



**FINAL DECISION
SA Power Networks
determination 2015–16 to
2019–20**

**Attachment 15 – Pass through
events**

October 2015

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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 SA Power Networks' 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

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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 yet 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 SA Power Networks 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 SA Power Networks for the 2015–20 regulatory control period:

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

These events are defined in table 15.1 below.

¹ NER, cl. 6.6.1.

Table 15.1 Approved cost pass through definitions

Event	Definition
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 SA Power Networks 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 SA Power Networks 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.
Insurance cap event	<p>An insurance cap event occurs if:</p> <ul style="list-style-type: none"> 1. SA Power Networks makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy, 2. SA Power Networks incurs costs beyond the relevant policy limit, and 3. the costs beyond the relevant policy limit materially increase the costs to SA Power Networks in providing direct control services <p>For this insurance cap event:</p> <ul style="list-style-type: none"> 4. the relevant policy limit is the greater of: <ul style="list-style-type: none"> a. SA Power Networks 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 final decision 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 SA Power Networks 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) the AER will have regard to:</p> <ul 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 SA Power Networks 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, SA Power Networks:</p> <ul style="list-style-type: none"> 1. 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 2. incurs additional costs associated with funding an insurance claim, which would otherwise have been covered by the insolvent insurer.

Event	Definition
	<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"> i. SA Power Networks' attempts to mitigate and prevent the event from occurring by reviewing and considering the insurer's track record, size, credit rating and reputation. ii. In the event that a claim would have been made after the insurance provider became insolvent, whether SA Power Networks 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 SA Power Networks 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> <ul style="list-style-type: none"> i. whether SA Power Networks 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.

15.2 SA Power Networks' revised proposal

In our preliminary decision we did not accept all the nominated pass through events proposed by SA Power Networks. Instead we substituted our own definitions of natural disaster event, insurance cap event (formerly named liability above insurance cap) and insurer credit risk event which we considered satisfied the requirements of the NER. We did not accept SA Power Networks' initial proposal for a general nominated pass through event, Kangaroo Island cable failure event or native title event.²

In its revised proposal, SA Power Networks adopted some elements of our preliminary decision but not others. In particular, SA Power Networks:³

- challenged our inclusion, in the definitions of natural disaster event, insurance cap event and insurer credit risk event, of information on how we would assess the events

² AER, *Preliminary decision, SA Power Networks' determination, Attachment 15*, April 2015, p. 6.

³ SA Power Networks, *Revised Regulatory Proposal*, July 2015, p. 293.

- amended our definition of natural disaster event 'to expressly include significant weather as classified by the Bureau of Meteorology' and removed the word 'major' and its definition
- did not accept our preliminary decision to reject its proposed Kangaroo Island cable failure event
- proposed a new terrorism event.

These are discussed further in section 15.4 below.

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 SA Power Networks.⁴

Our approach provides the distributor with a reasonable opportunity to recover at least the efficient costs⁵ it incurs,⁶ while also providing effective incentives to promote economic efficiency.⁷ It promotes a balance between the economic costs and risks for promoting efficient investment.⁸ We have maintained the same approach in this final decision.

The NER include the following nominated pass through event considerations which we must have regard to when assessing nominated pass through events:⁹

The nominated pass through event considerations are:

- whether the event proposed is an event covered by a category of pass through event specified in clause 6.6.1(a1)(1) to (4) (in the case of a distribution determination) or clause 6A.7.3(a1)(1) to(4) (in the case of a transmission determination);
- whether the nature or type of event can be clearly identified at the time the determination is made for the service provider;
- whether a prudent service provider could reasonably prevent an event of that nature or type from occurring or substantially mitigate the cost impact of such an event;
- whether the relevant service provider could insure against the event, having regard to:

⁴ AER, *Preliminary decision, SA Power Networks' determination 2015-20, Attachment 15*, April 2015, pp. 8–10.

⁵ 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.

⁶ NEL, s.7A(2).

⁷ NEL, s. 7A(3).

⁸ NEL, s. 7A(6).

