PRELIMINARY DECISION
Ergon Energy determination
2015−16 to 2019−20

Attachment 15 − Pass through events

April 2015

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 preliminary decision on Ergon Energy's 2015–20 distribution determination. It should be read with all other parts of the preliminary decision.

The preliminary 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

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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 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 DNSPs:

- a regulatory change event
- a service standard event
- a tax change event
- a retailer insolvency event
- in addition to those defined events, an event specified in a determination for a regulatory control period (nominated pass through event).[1]

This attachment sets out our preliminary decision on the additional pass through events that will apply to Ergon Energy for the 2015–20 regulatory control period.

15.1 Preliminary decision

We do not accept the nominated pass through events as drafted by Ergon Energy and have proposed alternative definitions for:

- insurance cap event
- natural disaster event
- insurance event.

These are set out in section **Error! Reference source not found.** below.

We do not accept the following proposed pass through events:

- retail separation event
- isolated network separation event.

15.2 Ergon Energy's proposal

Ergon Energy's proposed nominated pass through events and definitions are set out in **Error! Reference source not found.**.

1 NER, cl. 6.5.10.

Table 15.1 Ergon Energy's proposed pass through events

Proposed event	Proposed definition
insurance cap event	An insurance cap event is an event whereby: 1. Ergon Energy: (a) makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy, or (b) would have been entitled to make a claim or claims or receive the benefit of a payment or payments under a relevant insurance policy but for the application of a relevant policy limit 2. Ergon Energy incurs costs beyond the relevant policy limit, and those costs would have been recovered under the insurance policy had the limit not been exhausted, and 3. the costs beyond the relevant policy limit materially increase the costs to Ergon Energy of providing direct control services. For this insurance cap event: 1. the relevant policy limit is the greater of: (a) Ergon Energy’s actual policy limit at the time of the event that gives, or would have given, rise to the 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. 2. a relevant insurance policy is an insurance policy held during the regulatory control period 2015-20 or a previous regulatory control period in which Ergon Energy was regulated. Note: For the avoidance of doubt, in assessing an insurance cap event cost pass through application under rule 6.6.1, the AER will have regard to: 1. the insurance premium proposal submitted by Ergon Energy in its Regulatory Proposal 2. the forecast operating expenditure allowance approved in the AER’s final decision 3. the reasons for that decision.
natural disaster event	Any major cyclone, fire, flood, earthquake or other natural disaster beyond the reasonable control of Ergon Energy that occurs during the regulatory control period 2015-20 and materially increases the costs to Ergon Energy of providing direct control services. Note: In assessing a natural disaster event pass through application, the AER will have regard to: 1. the insurance premium proposal submitted by Ergon Energy in its Regulatory Proposal 2. the forecast operating expenditure allowance approved in the AER’s final decision 3. the reasons for that decision. The term 'major' in the above paragraph means an event that is serious and significant.
insurance event	An event for which the risk of its occurrence is the subject of insurance taken out by or for Ergon Energy, for which an allowance is provided in Ergon Energy’s annual revenue requirement and in respect of which:

	1. the cost of the premium paid or required to be paid by Ergon Energy in the regulatory year in which the cost of the premium changes is materially higher or lower than the premium that is provided for in the annual revenue requirement for that regulatory year, or 2. the risk eventuates and, as a consequence, Ergon Energy incurs or will incur all or part of a deductible where the amount so incurred or to be so incurred in a regulatory year is materially higher or lower than the allowance for the deductible (if any) that is provided for in the annual revenue requirement for that regulatory year, or 3. insurance becomes unavailable to Ergon Energy, or 4. insurance becomes available to Ergon Energy on terms materially different to those existing at the time the distribution determination was made (other than as a result of any act or omission of Ergon Energy which is inconsistent with good electricity industry practice).
retail separation event	Any legislative or administrative act of the Queensland Government to separate the retail electricity business of Ergon Energy in whole or in part from the electricity distribution function of Ergon Energy (including by way of a sale of the retail business), which materially changes the costs to Ergon Energy of providing direct control services in the regulatory control period 2015-20.
isolated network separation event	Any legislative or administrative act of the Queensland Government to separate the isolated network function of Ergon Energy in whole or in part from the grid-connected electricity distribution function of Ergon Energy, which materially changes the costs to Ergon Energy of providing direct control services in the regulatory control period 2015-20.

Source: Ergon Energy, *Attachment 04.01.03 Nominated cost pass through events*, pp. 5–16.

