



**PRELIMINARY DECISION**  
**United Energy distribution**  
**determination**  
**2016 to 2020**

**Attachment 15 – Pass through**  
**events**

October 2015

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## Note

This attachment forms part of the AER's preliminary decision on United Energy's revenue proposal 2016–20. 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

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## Shortened forms

Shortened form	Extended form
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
AMI	Advanced metering infrastructure
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
PTRM	post-tax revenue model
RAB	regulatory asset base
RBA	Reserve Bank of Australia
repex	replacement expenditure

Shortened form	Extended form
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 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 not built into our determination. The NER includes the following prescribed pass through events:

- a regulatory change event
- a service standard event
- a tax change event
- a retailer insolvency event.<sup>1</sup>

In addition to the above (prescribed) events, an event may be specified in a determination for a regulatory control period (nominated pass through event).<sup>2</sup> United Energy proposed six nominated pass through events in addition to the events prescribed by the NER.<sup>3</sup>

This attachment sets out our preliminary decision on the additional pass through events for United Energy during the 2016–20 regulatory control period.

### 15.1 Preliminary decision

We do not approve the following nominated pass through events as put to us by United Energy, but our preliminary decision includes alternative definitions for these events:

- insurance cap event
- insurer's credit risk event
- natural disaster event
- terrorism event
- retailer insolvency event.

We do not accept United Energy's proposed National Energy Customer Framework (NECF) event.

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<sup>1</sup> Note, this is only a prescribed event in jurisdictions where the National Energy Customer Framework has commenced, and therefore does not apply in Victoria.

<sup>2</sup> NER, cl. 6.6.1(a1).

<sup>3</sup> United Energy, *2016 to 2020 Regulatory Proposal*, April 2015, p. 142.

## 15.2 United Energy's proposal

United Energy's proposed nominated pass through events are set out in Table 15-1.

**Table 15-1 United Energy's proposed pass through events**

Proposed event	United Energy's proposed definition
Insurance cap event	<p>"An insurance cap event occurs if:</p> <ul style="list-style-type: none"> <li>(i) United Energy makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy;</li> <li>(ii) United Energy incurs costs beyond the relevant policy limit.</li> </ul> <p>For this insurance cap event:</p> <p>The relevant policy limit is the greater of:</p> <ul style="list-style-type: none"> <li>(i) United Energy's actual policy limit at the time of the event that gives, or would have given rise to a claim; and</li> <li>(ii) The policy limit that is explicitly or implicitly commensurate with the allowance for insurance premiums that is included in the forecast operating expenditure allowance approved in the AER's final decision for the regulatory control period in which the insurance policy is issued.</li> </ul> <p>A relevant insurance policy is an insurance policy held during the 2016-20 regulatory control period or a previous regulatory control period in which United Energy was regulated."</p>
Insurer's credit risk event	<p>"An insurer's credit risk event is:</p> <p>Insurer Credit Risk Event means an event where the insolvency of the nominated insurers of United Energy occurs, as a result of which United Energy:</p> <ul style="list-style-type: none"> <li>(i) Incurs higher or lower costs for insurance premiums than those incurred immediately prior to the insolvency; or</li> <li>(ii) In respect of a claim for a risk that would have been insured by the United Energy's insolvent insurers, is under a new policy subject to a higher or lower claim limit or a higher or lower deductible than would have applied under the policy with the insolvent insurer; or</li> <li>(iii) Incurs additional costs associated with self-funding an insurance claim which would have otherwise been covered by the insolvent insurer." </li></ul>
Natural disaster event	<p>"A natural disaster event is:</p> <p>Any major fire, flood, earthquake or other natural disaster beyond the reasonable control of United Energy that occurs during the 2016-20 regulatory control period.</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 United Energy's annual revenue requirement for a regulatory year)."</p>