⁹ NER, cl. 6.5.10(b); NER glossary, definition of 'nominated pass through event considerations'.

- (1) the availability (including the extent of availability in terms of liability limits) of insurance against the event on reasonable commercial terms; or
- (2) whether the event can be self-insured on the basis that:
 - (i) it is possible to calculate the self-insurance premium; and
 - (ii) the potential cost to the relevant service provider would not have a significant impact on the service provider's ability to provide network services; and.
- (e) any other matter the AER considers relevant and which the AER has notified Network Service Providers is a nominated pass through event consideration.

15.3.1 Interrelationships

As we discussed in our preliminary decision, the nominated pass through events are interrelated with other parts of this determination, in particular with SA Power Networks' 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

This section sets out our reasons for the final decision on each pass through event.

15.4.1 Assessment factors

In our preliminary decision we rejected SA Power Networks' proposed definitions for the natural disaster event, insurance cap event and insurer credit risk event, and substituted alternative definitions that we considered satisfied the requirements of the NER. In its revised proposal SA Power Networks accepted our decision to approve pass throughs for these events, but proposed amended definitions. Amongst the changes proposed by SA Power Networks, it opposed inclusion of assessment factors in the pass through event definitions.¹⁰

The assessment factors are matters set out by the NER which we are to have regard to in assessing pass through applications.¹¹ In our preliminary decision we included these factors in the definitions of natural disaster and insurer credit risk events, whereas SA Power Networks had not. However, SA Power Networks' insurance cap event definition did include assessment factors.¹²

¹⁰ SA Power Networks, *Revised Regulatory Proposal*, July 2015, p. 293.

¹¹ NER, cl. 6.6.1(j).

¹² SA Power Networks, *Regulatory Proposal*, October 2014, p. 275.

In relation to all three of these events, SA Power Networks argued in its revised proposal that:

- the definitions of pass through events should not include factors that go to the assessment of a pass through application¹³
- including these factors would be inconsistent with the definitions of prescribed pass through events in the NER, which do not include this detail.¹⁴

On the insurance cap event definition, SA Power Networks acknowledged it had changed its approach between its initial regulatory proposal and its revised regulatory proposal. SA Power Networks said in its revised proposal it had given the matter further consideration and obtained legal advice, leading to its new position to oppose inclusion of assessment factors in the event definition.¹⁵

In response to SA Power Networks' revised proposal, we maintain that including assessment factors in the definitions of nominated pass through events is consistent with the NER. The NER list a number of factors to which we must have regard in making a determination on a pass through application, including any factors we considers relevant.¹⁶ We consider including additional factors we consider relevant to a nominated pass through event in the event definition provides greater predictability and transparency in the operation of nominated pass through events. This clarity supports the NER nominated pass through event considerations which require nominated pass through events be clearly identified at the time the determination is made.¹⁷ In the case of the natural disaster event, insurance cap event and insurer credit risk event, this includes whether the distributor has insurance against the event as well as the level of insurance acquired.

¹³ SA Power Networks, *Revised Regulatory Proposal*, July 2015, p. 293.

¹⁴ SA Power Networks, *Revised Regulatory Proposal*, July 2015, p. 294.

¹⁵ SA Power Networks, *Revised Regulatory Proposal*, July 2015, p. 294.

¹⁶ NER, cl. 6.6.1(j)(8).

¹⁷ NER, Chapter 10 (Glossary), Definition of 'Nominated pass through event considerations', paragraph (b).

15.4.2 Natural disaster event

SA Power Networks did not accept our amended definition of a natural disaster event.¹⁸

Storm

SA Power Networks challenged our removal of 'storm' from the definition of a natural disaster event. In response to our preliminary decision SA Power Networks proposed to change the term 'storm' to 'significant weather'.¹⁹ SA Power Networks noted the Bureau of Meteorology "provides a section within its monthly weather review titled 'significant weather' which includes thunder storms, strong winds, cyclones etc."²⁰

We do not agree with the inclusion of the term 'significant weather' in the natural disaster event definition. The term 'significant weather' is not sufficiently clear so as to indicate when such a pass through would apply. The term, as used by the Bureau of Meteorology in its monthly weather review, includes a wide range of weather events from 'early season snow' to 'strong wind'.²¹ If a major 'storm', 'significant weather event' or other natural disaster event occurs, it would likely fall within the category 'other natural disaster...' in our amended definition.