15.3 AER's assessment approach

We must decide which of Ergon Energy's proposed nominated pass through events will apply for the 2015–20 regulatory control period. Pass through events transfer financial risks from NSPs to consumers. If one of the nominated events occurs, the costs of the event that we assess as meeting the factors set out in the NER are passed through to consumers and network charges increase.[2]

Our approach has been guided by the National Electricity Objective (NEO) and the Revenue and Pricing Principles. It provides the NSP with a reasonable opportunity to recover at least the efficient costs the operator incurs,[3] while also providing effective incentives to promote economic efficiency.[4] It promotes a balance between the economic costs and risks for promoting efficient investment.[5]

The NER includes the following nominated pass through event considerations which we must have regard to when assessing nominated pass through events.

The *nominated pass through event considerations* are:

2 NER, cll. 6.6.1(d),(g) and (j).
3 s.7A(2) of the NEL.
4 s.7A(3) of the NEL.
5 s.7A(6) of the NEL.

> (a) 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*);
>
> (b) whether the nature or type of event can be clearly identified at the time the determination is made for the service provider;
>
> (c) whether a prudent service provider could reasonably prevent an event of that nature or type from occurring or substantially mitigate the cost impact of such an event;
>
> (d) whether the relevant service provider could insure against the event, having regard to:
>
> > (1) the availability (including the extent of availability in terms of liability limits) of insurance against the event on reasonable commercial terms; or
> >
> > (2) whether the event can be self-insured on the basis that:
> >
> > > (i) it is possible to calculate the self-insurance premium; and
> > >
> > > (ii) the potential cost to the relevant service provider would not have a significant impact on the service provider's ability to provide *network services*; and.
>
> (e) any other matter the *AER* considers relevant and which the *AER* has notified *Network Service Providers* is a nominated pass through event consideration.[6]

These considerations involve an assessment of the incentives on NSPs to manage their risks efficiently.

For systemic risks, NSPs are compensated through the allowed rate of return. NSPs also face business-specific, or residual, risks. These activities are generally compensated through the opex and capex allowances. Beyond this, an NSP may manage other risks through a number of other strategies, including:

- prevention (avoiding the risk)
- mitigation (reducing the negative effect or probability of the risk)
- insurance (transferring the risk to another party)
- self-insurance (putting aside funds to manage the likely costs associated with a risky event).

An efficient business will manage its risk by employing the most cost effective combination of these strategies. For example, if a cost is reasonably predictable a business should factor it into its proposed opex and capex . In addition, an NSP may invest in its networks to mitigate the impact of certain events occurring. Alternatively, if the probability of events occurring can be readily estimated then the event should be insurable.

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

Pass through events cover those limited circumstances for which the risks cannot be managed efficiently in these ways and for which the NSP should be able to recover its efficient costs.

A factor for us to consider, which is reflected in the pass through event considerations, is who is best placed to manage risk. Generally, the party who is in the best position to manage the risk should bear the risk. If the NSP, or customers, are fully exposed to a risk, this may lead to adverse outcomes.

For example, where it is not possible for an NSP to insure against a risk, NSPs may need to share that risk with customers, to ensure that the service can continue to be provided if the event happens. The uninsurable risk may be outside the control of the NSP and have a low probability of occurring, but it might also have a significant cost impact. The most efficient and prudent solution to manage that type of risk may be to require customers to accept some of the burden of that risk, by allowing a pass through in the unlikely event that the risk eventuates. On the other hand, if the NSP is able to pass through all the costs of such an event, this may reduce the NSP's incentive to take prudent actions to prevent or mitigate the potential cost impact of the risk. Accordingly, while customers may need to accept some of the burden of the risk, the NSP will need to share some of the risk too. That might be achieved, for example, by making a pass through conditional on the NSP demonstrating that it has acted prudently and efficiently in managing the potential impact of the event.

We consider all of these issues when assessing a nominated pass through event with the aim of achieving the right balance, in the long term interests of consumers, in accordance with the nominated pass through event considerations.

As a matter of good regulatory practice, an additional factor we take into account is consistency in our approach to assessing nominated pass through events across our determinations.

15.3.1 Interrelationships

As we mentioned above, pass through events are not the only mechanism in this determination by which Ergon Energy can manage its risks. The nominated pass through events are interrelated with other parts of this determination, in particular with the proposed opex and capex allowances and the rate of return. These interrelationships require the AER to balance the incentives in the various parts of its decision.