Proposed event	United Energy’s proposed definition
Terrorism event	<p>“A terrorism event is:</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, but not limited to, the intention to influence or intimidate any government and/or put the public, or any section of the public, in fear).”</p>
Retailer insolvency event	<p>“A retailer insolvency event occurs if:</p> <p>A retailer (as defined in the Rules) fails to pay United Energy an amount to which United Energy is entitled for the provision of direct control services (as defined in the Rules) where:</p> <ul style="list-style-type: none"> <li>(i) An insolvency official has been appointed in respect of that retailer; and</li> <li>(ii) United Energy is not entitled to payment of that amount in full under the terms of any credit support provided in respect of that retailer.</li> </ul> <p>For this retailer insolvency event, the Rules shall be read and applied as if:</p> <ul style="list-style-type: none"> <li>(i) Clauses 6.6.1(c)(6)(iii), 6.6.1(l) and 6.6.1(m) applied in Victoria,</li> <li>(ii) In clause 6.6.1(l), “<i>retailer insolvency costs</i>” were omitted and substituted with “<i>retailer insolvency costs</i>”,</li> <li>(iii) The definition of ‘positive change event’ were amended, and the definition of ‘retailer insolvency costs’ inserted, as proposed by the COAG Energy Council on 20 March 2014 giving rise to the AEMC Consultation paper for a National Electricity Amendment (Retailer insolvency events – cost pass through provisions) Rule 2015, and</li> <li>(iv) ‘retailer insolvency costs’ is a defined term in the Rules, defined as proposed by the COAG Energy Council on 20 March 2014 giving rise to the AEMC Consultation paper for a National Electricity Amendment (Retailer insolvency events – cost pass through provisions) Rule 2015.”</li> </ul>
National Energy Customer Framework (NECF) event	<p>“National Energy Customer Framework Event means a legislative or administrative act or decision that:</p> <ul style="list-style-type: none"> <li>(i) Occurs during the regulatory control period;</li> <li>(ii) Has the effect of implementing in Victoria, either in part or in its entirety, the National Energy Customer Framework; and</li> <li>(iii) Increases the costs to United Energy of providing direct control services.</li> </ul> <p>For the purposes of this definition:</p> <p>The “National Energy Customer Framework” means any regulatory instruments (including, but not only, legislation, codes, guidelines, regulations or rules) that give effect, in Victoria, to any or all of the Schedule to the National Energy</p>

Proposed event	United Energy's proposed definition
	<p>Retail Law (South Australia) Act 2011, the National Energy Retail Regulations (South Australia) and the National Energy Retail Rules (South Australia) as amended from time to time including any amendment, withdrawal or introduction of any associated Victorian regulatory instruments (including, but not only, legislation, codes, guidelines, regulations or rules).</p> <p>The increase in costs will, for the purposes of the definition of materially in Chapter 10 of the Rules, be deemed to meet that definition, but only for the purposes of that definition. The eligible pass through amount will be the actual increase in costs.”</p>

Source: United Energy, *2016 to 2020 Regulatory Proposal*, April 2015, pp. 142-147.

### 15.3 AER's assessment approach

We must decide which of United Energy's proposed nominated pass through events will apply for the 2016–20 regulatory control period. Pass through events transfer financial risks from the distributors 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.<sup>4</sup>

Our approach has been guided by the National Electricity Objective (NEO) and the Revenue and Pricing Principles. These provide the distributor with a reasonable opportunity to recover at least the efficient costs incurred in providing services.<sup>5</sup> They also provide incentives to promote economic efficiency.<sup>6</sup> Together, they promote a balance between the economic costs and risk management to promote efficient investment.<sup>7</sup>

The NER include the following nominated pass through event considerations which we must have regard to when assessing nominated pass through events.<sup>8</sup>

*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;

<sup>4</sup> NER, cl. 6.6.1(d),(g) and (j).

<sup>5</sup> NEL, s. 7A(2).

<sup>6</sup> NEL, s. 7A(3).

<sup>7</sup> NEL, s. 7A(6).