Having taken the nominated pass through considerations into account, we have decided not to include 'significant weather' in the definition of the natural disaster event. In particular, we consider that this will help to ensure that the nature or type of pass through event can be clearly identified.²²

Proviso: Consequence of the act or omissions

SA Power Networks also challenged the addition of the following consideration in our proposed definition of the natural disaster event:²³

Provided the fire, flood or other event was not a consequence of the acts or omissions of the service provider.

SA Power Networks argued the provision was 'effectively restating clause 6.6.1(j)(3) of the NER'.²⁴ Also, that consideration of acts or omissions of the distributor is properly an issue for our assessment of a pass through application, from which we may alter the revenues to be recovered by SA Power Networks from consumers.

¹⁸ SA Power Networks, *Revised Regulatory Proposal*, July 2015, p. 294.

¹⁹ SA Power Networks, *Revised Regulatory Proposal*, July 2015, p. 294.

²⁰ SA Power Networks, *Revised Regulatory Proposal*, July 2015, p. 294.

²¹ Bureau of Meteorology, *Monthly Weather Review - Australia*, May 2015, p.3.

²² NER, cl. 6.5.10(b); NER glossary, definition of 'nominated pass through event considerations'.

²³ SA Power Networks, *Revised Regulatory Proposal*, July 2015, p. 294.

²⁴ SA Power Networks, *Revised Regulatory Proposal*, July 2015, p. 294.

Our assessment approach for nominated pass through events includes consideration of who is best placed to bear the risks of events occurring. Adopting a definition which notes we will not allow distributors to pass through costs where the event has been caused by the distributor is consistent with the regulatory regime. Specifically, the nominated pass through event considerations require we take into account whether a prudent distributor could reasonably prevent an event of that nature or type from occurring.²⁵ Inclusion of the proviso around acts or omissions of the service provider means the definition of a natural disaster event is consistent with the nominated pass through event considerations.

Moreover, we have sought to maintain the incentive properties of the regulatory regime by excluding events that businesses have control over. We therefore maintain this element of the definition. This is consistent with the nominated pass through event considerations, which include 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.²⁶

'Major'

In its original proposal SA Power Networks included the word 'major' as part of the definition of 'natural disaster event'. In its revised proposal, SA Power Networks indicated it had reconsidered its approach and now considers the word 'is inappropriate, creates confusion and uncertainty'.²⁷ SA Power Networks submitted that it now considers the inclusion of the word 'major' is not necessary. This is because, if the materiality threshold (one per cent of the maximum allowed revenue for that year) is met, then the event is clearly a 'major' event.²⁸

We consider 'major' means an event that is serious or significant. It does not refer to whether the cost impact of the event is 'material'. If the costs of non-major natural disaster events are able to be passed through, an unacceptable amount of manageable and affordable risk will be transferred from the distributor to its customers. We have previously stated that including the term 'major' in the natural disaster event definition would incentivise a distributor to manage the risk through insurance, self-insurance and mitigation.²⁹

Including a definition of the term 'major' in the natural disaster definition is consistent with the nominated pass through event considerations, including:

- 'major' allows the event to be more clearly identified³⁰

²⁵ NER, cl. 6.5.10(b); NER, Chapter 10, Glossary, definition of 'nominated pass through event considerations'.

²⁶ NER, Chapter 10, Glossary: Definition of 'nominated pass through event considerations', sub-clause (c).

²⁷ SA Power Networks, *Revised Regulatory Proposal*, July 2015, p. 295.

²⁸ SA Power Networks, *Revised Regulatory Proposal*, July 2015, p. 295.

²⁹ AER, *Final Decision, ElectraNet Transmission Determination 2013–14 to 2017–18*, April 2013, p. 193.

