



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

**Attachment 15 – Pass through
events**

April 2015

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Note

This attachment forms part of the AER's preliminary decision on SA Power Networks' 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

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 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
- 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 SA Power Networks for the 2015–20 regulatory control period.

15.1 Preliminary decision

We do not accept the following nominated pass through events as drafted by SA Power Networks, but have proposed the following alternative definitions:

- liability above insurance cap event
- natural disaster event
- insurer credit risk event.

We do not accept the following proposed pass through events:

- general nominated pass through event
- Kangaroo Island cable failure event
- native title event.

15.2 SA Power Networks' proposal

SA Power Networks' proposed nominated pass through events and definitions are set out in Table 15.1.

¹ NER, cl. 6.5.10.

Table 15.1 SA Power Networks' proposed pass through events

Proposed event	Proposed definition
<p>Liability above insurance cap event</p>	<p>A Liability above insurance cap event occurs if:</p> <ul style="list-style-type: none"> ○ SA Power Networks makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy, ○ SA Power Networks incurs costs beyond the relevant policy limit, and ○ the costs beyond the relevant policy limit materially increase the costs to SA Power Networks in providing direct control services. <ul style="list-style-type: none"> • For this insurance cap event the relevant policy limit is the greater of: <ul style="list-style-type: none"> ○ SA Power Networks' actual policy limit at the time of the event that gives, or would have given rise to a claim, and ○ 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. ○ 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. • Note for the avoidance of doubt, in assessing a Liability above insurance cap event cost pass through application under rule 6.6.1(j), the AER will have regard to: <ul style="list-style-type: none"> ○ the insurance premium Proposal submitted by SA Power Networks in its regulatory Proposal; ○ the forecast operating expenditure allowance approved in the AER's final decision; and ○ the reasons for that decision.
<p>Insurer credit risk event</p>	<p>The insolvency of a nominated insurer of SA Power Networks, as a result of which SA Power Networks:</p> <ul style="list-style-type: none"> (i) incurs materially higher or lower costs for insurance premiums than those allowed for in the Distribution Determination; or (ii) in respect of a claim for a risk that would have been insured by SA Power Networks' insurers, is subject to a materially higher or lower claims limit or a materially higher or lower deductible than would have applied under that policy.
<p>Natural disaster event</p>	<p>Any major fire, storm, flood, earthquake, or other natural disaster beyond the control of SA Power Networks that occurs during the Regulatory Control Period and materially increases the costs to SA Power Networks of providing Direct Control Services.</p>
<p>General nominated pass through event</p>	<p>A general nominated pass through event occurs in the following circumstances:</p> <ol style="list-style-type: none"> 1. An uncontrollable and unexpected event occurs during the next regulatory control period, the effect of which could not have been prevented or mitigated by prudent operation risk management. 2. The change in costs of providing distribution services as a result of the event is material. 3. The event does not fall into any of the following definitions: <ul style="list-style-type: none"> • a 'regulatory change event' in the NER (read as if paragraph (a) of the definition was not part of the definition) • a 'service standard event'; • a 'tax change event'; • a 'retailer insolvency event'; and

Proposed event	Proposed definition
	<ul style="list-style-type: none"> any other event specified in a distribution determination as a pass through event for the determination.
Kangaroo Island cable failure event	Any failure of the SA Power Networks 33kV undersea cable supplying Kangaroo Island which is beyond the control of SA Power Networks that occurs during the Regulatory Control Period and materially increases the costs to SA Power Networks of providing Direct Control Services.
Native title event	<p>“An event whereby, as the result of a native title claim, SA Power Networks incurs material costs constituting:</p> <ul style="list-style-type: none"> any compensation or damages payable by SA Power Networks, for example as a result of a registered Indigenous Land Use Agreement (ILUA), a consent determination or a decision of a Court; and/or legal fees and disbursements associated with negotiation and litigation in relation to native title claims.

Source: SA Power Networks, *Regulatory proposal 2015–2020*, October 2014, pp. 273–277.

15.3 AER’s assessment approach

We must decide which of SA Power Networks' proposed nominated pass through events will apply for the 2015–20 regulatory control period. Pass through events transfer financial risks from the 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 include the following nominated pass through event considerations which we must have regard to when assessing nominated pass through events.⁶

The nominated pass through event considerations are:

(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;

² NER, cl. 6.6.1(d),(g) and (j).

³ NEL, s.7A(2).

⁴ NEL, s.7A(3).

⁵ NEL, s.7A(6).

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

(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.

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.

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 SA Power Networks 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 SA Power Networks' proposed pass through events. We have:

- Proposed alternative definitions for SA Power Networks' proposed liability above insurance cap event, insurer credit risk event and natural disaster event.
- Not accepted SA Power Networks' proposed general nominated pass through event, Kangaroo Island cable failure event, or native title event.

15.4.1 Liability above insurance cap event

The liability above insurance cap event would allow SA Power Networks to recover material costs incurred which exceed its insurance claim limit.⁷

We accept that a liability above insurance cap event can be consistent with the nominated pass through considerations, if appropriately defined. We do not accept the proposed definition of the liability above insurance cap event. To this end we have amended SA Power Networks' proposed definition of this pass through event to reflect matters that we will have regard to in assessing an event.