<sup>8</sup> 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.<sup>9</sup>

These considerations involve an assessment of the incentives for distributors to manage their risks efficiently.

For systemic risks, distributors are compensated through the allowed rate of return. Distributors also face business-specific, or residual, risks. These activities are generally compensated through the opex and capex allowances. Beyond this, a distributor 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 risk 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, a distributor 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 distributor should be able to recover its efficient costs.

A factor for us to consider, which is reflected in the nominated pass through event considerations, is who is best placed to manage a given risk. Generally, the party who

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

is in the best position to manage a risk should bear the risk of that event occurring. If the distributor or its customers are fully exposed to a risk, this may lead to adverse outcomes.

For example, where it is not possible for a distributor to insure against a risk, a distributor may need to share that risk with customers to ensure the service may continue should the event occur. The uninsurable risk may also be outside the control of the distributor and have a low probability of occurring, but a significant cost impact if it does occur. 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 distributor is able to pass through all the costs of such an event, its incentive to take prudent actions to prevent or mitigate the potential cost impact of the risk may be weakened. Accordingly, while customers may need to accept some of the burden of the risk, the distributor will need to share some of the risk too. That might be achieved, for example, by making a pass through conditional on the distributor demonstrating 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 United 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 us to balance the incentives under the various parts of our decision.

## **15.4 Reasons for preliminary decision**

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

- not accepted United Energy's proposed insurance cap event, insurer's credit risk event, natural disaster event, terrorism event and retailer insolvency event, and substituted alternative definitions, and
- not accepted the National Energy Customer Framework (NECF) event.

### **15.4.1 Insurance cap event**

The insurance cap event would allow United Energy to ‘manage risk in circumstances where insurance premiums are prohibitively expensive.’<sup>10</sup> We accept an insurance cap event can be consistent with the nominated pass through considerations, if appropriately defined. We do not accept the proposed definition. We propose an alternative definition which more clearly identifies this event by incorporating factors we will have regard to when assessing a claim for a pass through.

We accept the insurance cap event would protect United Energy from high cost impact events which would be uneconomical to insure against. We consider consumers benefit 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 note, however, that if a pass through event of this type were to occur, in assessing United Energy’s application to pass through costs we would consider the efficiency of United Energy’s decisions and actions. We would consider whether it failed to take reasonable action to reduce the magnitude of the amount being claimed through the pass through mechanism, and whether any act or omission it took in response to the event increased the magnitude of the amount claimed.<sup>11</sup> This maintains United Energy’s incentive to mitigate the risks associated with the event, including through acquiring an appropriate level of insurance and implementing other practical risk minimisation strategies in its operations.

The NER list a number of relevant factors to which we must have regard in making a determination on a pass through application, including any factors the AER considers relevant.<sup>12</sup> We consider including additional factors we consider relevant to a nominated pass through event provides greater transparency in the operation of nominated pass through events. We consider this supports the nominated pass through event considerations, which require that events themselves can be clearly identified at the time of our determination.<sup>13</sup> Our substitute definition explicitly clarifies that both United Energy’s actual insurance policy and the level of insurance that an efficient and prudent service provider would obtain are relevant to this assessment.

Lastly, our approved definition makes it clear that this event will only be triggered where the costs incurred beyond the policy limit result in a material increase in the cost of providing direct control services.

The amended definition we have included in this preliminary decision is as follows:

An insurance cap event occurs if:

1. United Energy makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy,

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<sup>10</sup> United Energy, *2016 to 2020 Regulatory Proposal*, April 2015, p. 143.

<sup>11</sup> NER, cl. 6.6.1(j)(3).

<sup>12</sup> NER, cl. 6.6.1(j)(8).

<sup>13</sup> NER glossary, definition of ‘nominated pass through event considerations’, (b).

2. United Energy incurs costs beyond the relevant policy limit, and
3. the costs beyond the relevant policy limit materially increase the costs to United Energy in providing direct control services.