³⁰ NER, Chapter 10, Glossary: Definition of 'nominated pass through event considerations', sub-clause (b)

- it ensures manageable and affordable risk lies with SA Power Networks, and not its customers³¹
- it provides an incentive for SA Power Networks to manage the risk through insurance, self insurance and mitigation³².

Inclusion of assessment factors

SA Power Networks challenged our preliminary decision to include of assessment factors in pass through event definitions (discussed in 15.4.1 above). SA Power Networks also argued we should not include in the definition of a natural disaster event that we would have regard to whether a 'declaration' has been made by a 'relevant government authority' that such an event has occurred.³³

Whether a relevant government authority has made a relevant declaration in respect of these pass through events is a factor that we would have regard to in considering whether to approve a pass through application.³⁴ We consider including this factor in the definition of a natural disaster event adds clarity around when this type of nominated pass through event may be considered to have occurred, which is a nominated pass through event consideration.³⁵ This has also been our approach in a number of recent decisions. For these reasons and those discussed in section 15.4.1 above we maintain that the assessment factors should remain in the definition.

15.4.3 Insurance cap event

In its revised proposal SA Power Networks proposed that no assessment factors be included in the definition of an insurance cap event.³⁶ For the reasons discussed in section 15.4.1 above we maintain that the assessment factors should remain in the definition.

15.4.4 Insurer credit risk event

In its revised proposal SA Power Networks proposed that no assessment factors be included in the event definitions (discussed in section 15.4.1 above).³⁷ SA Power Networks also submitted additional arguments, specific to the insurer credit risk event, against inclusion of assessment factors in the event definition. SA Power Networks presented a quote from our preliminary decision:³⁸

³¹ NER, Chapter 10, Glossary: Definition of 'nominated pass through event considerations', sub-clause (c).

³² NER, Chapter 10, Glossary: Definition of 'nominated pass through event considerations', sub-clause (d).

³³ SA Power Networks, *Revised Regulatory Proposal*, July 2015, p. 296.

³⁴ NER, cl. 6.6.1(j)(8).

³⁵ NER, cl. 6.5.10(b); NER glossary, definition of 'nominated pass through event considerations', sub-clause (b).

³⁶ SA Power Networks, *Revised Regulatory Proposal*, July 2015, p. 297.

³⁷ SA Power Networks, *Revised Regulatory Proposal*, July 2015, p. 297.

³⁸ SA Power Networks, *Revised Regulatory Proposal*, July 2015, p. 297.

'As a result of ... consultation [with SA Power Networks and others], we have clarified that we may allow NSPs to pass through claims that would have been made immediately after the insurer became insolvent and before the NSP had a reasonable opportunity to acquire new insurance for those risks. This amendment maintains an incentive on NSPs to acquire new insurance as soon as reasonably possible after an insurance provider becomes insolvent.'

SA Power Networks indicated some of its insurance coverage is occurrence based, rather than application based. That is, a claim is based on when an event occurred rather than when an insurance claim is lodged. In the case of a retrospective insurance claim,³⁹ SA Power Networks argued it may be unaware an insurer had become insolvent at the time an event occurred. On this basis SA Power Networks argued against the inclusion of assessment factors in the definition of an insurer credit risk event.

We consider SA Power Networks should take steps to ensure it is aware if and when any of its insurers become insolvent, and to mitigate any potential losses accordingly. We consider this is good business practice. Moreover, the assessment factors for the insurer credit risk event simply state that, in considering a pass through application, we will consider whether SA Power Networks had reasonable opportunity to procure replacement insurance coverage. In its pass through application SA Power Networks may demonstrate that it was not able to be aware of an insurer's insolvency at the time an event occurred. For these reasons and those discussed in section 15.4.1 above we maintain that the assessment factors should remain in the definition.

15.4.5 General nominated pass through event

While SA Power Networks submitted it does not agree with our reasoning behind our preliminary decision to not accept a general nominated pass through event, it did not include a general nominated pass through event in its revised proposal.⁴⁰

15.4.6 Terrorism event

SA Power Networks proposed the following definition of a terrorism event in its revised proposal:

'A terrorism event occurs if:

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

³⁹ An insurance claim could be retrospective if, for example, damage to the network caused by a discrete event was not immediately apparent. This may lead to an insurance claim being made in relation to an event which occurred in the past.