SA Power Networks 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 SA Power Networks 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 SA Power Networks 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 SA Power Networks' proposed definition of a liability above insurance cap event is not sufficiently clear to satisfy the nominated pass through event considerations. 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. If a pass through event of this kind were to occur, in assessing SA Power Networks' application to pass through costs, we will consider the efficiency of SA Power Networks' 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.⁸ This gives SA Power Networks an incentive to mitigate the risks associated with the event. This may

⁷ SA Power Networks, *Regulatory proposal 2015–2020*, p. 275.

⁸ NER, cl. 6.6.1(j)(3).

include acquiring an appropriate level of insurance and implementing other practical risk minimisation strategies in its operations.⁹

As set out below, in our proposed definition for SA Power Networks we have:

- included the term, 'relevant insurance policy', 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 SA Power Networks has sought to mitigate the risks of the event occurring.
- Removed the term, 'the reasons for that decision' in the final dot point as it duplicates clause 6.6.1(j)(3) of the NER.
- For consistency with other determinations made at this time we have referred to this event as the 'insurance cap event'.

An insurance cap event occurs if:

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

For this insurance cap event:

4. the relevant policy limit is the greater of:
 - 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.

⁹ 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.

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:

- 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.

15.4.2 Natural disaster event

This event will allow SA Power Networks 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 SA Power Networks' 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, subject to the comments below, accept that there may be merit in approving both events because the SA Power Networks may incur costs in a natural disaster event which an insurance policy would not ordinarily cover.

In relation to this event, we note:

- SA Power Networks has a range of measures in place to mitigate the impacts of an event, should one occur.^{10 11}
- SA Power Networks currently has some commercial insurance for natural disasters.¹² This would not likely cover all the costs associated with a natural disaster event, however taking out further insurance would likely be inefficient and result in an unnecessary cost increase to customers.¹³

These events are largely beyond the control of SA Power Networks but potentially could have a high cost impact. As noted above, we consider that SA Power Networks has taken prudent actions to mitigate the risks of these events occurring and the likely costs to the network if they do occur. Based on our assessment approach these should therefore be included as nominated pass through events.

However, we do not accept SA Power Networks' proposed definition of the natural disaster event. SA Power Networks' 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

¹⁰ NER, glossary, definition of 'nominated pass through event considerations', paragraph (c).

¹¹ SA Power Networks, Attachment 20.50; SA Power Networks: Bushfire Mitigation Summary, November 2014.

¹² NER, glossary, definition of 'nominated pass through event considerations', paragraph (d)(1).

¹³ SA Power Networks, *Regulatory proposal*, October 2014, p. 275.

whether SA Power Networks has taken prudent and efficient steps to insure against the event.¹⁴

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 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 as a factor that we will have regard to.

We do not agree with the inclusion of the term, 'storm', in the natural disaster event definition. We accept that some storms may constitute a natural disaster and, thereby, may give rise to a pass through event. However, the term, 'storm' is not sufficiently clear so as indicate when such a pass through would apply. If a major storm does occur, then it would likely fall within 'or other natural disaster ...'.

In our proposed definition for SA Power Networks we have:

- amended the proposed definition to incorporate factors that we will have regard to when assessing a pass through application
- removed the word 'storm' from SA Power Networks' proposed definition.

Accordingly, we have proposed the following new definition.

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 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

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 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.

¹⁴ NER, glossary, definition of 'nominated pass through event considerations', paragraph (d).

15.4.3 Insurer credit risk

The insurer credit risk event is intended to provide for circumstances in which an insurance claim would be successful, but SA Power Networks is unable to recover outstanding insurance claims as a result of the insolvency of an insurance provider.

We accept that an insurer credit risk event can be consistent with the nominated pass through considerations, if appropriately defined. We do not accept the proposed definition of an insurer credit risk event because we do not consider that it provides sufficient clarity around when we would accept an event. We also do not accept the element of the definition which would allow the NSP to recover the costs associated with variations to the insurance premium. To this end, we have amended SA Power Networks' 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. 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.

We therefore accept that an insurer credit risk event can be consistent with the nominated pass through considerations, if appropriately defined. We consulted with SA Power Networks and others on an appropriate definition for this event.¹⁵ 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. We have also defined this pass through event to include the matters that we will have regard to in assessing an event.

In its definition for this event, SA Power Networks 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.

As set 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'.

¹⁵ Information request and response 043, 30 March 2015.

An insurer's credit risk event occurs if:

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:

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.

Note: In assessing an insurer's credit risk event pass through application, the AER will have regard to, amongst other things,

- 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.