For this insurance cap event:

4. the relevant policy limit is the greater of:
  - a. United 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 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 2016–20 regulatory control period or a previous regulatory control period in which United 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), the AER will have regard to:

the relevant insurance policy for the event, and

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

#### 15.4.2 Insurer's credit risk event

This event would allow United Energy to pass through costs in the event an insurer becomes insolvent. We accept an insurer's credit risk event can be consistent with the nominated pass through considerations, if appropriately defined. We do not accept the proposed event as United Energy has defined it.

NSPs are limited in the extent to which they can avoid losses in the event in insurer insolvency, short of taking out multiple insurance policies to cover the same risks.

We note United Energy:

- obtains insurance from insurers with a S&P credit rating of A- or better
- has multiple insurers, which diversifies risk
- monitors the credit ratings of insurers
- assesses the ongoing viability and credit rating of its insurers.<sup>14</sup>

Despite these efforts, an insurer may fail and leave United Energy exposed in circumstances beyond its ability to control. We accept the options available to distributors 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.

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<sup>14</sup> United Energy, *2016 to 2020 Regulatory Proposal*, April 2015, p. 144.

United Energy's proposed insurer credit risk event is broader in two respects than that we have approved in recent decisions.

First, in its proposed definition for this event, United Energy sought to include provision for it to pass through costs associated with changes to insurance premiums as a result of an insurer becoming insolvent.<sup>15</sup> The nominated pass through event considerations require us to consider whether a prudent service provider could reasonably prevent an event from occurring or substantially mitigate the cost impact of such an event.<sup>16</sup> We must also consider whether the relevant service provider could insure against the event, having regard to the availability (including the extent of availability in terms of liability limits) of insurance against the event on reasonable commercial terms.<sup>17</sup>

We consider insurance premiums are a typical business expense, subject to ordinary market factors in the economy. This is a risk businesses are best placed to manage, rather than customers. This view is consistent with our approach in recent decisions. Our substitute definition therefore does not allow United Energy to pass through higher or lower costs for insurance premiums as a result of the failure of an insurer.

Second, in recent decisions we have approved an insurer credit risk event that goes to costs specific to existing or potential claims to the failed insurer. United Energy's proposed definition does not include that limitation. When regard is had to the nominated pass through event considerations<sup>18</sup>, we consider this important so that service providers do not have the incentive to delay the purchase of alternative insurance, thereby transferring the risk of insurable events to customers.<sup>19</sup>

The NER list a number of relevant factors to which we must have regard in making a determination on a pass through application, including any factors the AER considers relevant.<sup>20</sup> As discussed above, we consider including additional factors we consider relevant to a nominated pass through event provides greater transparency in the operation of nominated pass through events and supports the nominated pass through event considerations.<sup>21</sup> Our substitute definition explicitly clarifies that United Energy's attempts to mitigate or prevent the event from occurring<sup>22</sup>, and whether it had a reasonable opportunity to obtain alternative insurance<sup>23</sup>, are relevant to this assessment.

We therefore do not accept United Energy's proposed definition of this event. Our preliminary decision is to instead approve a narrower and more clearly defined event, as follows:

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<sup>15</sup> United Energy, 2016 to 2020 Regulatory Proposal, April 2015, p. 144.

<sup>16</sup> NER glossary, definition of 'nominated pass through event considerations', (c).

<sup>17</sup> NER glossary, definition of 'nominated pass through event considerations', (d).

<sup>18</sup> NER glossary, definition of 'nominated pass through event considerations', (c), (d).

<sup>19</sup> NER glossary, definition of 'nominated pass through event considerations', (c).

<sup>20</sup> NER, cl. 6.6.1(j)(8).

<sup>21</sup> NER glossary, definition of 'nominated pass through event considerations', (b).

<sup>22</sup> NER glossary, definition of 'nominated pass through event considerations', (c).

<sup>23</sup> NER glossary, definition of 'nominated pass through event considerations', (d).