⁴⁰ SA Power Networks, *Revised Regulatory Proposal*, July 2015, p. 297–298.

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 SA Power Networks in providing direct control services.'

We accept that a terrorism event can be consistent with the nominated pass through considerations, if appropriately defined. We do not accept the proposed definition. We have amended the proposed definition to incorporate factors we will have regard to when assessing a claim for a pass through. In this respect, we have added to the proposed event definition:

Note: In assessing a terrorism event pass through application, the AER will have regard to, amongst other things:

- i. whether SA Power Networks 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.

A prudent and efficient distributor may be able to take actions which reduce the vulnerability of the network to terrorist attacks and would obtain insurance in respect of terrorism events. We note SA Power Networks' ability to prevent or mitigate the cost impact of a terrorism event is limited even when regard is had to the security measures SA Power Networks has in place.⁴¹

Whether a relevant government authority has made a relevant declaration in respect of a terrorism event is also a factor we would have regard to in making a determination on a pass through application for a terrorism event. We consider this adds clarity around when this type of nominated pass through event may be considered to have occurred. For these reasons and those discussed in section 15.4.1 above we maintain that the assessment factors should be included in the definition.

We consider there may be some overlap between an insurance cap event and the terrorism event, but accept the need to have both because SA Power Networks may incur costs which an insurance policy would not ordinarily cover. The amendment to the pass through event definition assists in avoiding the overlap.

Our amended definition is set out in table 15.1 above.

15.4.7 Kangaroo Island cable failure event

SA Power Networks did not accept our preliminary decision in relation to the Kangaroo Island cable failure event.⁴² This event would allow SA Power Networks to recover the

⁴¹ NER, Chapter 10, Glossary: Definition of 'nominated pass through event considerations', sub-clause (c); SA Power Networks, *Revised Regulatory Proposal*, July 2015, pp. 298–299.

⁴² SA Power Networks, *Revised Regulatory Proposal*, July 2015, p. 299.

costs it would incur in maintaining power on Kangaroo Island and repairing the undersea cable in the event it were to fail and cause widespread loss of power for customers on Kangaroo Island. For the following reasons we do not accept this pass through event:

- It is appropriate SA Power Networks bears the risk of its feeder cable failing, unless caused by natural disaster or act of terrorism. We consider that a prudent service provider could take reasonable steps to prevent cable failure from occurring or substantially mitigate the cost impact of a cable failure.⁴³
- SA Power Networks has not provided evidence that commercial insurance to cover this risk is unavailable.⁴⁴

We discuss these reasons further below.

In its revised regulatory proposal, SA Power Networks stated:

The NER envisages that consideration by the AER as to whether a NSP has prudently and efficiently managed the risk of an event is a post-event assessment matter; it is not a matter that is relevant to a determination as to whether an event should be approved (or rejected) as a nominated pass through event.

We do not accept this interpretation of the NER. In considering whether to accept a nominated cost pass through event proposed by a distributor, the NER requires us to take into account the nominated pass through event considerations. These include:⁴⁵

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

Therefore, the actions a distributor could take to manage the risk of a pass through event are relevant to determining whether we should accept a nominated pass through event. While similar considerations may also be relevant in determining a pass through amount,⁴⁶ this does not mean we should not consider them when deciding whether or not to accept a nominated pass through event.

In its revised proposal SA Power Networks said our preliminary decision to approve capex for construction of a second cable indicated we had accepted SA Power Networks could not reasonably prevent this event from occurring.⁴⁷ Our reasons for approving capex for a second cable are set out in attachment six to this final decision. Approval of capex for SA Power Networks to construct a second cable does not mean we accept SA Power Networks is unable to mitigate the risk of this event.

⁴³ NER, Chapter 10, Glossary: Definition of 'nominated pass through event considerations', sub-clause (c).