15.4 Reasons for preliminary decision

In this section we set out the reasons for our preliminary decisions on each of Ergon Energy's proposed pass through events. We have:

- proposed alternative definitions for the insurance cap event, insurance event, and the natural disaster event.
- not accepted the retail separation event or the isolated network separation event.

15.4.1 Insurance cap event

The insurance cap event would allow Ergon Energy to recover material costs incurred which exceed its insurance claim limit.[7] We accept that an insurance cap event can be consistent with the nominated pass through considerations, if appropriately defined. We do not accept Ergon Energy's proposed definition of the insurance cap event. We have amended its proposed definition to reflect matters that we will have regard to in assessing an event.

Ergon Energy is funded through its opex allowance to obtain an appropriate level of insurance for these types of risks. Subject to the comments below, we accept that an insurance cap event would protect it from high cost impact events which would be uneconomic to insure against. We consider consumers can benefit from the inclusion of such an event because they are not required to fund excessive premiums where insurance, if available, would be uneconomic. Consumers then only bear the risk should an insurance cap event occur.

We expect that Ergon Energy will obtain efficient levels of insurance cover, commensurate with its business risk, as reflected in its opex allowance. We also note the following:

- the extent to which Ergon Energy is able to reasonably prevent costs being incurred which exceed its insurance cap, or take steps to mitigate incurring costs above the cap, is limited
- the coverage of insurance should be capped at a level beyond which it is unable or uneconomic to insure, having regard to the cost of premiums and the likelihood of the event.

However, we consider Ergon Energy's proposed definition of an insurance cap event is not sufficiently clear to satisfy the nominated pass through event considerations.[8] We have therefore amended the proposed definition to make the operation of this event more transparent, by incorporating factors that we will have regard to when assessing a pass through application under this event. In our proposed definition for Ergon Energy we have:

- included the term, 'relevant insurance policy', at paragraph 5(i) to use consistent terminology throughout our definition.
- Removed the reference to the 'forecast opex allowance approved in the AER's final decision' and replaced it instead with 'the level of insurance that an efficient and prudent NSP would obtain in respect of the event'. We consider that clause 6.6.1(j) of the NER would require us to consider the opex allowance and how Ergon Energy has sought to mitigate the risks of the event occurring.

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7 Ergon Energy, *Attachment 04.01.03 Nominated cost pass through events*, p. 7.

8 NER, glossary, definition of 'nominated pass through event considerations', paragraph (b).

If a pass through event of this kind were to occur, in assessing Ergon Energy's application to pass through costs, we will consider the efficiency of Ergon Energy's decisions and actions. We would consider whether it failed to take reasonable action to reduce the magnitude of the amount being claimed and whether any act or omission it took in response to the event increased the magnitude of the amount claimed.[9] This gives Ergon Energy an incentive to mitigate the risks associated with the event. This may include acquiring an appropriate level of insurance and implementing other practical risk minimisation strategies in its operations.

We consider that the definition of the insurance cap event should reflect this. Accordingly, we have proposed a new definition as set out below.[10]

> An insurance cap event occurs if:
>
> 1. Ergon Energy makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy,
>
> 2. Ergon Energy incurs costs beyond the relevant policy limit, and
>
> 3. the costs beyond the relevant policy limit materially increase the costs to Ergon Energy in providing direct control services.
>
> For this insurance cap event:
>
> 4. the relevant policy limit is the greater of:
>
> a. Ergon Energy'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 Ergon Energy was regulated.
>
> 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:
>
> i. the relevant insurance policy for the event, and

9 NER, cl. 6.6.1(j)(3).

10 We note that we have not explicitly excluded insurance cap events that arise due to a finding of negligence. Negligence suggests the NSP may have some control over the event or some opportunity to limit the magnitude of the event. This may be a factor that we would have regard to in assessing such a pass through application. However, we do not consider it would be appropriate to exclude all events where the suggestion of negligence on behalf of the business has been raised. We further note that unlawful conduct and gross negligence would not be covered by an insurer and that acts or omissions resulting from such unlawful conduct or gross negligence would be relevant considerations when assessing a pass through event application, having regard to the relevant factors set out in the NER.

ii. the level of insurance that an efficient and prudent NSP would obtain in respect of the event.

15.4.2 Natural disaster event

This event will allow Ergon Energy to pass through the costs associated with natural disasters. We accept that a natural disaster event can be consistent with the nominated pass through considerations, if appropriately defined. We do not accept the proposed definition. To this end, we have amended Ergon Energy's proposed definition of this pass through event to reflect matters that we will have regard to in assessing an event.

