
| SLCAPM | Sharpe-Lintner capital asset pricing model |
| STPIS | service target performance incentive scheme |
| WACC | weighted average cost of capital |

15 Pass through events

The pass through mechanism of the National Electricity Rules (NER) recognises that a distributor can be exposed to risks beyond its control, which may have a material impact on its costs. A cost pass through enables a distributor to recover (or pass through) the costs of defined unpredictable, high cost events that are not built into our distribution determination. The NER includes the following prescribed pass through events for all distributors:

- a regulatory change event
- a service standard event
- a tax change event
- a retailer insolvency event
- any other event specified in a determination as a pass through event (nominated pass through event).¹

This attachment sets out our final decision on the pass through events that will apply to Energex for the 2015–20 regulatory control period.

15.1 Final decision

Our final decision is that the following nominated pass through events will apply to Energex for the 2015–20 regulatory control period:

- insurance cap event
- insurer credit risk event
- terrorism event
- natural disaster event

These events have the definitions listed in table 15.1 below.

¹ NER, cl. 6.5.10.

Table 15.1 Approved cost pass through definitions

| Event | Definition |
|---------------------------|--|
| Insurance cap event | <p>An insurance cap event occurs if:</p> <ol style="list-style-type: none"> 1. Energex makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy, 2. Energex incurs costs beyond the relevant policy limit, and 3. the costs beyond the relevant policy limit materially increase the costs to Energex in providing direct control services <p>For this insurance cap event:</p> <ol style="list-style-type: none"> 4. the relevant policy limit is the greater of: <ol style="list-style-type: none"> a. Energex's actual policy limit at the time of the event that gives, or would have given rise to a claim, 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 distribution determination for the regulatory control period in which the insurance policy is issued. 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 Energex was regulated. <p>Note for the avoidance of doubt, in assessing an insurance cap event cost pass through application under rule 6.6.1(j) of the NER the AER will have regard to:</p> <ol style="list-style-type: none"> i. the relevant insurance policy for the event, and ii. the level of insurance that an efficient and prudent NSP would obtain in respect of the event. |
| Insurer credit risk event | <p>An insurer's credit risk event occurs if:</p> <p>A nominated insurer of Energex becomes insolvent, and as a result, in respect of an existing or potential insurance claim for a risk that was insured by the insolvent insurer, Energex:</p> <ol style="list-style-type: none"> i. is subject to a higher or lower claim limit or a higher or lower deductible than would have otherwise applied under the insolvent insurer's policy; or ii. incurs additional costs associated with funding an insurance claim, which would otherwise have been covered by the insolvent insurer. <p>Note: In assessing an insurer's credit risk event pass through application, the AER will have regard to, amongst other things,</p> <ul style="list-style-type: none"> - Energex's attempts to mitigate and prevent the event from occurring by reviewing and considering the insurer's track record, size, credit rating and reputation. - In the event that a claim would have been made after the insurance provider became insolvent, whether Energex had reasonable opportunity to insure the risk with a different provider. |
| 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 Energex in providing direct control services.</p> <p>Note: In assessing a terrorism event pass through application, the AER will have regard to, amongst other things:</p> |

| Event | Definition |
|------------------------|---|
| | <ul style="list-style-type: none"> i. whether Energex has insurance against the event, ii. the level of insurance that an efficient and prudent NSP would obtain in respect of the event, and iii. whether a declaration has been made by a relevant government authority that a terrorism event has occurred. |
| 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 Energex in providing direct control services, provided the fire, flood or other event was not a consequence of the acts or omissions of the service provider.</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 Rules (that is 1 per cent of the distributor's annual revenue requirement for that regulatory year).</p> <p>Note: 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"> i. whether Energex has insurance against the event, ii. the level of insurance that an efficient and prudent NSP would obtain in respect of the event, and iii. whether a relevant government authority has made a declaration that a natural disaster has occurred. |

Source:

15.2 Energex's revised proposal

Energex did not comment on pass through events in its revised proposal.²

15.3 AER's assessment approach

Our approach to assessing cost pass through events was described in detail in attachment 15 of our preliminary decision for Energex.³

Our approach provides the network service provider (NSP) with a reasonable opportunity to recover at least the efficient costs⁴ the operator incurs,⁵ while also providing effective incentives to promote economic efficiency.⁶ It promotes a balance between the economic costs and risks for promoting efficient investment.⁷

We have maintained the same approach in this final decision.

² Energex, *Revised Regulatory Proposal*, 3 July 2015.

³ AER, *Preliminary decision, Energex determination, Attachment 15*, April 2015, pp. 8–10.

⁴ Under cl. 6.6.1(d), (g) and (j) of the NER, we are to make a decision on the costs of providing direct control services as a result of a pass through event occurring. Direct control services include alternative control services and standards control services.

⁵ NEL, s. 7A(2).

⁶ NEL, s. 7A(3).

⁷ NEL, s. 7A(6).

15.3.1 Interrelationships

As we discussed in the preliminary decision, the nominated pass through events are interrelated with other parts of this determination, in particular with Energex's proposed opex and capex allowances and the rate of return. These interrelationships require that we balance our decision to accept nominated pass through events with the need to maintain appropriate incentives in other parts of our decision.

15.4 Reasons for final decision

Energex did not comment on our preliminary decision on pass through events in its revised proposal. We did not receive any submissions that raised new issues in respect of this aspect of our preliminary decision and Energex's revised proposal.

In our preliminary decision, we set out in detail our reasons for:

- amending Energex's proposed definitions of insurance cap event, insurer credit risk event, terrorism event and natural disaster event.⁸
- not accepting Energex's proposed smart meter event.⁹

Our final decision is the same as our preliminary decision: we approve the nominated pass through events set out in Table 15.1table 15.1, above. As such, our preliminary decision reasons form part of this final decision. Those reasons remain the same for this final decision on Energex's cost pass through events.

⁸ AER, *Preliminary decision, Energex Determination, attachment 15*, April 2015, pp. 11, 13, 14, 15, 17.

⁹ AER, *Preliminary decision, Energex Determination, attachment 15*, April 2015, p. 18.