⁴⁴ NER, Chapter 10, Glossary: Definition of 'nominated pass through event considerations', sub-clause (d).

⁴⁵ NER, chapter 10, Glossary: Definition of 'nominated pass through event considerations', sub-clause (c).

⁴⁶ NER, cll. 6.6.1(d), (g) and (j).

⁴⁷ SA Power Networks, *Revised Regulatory Proposal*, July 2015, p. 300.

In our preliminary decision we stated it would not be appropriate for customers to bear the risk of the Kangaroo Island undersea cable failing. We continue to hold this view. This does not prevent SA Power Networks submitting to us a cost pass through application should the cable fail due to a natural disaster or terrorism event. In those cases, we consider it may be appropriate for customers to bear the risk associated with cable failure. However, more generally it is appropriate for SA Power Networks, as the owner and operator of the cable, to bear the risk of its failure.

A cable failure could occur for a range of reasons which are reasonably under the control of SA Power Networks. These include maintenance faults or problems created by the manner of its installation. These are matters which we consider a prudent service provider could reasonably prevent from occurring, or substantially mitigate the cost impact of such an event.⁴⁸

The existing cable is still within its expected 30 year life. When the second cable is expected to become operational in 2018 the existing cable will still be five years away from the end of its expected life—it was installed in 1993. We further note the previous Kangaroo Island cable operated to a life of 37 years.

In its revised proposal, SA Power Networks said most distributors are not exposed to the risk of undersea cables failing. However, we consider there are in fact many examples of undersea cables operated by Australian NSPs. These include:

- Ergon Energy operates several undersea cables, including to Hayman Island (30 kilometres) and Magnetic Island (10 kilometres)
- Basslink connects Tasmania to Victoria, including 290 kilometres of undersea cable
- Ausgrid operates cables running under Sydney Harbor.

We note neither Ergon Energy nor Ausgrid have a specific pass through event for undersea cables. We acknowledge physical inspection of cable underground or under water, or both, is of course more difficult than otherwise. But these circumstances are not unique to the Kangaroo Island cable. In our view they do not justify transferring the risk of asset failure, in all circumstances, from SA Power Networks to its customers. We consider SA Power Networks has not substantiated why this particular asset requires its own pass through event. Particularly when, as submitted by SA Power Networks, the second cable is expected to become operational within the 2015–20 regulatory control period, before the end of the existing cable's expected life.

The nominated pass through event considerations also require us to consider whether the service provider could insure against the event.⁴⁹ In its regulatory proposal SA Power Networks stated it was unable to obtain appropriate insurance that was commercially viable. However, SA Power Networks has not submitted evidence to support that proposition. We also note SA Power Networks could have mitigated risk

⁴⁸ NER, Chapter 10, Glossary: Definition of 'nominated pass through event considerations', sub-clause (c).

⁴⁹ NER, Chapter 10, Glossary, nominated pass through event considerations (d)(1).

associated with cable failure by prioritising construction of a second cable from its existing capex budget.

In our final decision for the 2010–15 regulatory control period, we said the ‘general nominated [pass through] event provides a mechanism whereby SA Power Networks (then ETSA Utilities) could seek to pass through costs associated with a Kangaroo Island cable failure.’⁵⁰ The position we took at that time did not presage that such a pass through application would necessarily be approved. Rather, it simply acknowledged it would be within SA Power Networks’ rights to submit an application for our consideration. If there had been a failure of the Kangaroo Island cable, we would still have needed to assess whether SA Power Networks could have avoided the event or mitigated its effects in determining the pass through amount under the NER⁵¹.

15.4.8 Native title event

SA Power Networks did not propose a native title event in its revised proposal for the 2015–20 regulatory control period.⁵² As such, we have not departed from our preliminary decision not to include a native title event as a pass through event.

⁵⁰ AER, *Final Decision, ETSA Utilities distribution determination 2010–15*, p.239.

⁵¹ NER, cl. 6.6.1(j)(3).

⁵² SA Power Networks, *Revised Regulatory Proposal*, July 2015, p. 303.