We consider that there may be some overlap between an insurance cap event and a natural disaster event, but accept the need to have both because the NSP may incur costs which an insurance policy would not ordinarily cover.

In relation to this event, we note:

- Ergon Energy has a range of measures in place to mitigate the impacts of an event, should one occur.[11] [12]
- Ergon Energy is unable to take out sufficient external insurance for natural disasters on reasonable terms or this would likely be inefficient and result in an unnecessary cost increase to customers (although it has some parametric insurance).[13] [14]
- Ergon Energy has included a self-insurance amount in its opex proposal for bushfire liabilities but would not be in a position to self-insure effectively against all natural disaster events given the likely cost impacts.[15] [16]

However, we do not accept Ergon Energy's proposed definition of the natural disaster event. Ergon Energy's opex allowance includes funding for insurance yet it may have an incentive to keep that allowance (and not insure the risk) while managing this risk through the pass through mechanism. We consider that this incentive can be balanced if the definition of the natural disaster event recognises that, in assessing a pass through application under this event, we will have regard to whether Ergon Energy has taken prudent and efficient steps to insure against the event.[17]

We have removed the reference to the 'forecast opex allowance approved in the AER's final decision' and replaced it instead with 'the level of insurance that an efficient and prudent NSP would obtain in respect of the event'. We consider that clause 6.6.1(j) of

[11] NER, glossary, definition of 'nominated pass through event considerations', paragraph (c).

[12] Ergon Energy, *Attachment 04.01.03 Nominated cost pass through events*, pp. 6–7.

[13] NER, glossary, definition of 'nominated pass through event considerations', paragraph (d)(1).

[14] Ergon Energy, *Attachment 04.01.03 Nominated cost pass through events*, pp. 7–8.

[15] NER, glossary, definition of 'nominated pass through event considerations', paragraph (d)(2).

[16] Ergon Energy, *Attachment 04.01.03 Nominated cost pass through events*, pp. 7–8.

[17] NER, glossary, definition of 'nominated pass through event considerations', paragraph (d).

the NER would require us to consider the opex allowance and how Ergon Energy has sought to mitigate the risks of the event occurring.

Whether a relevant government authority has made a relevant declaration in respect of a natural disaster event is also a factor that we would also have regard to in considering whether to approve such a pass through event. We consider that this adds clarity around the purpose of this nominated pass through event and when it is likely to be considered to have occurred. We therefore have included this element in our definition.

Accordingly, we have proposed the following new definition**Error! Reference source not found.**.

> A natural disaster event occurs if:
>
> > Any major fire, flood, earthquake or other natural disaster occurs during the 2015-20 regulatory control period and materially increases the costs to Ergon Energy 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
> >
> > 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).
> >
> > Note: In assessing a natural disaster event pass through application, the AER will have regard to, amongst other things:
> >
> > > i. whether Ergon Energy 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.

15.4.3 Insurance event

The insurance event is intended to provide for circumstances in which an insurance claim is successful, but Ergon Energy is unable to recover outstanding insurance claims or the deductible is different to that envisaged under the policy.

We accept that an insurance event can be consistent with the nominated pass through considerations, if appropriately defined. We do not accept the proposed definition of an insurance event because we do not consider that it provides sufficient clarity around when we would accept an event.

We do not accept the element of the definition which would allow the NSP to recover the costs associated with variations to the insurance premium or insurance becoming unavailable. We consider that the event proposed by Ergon Energy is too broad in that it does not specify what may give rise to the event occurring. This may remove incentives Ergon Energy has to make certain that its insurance policies are adequate. In doing so, the proposed definition may be simply passing the risk on to consumers.

To this end, we have amended Ergon Energy's proposed definition of this pass through event to reflect matters that we will have regard to in assessing an event.

An NSP may suffer a significant loss as a consequence of an insurer becoming insolvent and thereby unable to satisfy all insurance claims. We have included the insolvency of an insurer in the pass through definition. NSPs are also limited in the extent to which they can avoid such losses, short of taking out multiple insurance policies to cover the same risks. We accept that the options available to NSPs to manage these risks are limited and, given the rarity of such events, may in fact result in greater expenditure on insurance than is prudent or efficient.