An insurer's credit risk event occurs if:

A nominated insurer of United 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, United 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,

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

### 15.4.3 Natural disaster event

This event would allow United Energy to pass through costs associated with natural disasters. We accept a natural disaster event can be consistent with the nominated pass through considerations, if appropriately defined. For the reasons below, we do not accept United Energy's proposed definition and have substituted a definition that is consistent with the nominated pass through event considerations.

The nominated pass through event considerations require us to have regard to whether a prudent service provider could reasonably prevent an event of this nature or type from occurring, could substantially mitigate the cost impact of such an event, or could insure (or self-insure) against the event.<sup>24</sup> We must also consider whether the nature or type of event can be clearly identified at the time of our determination.<sup>25</sup>

United Energy's proposed definition excludes natural disasters that are beyond its reasonable control. We do not consider this characterisation of a *natural* disaster appropriate. In the context of the pass through mechanism we consider the event more appropriately identified by reference to the impact it may have on the distributor. To that end, we consider the pass through event would be more clearly identified as requiring a natural disaster that was not a consequence of the acts or omissions of the service provider, but which has materially increased its costs in providing direct control services.<sup>26</sup> We consider this better identifies the nature or type of event<sup>27</sup> and provides consistency with recent decisions for gas and electricity network service providers in other jurisdictions.

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<sup>24</sup> NER, glossary, definition of 'nominated pass through event considerations', paragraph (c), (d).

<sup>25</sup> NER, glossary, definition of 'nominated pass through event considerations', paragraph (b).

<sup>26</sup> NER, glossary, definition of 'nominated pass through event considerations', paragraph (c).

<sup>27</sup> NER, glossary, definition of 'nominated pass through event considerations', paragraph (b).



The NER list a number of relevant factors to which we must have regard in making a determination on a pass through application, including any factors the AER considers relevant.<sup>28</sup> We consider including additional factors we consider relevant to a nominated pass through event provides greater transparency and certainty in the operation of nominated pass through events. We consider this clarity supports the nominated pass through event considerations above. We have therefore amended United Energy's proposed definition to reflect factors that we will have regard to when assessing a pass through application.

Whether a relevant government authority has made a declaration in respect of a natural disaster event is another factor we will consider when assessing whether a pass through event has occurred. This is therefore reflected in our definition. We will also consider what insurance United Energy has, what insurance an efficient and prudent distributor would have, against the impact of a natural disaster event. This is also reflected in our definition. We consider there may otherwise be some overlap between an insurance cap event and a natural disaster event, but accept the need to have both because United Energy may incur costs which an insurance policy would not ordinarily cover.

Our preliminary decision is to approve a narrower and more clearly defined natural disaster event, as follows:

A natural disaster event occurs if:

Any major fire, flood, earthquake or other natural disaster occurs during the 2016–20 regulatory control period and materially increases the costs to United 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 DNSP'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 United Energy has insurance against the event,
- ii. the level of insurance that an efficient and prudent NSP would obtain in respect of the event,
- iii. whether a relevant government authority has made a declaration that a natural disaster has occurred.

#### **15.4.4 Terrorism event**

This event would allow United Energy to pass through the costs of terrorism events. We note United Energy's ability to forecast either the occurrence or cost impact of a

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<sup>28</sup> NER, cl. 6.6.1(j)(8),

terrorism event is limited.<sup>29</sup> A prudent and efficient distributor may, however, 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 accept a terrorism event can be consistent with the nominated pass through considerations, if appropriately defined. We do not accept the proposed definition. We propose a new definition which supports the nominated pass through event considerations by incorporating factors we will have regard to when assessing a pass through application. These are the same factors as those discussed above in the context of the natural disaster event.

Whether a relevant government authority has made a declaration in respect of a terrorism event is a factor we will consider when assessing whether to a pass through event has occurred. This is therefore reflected in our definition. We will also consider what insurance United Energy has, what insurance an efficient and prudent distributor would have, against the impact of a terrorism event. This is also reflected in our definition. We consider there may otherwise be some overlap between an insurance cap event and a terrorism event, but accept the need to have both because United Energy may incur costs which an insurance policy would not ordinarily cover.