15.4.4 General nominated pass through event

This general nominated event allows SA Power Networks to recover the costs of uncontrollable and unexpected events. We do not accept the general nominated event as a pass through event in our preliminary decision because the event cannot be clearly identified at the time the determination is made.¹⁶ We also cannot say if it is insurable. SA Power Networks stated that the 'nature of this type of event can be clearly identified'.¹⁷ It sought to make the general pass through event specific by excluding the prescribed pass through events and events where SA Power Networks could mitigate the cost impact of events or the likelihood of the event occurring. However, we do not consider its proposed definition, which could still be triggered in a broad range of situations, satisfies this requirement. The lack of clarity as to what this event may cover also means that we cannot be satisfied that SA Power Networks is unable to insure against the event or reliably measure the steps it has taken to explore alternative risk management options.¹⁸

SA Power Networks noted that we included a general pass through event in its 2010–15 distribution determination,¹⁹ and that in 2013 we approved a pass through application under this general nominated pass through event.²⁰

¹⁶ NER, glossary, definition of 'nominated pass through event considerations', paragraph (b).

¹⁷ SA Power Networks, *Regulatory proposal*, p. 277.

¹⁸ NER, glossary, definition of 'nominated pass through event considerations', paragraph (d).

¹⁹ SA Power Networks, *Regulatory proposal*, p. 277.

²⁰ SA Power Networks, *Regulatory proposal*, p. 277. See AER, *Final Decision SA Power Networks cost pass through application for Vegetation management costs arising from an unexpected increase in vegetation growth rates*, July 2013, p. 32. The AER allowed a cost pass through of \$35.1 million (\$2009–10) under the general nominated pass through event in relation to SA Power Networks' vegetation management costs.

SA Power Networks also referred to section 7A of the NEL and stated,²¹

In the absence of a general nominated pass through event being available, if a similar event was to occur during the next RCP, we would be prevented from recovering the additional costs of complying with our obligations.

The NER have changed significantly since our determination for the 2010–15 regulatory control period. In particular, the NER now include nominated pass through event considerations which we must have regard to when assessing nominated pass through events. For the reasons set out above we do not consider that the proposed general nominated pass through event is consistent with the nominated pass through event considerations. This is also consistent with our recent decisions where NSPs have proposed a general nominated pass through event.²²

As noted in section 15.3, we have only allowed the nominated pass through events that we are satisfied meet the NEO and the Revenue and Pricing Principles. Under the Revenue and Pricing Principles the NSPs should be provided with a reasonable opportunity to recover their efficient costs of providing direct control services and complying with a regulatory obligation. NSPs should also be provided with effective incentives to promote economic efficiency. We do not consider this means that NSPs should be allowed a general pass through event which covers any event which is not prescribed and which the NSPs cannot prevent from occurring or mitigate the costs.

Accordingly, we are not satisfied that a general pass through event should be included in our preliminary decision for SA Power Networks.

15.4.5 Kangaroo Island cable failure event

This event would allow SA Power Networks to recover the costs it would incur in maintaining power on Kangaroo Island and repairing the undersea cable in the event that it were to fail and cause widespread loss of power for customers on Kangaroo Island.

We do not accept the Kangaroo Island cable failure event as a pass through event because we consider that a prudent service provider could reasonably prevent an event of this type from occurring.²³

As discussed in Attachment 6, our preliminary decision includes a forecast of \$47.2 million (\$2014–15) in our alternative estimate of required capex for the 2015–2020 period to install a second undersea cable to Kangaroo Island.

Under our assessment approach to nominated pass through events we have regard to who is best placed to bear the risk of the event occurring. All network service providers face risks associated with feeder cables failing. In our view, SA Power Networks is in a

²¹ SA Power Networks, *Regulatory proposal*, p. 277.

²² AER, *ActewAGL draft decision, Attachment 15*, pp. 12–13.

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

better position than consumers to bear the risk of this type of event. As noted in section 15.3, if the NSP has a degree of control, the availability of a pass through event can remove or dilute the incentive to manage the risk. We consider that allowing this event as a nominated pass through event may remove incentives on SA Power Networks to take adequate precautions in maintaining this cable. It is therefore inappropriate to transfer the risk of such an event to SA Power Networks' customers.

Accordingly, we are not satisfied that the Kangaroo Island cable failure event should be included in our preliminary decision for SA Power Networks.

15.4.6 Native title event

This event allows SA Power Networks to pass through the costs of compensation or damages arising from a native title claim.

We do not accept the native title event as a pass through event in our preliminary decision because SA Power Networks is in a position to mitigate the costs of such an event occurring.²⁴

SA Power Networks noted that it is currently involved in 10 native title matters and that it intends to resolve these on the basis of timetables set by the Federal Court.²⁵ SA Power Networks currently has an incentive to mitigate the impact any settlement will have on its customers. If SA Power Networks is able to pass through the costs of any agreement to customers then this dilutes the incentive on SA Power Networks to negotiate an outcome that is favourable to its customers. We therefore do not consider that a pass through would be an efficient outcome.

Accordingly, we are not satisfied that the native title event should be included in our preliminary decision for SA Power Networks.

²⁴ NER Chapter 10 (glossary), definition of 'nominated pass through event considerations', paragraph (c).

²⁵ SA Power Networks, *Regulatory Proposal*, p. 276.