In its definition for this event, Ergon Energy sought to pass through the costs associated with material changes to insurance premiums as a result of an insurer becoming insolvent. Insurance premiums are a typical business expense. They are subject to ordinary market factors of the economy. We consider this is a risk that businesses are best placed to bear rather than customers. We therefore do not consider it appropriate to allow this element of the nominated pass through event.

We consulted with Ergon Energy and others on an appropriate definition for this event.[18] As a result of this consultation, 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.

As set out below, we have proposed an alternative definition to incorporate factors that we will have regard to when assessing a claim for a pass through. We have also removed the element which would allow pass throughs for changes to insurance premiums. For consistency with other determinations made at this time we have referred to this event as the 'insurer's credit risk event'.

> An insurer’s credit risk event occurs if:
>
> > A nominated insurer of Ergon Energy 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, Ergon Energy:
> >
> > > 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.
> >
> > Note: In assessing an insurer's credit risk event pass through application, the AER will have regard to, amongst other things,

18 Information request and response 065, 30 March 2015.

- Ergon Energy'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 Ergon Energy had reasonable opportunity to insure the risk with a different provider.

15.4.4 Retail separation event

Ergon Energy noted that the former Queensland Government previously publicly stated its intention to sell Ergon Energy's retail assets.[19] We note recent comments from the current Queensland Government indicate that this is now unlikely. This event allows Ergon Energy to pass through the costs associated with vertical separation of its business.

We do not accept the retail separation event as a pass through event in our preliminary decision because the event is likely to be covered by another category of pass through event.[20]

Ergon Energy stated that the regulatory change event would not apply because this event is limited in its application to a regulatory obligation or requirement as defined under section 2D of the NEL. In Ergon Energy's view, any separation of Ergon Energy would not fall within this definition.

We note that the regulatory change event is defined in the Glossary to the NER as '[a] change in a *regulatory obligation or requirement* that…'. '[*R]egulatory obligation or requirement*' has the meaning assigned in the NEL.

We consider that a retail separation event would come within the definition of the NEL, in particular section 2D(1)(b)(v) which states:

> (1) A regulatory obligation or requirement is—
>
> …
>
> (b) an obligation or requirement under—
>
> …
>
> an Act of a participating jurisdiction, or any instrument made or issued under or for the purposes of that Act (other than national electricity legislation or an Act of a participating jurisdiction or an Act or instrument referred to in subparagraphs (ii) to (iv)), that materially affects the provision, by a regulated network service provider, of electricity network services that are the subject of a distribution determination or transmission determination.

19 Ergon Energy, *Regulatory proposal Attachment 04.01.03 Nominated cost pass through events*, p. 13.

20 NER, glossary, definition of 'nominated pass through event considerations', paragraph (a).

Therefore, if the divestment of the retail assets materially changes Ergon Energy's costs, then Ergon Energy may be able to make a pass through application to the AER under one of the existing prescribed pass through events.

Ergon Energy noted that we allowed a retail (separation) project event for the NSW distributors.[21] Since then, the NER has been amended to include specific considerations which we must have regard to in approving a pass through event (the nominated pass through event considerations). As discussed above, a retail separation event is not consistent with these considerations, as the event will be covered by a category of pass through specified in clause 6.6.1(a1)(1) to (4) of the NER.

15.4.5 Isolated network separation event

Ergon Energy stated that the former Queensland Government indicated it was considering initiating an open tender or call for expressions of interest to supply various isolated systems which are not connected to the main electricity grid.[22] The isolated network separation event proposed by Ergon Energy would allow it to pass through the costs associated with this process.

We do not accept the isolated network separation event as a pass through event in our preliminary decision because the event is likely covered by another category of pass through event.[23]

Ergon Energy stated that the regulatory change event would not apply because this event is limited in its application to a regulatory obligation or requirement as defined under section 2D of the NEL. In Ergon Energy's view, an isolated network separation event would not fall within this definition.

For the same reasons as set out above in relation to the retail separation event, we consider that if the separation event materially changes Ergon Energy's costs, then Ergon Energy may be able to make a pass through application to the AER under one of the existing prescribed pass through events.

Accordingly, we do not consider there is a need for an additional specific pass through event to cover the potential costs of this event, beyond those set out in the NER or approved in this determination.

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21 Ergon Energy, *Regulatory proposal Attachment 04.01.03 Nominated cost pass through events*, p. 14.

22 Ergon Energy, *Regulatory proposal Attachment 04.01.03 Nominated cost pass through events*, p. 16.

23 NER, glossary, definition of 'nominated pass through event considerations', paragraph (a).