For the reasons above, we do not accept United Energy's proposed definition of this event. Our preliminary decision is to instead approve a narrower and more clearly defined terrorism event, as follows:

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 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 United Energy in providing direct control services.

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

- i. whether United 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 declaration has been made by a relevant government authority that a terrorism event has occurred.

#### **15.4.5 Retailer insolvency event**

A retailer insolvency event would allow United Energy to pass through changes in the costs of providing direct control services in the event of a retailer insolvency event.

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<sup>29</sup> United Energy, *2016 to 2020 Regulatory Proposal*, April 2015, p. 142.

Since the National Energy Customer Framework (NECF) has not been adopted in Victoria, the prescribed retailer insolvency event under the NER does not apply to Victorian distributors. We consider it appropriate to provide equivalent protection through a nominated pass through event.

United Energy has proposed its own definition of this event, and in doing so has drawn on a rule change proposal currently under consideration by the AEMC. The outcomes of that process are, as yet, unknown. The assumptions made in United Energy's proposal therefore create the risk that a nominated pass through event approved in the terms it has proposed would be inconsistent with that applied in other jurisdictions.

To ensure that the protection afforded Victorian distributors remains consistent with that available to distributors in NECF jurisdictions, we therefore consider it best to apply the NER event 'as in force from time to time'. In this way, changes to the NER prescribed retailer insolvency event during the regulatory control period will also apply to Victorian distributors as they take effect.

We therefore approve the following, nominated pass through event for United Energy:

Prior to the commencement of the National Energy Customer Framework in Victoria, **retailer insolvency event** has the meaning set out in the NER as in force from time to time.

Note: This retailer insolvency event will cease to apply as a nominated pass through event on commencement of the National Energy Customer Framework in Victoria.

#### 15.4.6 National Energy Customer Framework (NECF) event

The NECF event would allow United Energy to pass through changes in costs associated with the introduction of the NECF reforms in Victoria. We do not accept the nominated event because it is covered by another category of pass through event.

The timing of the adoption of all or parts of NECF in Victoria is currently unknown. The adoption of the NECF by the Victorian government may result in increased costs to NSPs. United Energy seeks a pass through event associated with the commencement of the NECF in Victoria, without a materiality threshold. United Energy seeks a pass through event that operates in a similar manner to that provided to the gas network businesses in Victoria.<sup>30</sup>

The nominated pass through event considerations require us to consider whether the event proposed is covered by a category of pass through event specific in clause 6.6.1(a1)(1) to (4). The NECF event is likely to fall within the definitions of the prescribed regulatory change event or service standard event. In its draft proposal,

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<sup>30</sup> AER, Final Decision, *SP AusNet 2013–17*, p. 176; AER, Final Decision, *Envestra 2013–17*, p. 231.

United Energy has failed to outline why the NECF event doesn't fall within these prescribed pass through event categories.<sup>31</sup>

Nor does United Energy's argument that there is uncertainty as to the timeframe of NECF implementation, and the extent to which the Victorian framework may be amended in the interim, explain why it would be appropriate for United Energy to pass through changes in costs that are not material. A materiality threshold applies to other regulatory change and service standard events, and we see no basis for distinction here.

#### **15.4.7 Application of pass through provisions to alternative control services**

We approve United Energy's proposal that nominated pass through events refer to 'direct control services'.<sup>32</sup> This means that United Energy may apply to pass through an increase (or decrease) in costs incurred in providing both standard and alternative control services. This is consistent with the prescribed pass through event definitions set out in the NER, which also reference direct control services.

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<sup>31</sup> United Energy, *2016 to 2020 Regulatory Proposal*, April 2015, p. 147.

<sup>32</sup> United Energy, *2016 to 2020 Regulatory Proposal*, April 2015, p. 147.