

Attachment 13: Pass through events

Regulatory proposal for the ACT electricity distribution network 2019–24
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Key points

Pass through events are a mechanism within the National Electricity Rules (Rules) by which Distribution Network Service Providers (DNSPs) can manage specified classes of risk. The Rules recognise through the pass through provisions that DNSPs can be exposed to risks beyond their control with a material impact on costs and, therefore, on their ability to provide Standard Control Services. The pass through mechanism enables a DNSP to recover (or 'pass through') the costs of defined, unforeseeable, high-cost events that are not built into a distribution determination.

Evoenergy uses other options where available rather than relying on the pass through mechanism as a risk management approach. Evoenergy adopts prudent risk and asset management measures to help ensure the safety, reliability and security of electricity supply to customers. Further, Evoenergy is certified to globally recognised standards for asset management, as well as for environmental, safety, quality and risk management.

The Rules include four default categories of pass through event, as well as allowing DNSPs to nominate other events which can be approved by the Australian Energy Regulator (AER). For the 2019–24 period, Evoenergy has chosen only to propose the nominated pass through events allowed by the AER in its recent electricity determinations and gas access arrangement decisions.

Each of Evoenergy's proposed nominated pass through events is consistent with the nominated pass through event considerations. In particular, each event can be clearly identified and defined; is not covered by the four default categories of pass through event provided for by the Rules; has a low probability of occurrence but the potential to have a significant cost impact; is beyond Evoenergy's ability to prevent, substantially mitigate, commercially insure or self-insure acting prudently and efficiently; identifies any additional factors that it is known will be relevant in assessing the amount to be passed through for the purpose of a pass through application for the event in accordance with clause 6.6.1(j) of the Rules; and is consistent with the nominated pass through events approved by the AER in its recent decisions for other service providers.

13.1. Introduction

The pass through event mechanism in the Rules is an effective option for DNSPs to recover the efficient costs of events that could not be forecast or efficiently managed as part of their regulatory proposals. In the AER's view:¹

The pass through mechanism recognises that an efficient revenue allowance cannot be established with complete certainty and that it

¹ AER 2010, South Australia distribution determination 2010-11 to 2014-15, May 2010, p. 223.

may not be efficient to require DNSPs to manage all situations or circumstances through their revenue allowance.

The pass through event mechanism also removes the need for customers to pay the cost of the events until they occur.

Evoenergy manages risks beyond systemic and business specific or residual risks, through a number of strategies including:

- prevention: avoiding the risk;
- mitigation: reducing the negative effect or probability of the risk;
- insurance: transferring the risk to another party via payment of a fair premium; and
- self-insurance: putting aside funds to manage the likely costs associated with a risky event.

The pass through mechanism supports Evoenergy's capability to efficiently manage the risk of operating the business. Specifically, the pass through events defined in the Rules address the risks to Evoenergy of costs incurred as a result of a limited range of unplanned and unforeseen events with a material cost consequence. Nominated pass through events enable the efficient management of additional unplanned and unforeseen events with high consequence that are not reflected in Evoenergy's revenue allowances and cannot be managed through avoidance, mitigation, commercial insurance or self-insurance.

The AEMC has recognised that the specification of nominated pass through events is necessary to ensure network service providers (NSPs) are provided with the opportunity to recover their efficient costs where those costs result from unforeseen and uncontrollable events for which insurance is limited or not available on commercial terms and self-insurance is not appropriate.²

In the absence of cost pass throughs in these circumstances, the AEMC recognised that efficient investment in, and efficient operation of, an NSP's network would likely be adversely affected over the long term contrary to the National Electricity Objective (NEO).³ That is, the specification of a nominated pass through event is necessary and contributes to the achievement of the NEO where that event is consistent with the nominated pass through event considerations specified in the Rules.

Evoenergy proposes four nominated pass through events for the 2019–24 regulatory period:

- a terrorism event;
- a natural disaster event;
- an insurance cap event; and
- an insurer credit risk event.

Table 13.1 sets out Evoenergy's proposed definitions for these four events.

² AEMC 2012, Rule Determination National Electricity Amendment (Cost pass through arrangements for Network Service Providers) Rule, pp. 18–19.

³ AEMC 2012, Rule Determination National Electricity Amendment (Cost pass through arrangements for Network Service Providers) Rule, p. 18.

Table 13.1 Evoenergy’s proposed nominated pass through events⁴

Proposed event	Nature and type of event
Terrorism event	<p>A terrorism event occurs if:</p> <p>An act (including, but not limited to, the use of force or violence or the threat of force or violence) of any person or group of persons (whether acting alone or on behalf of or in connection with any organisation or government), which from its nature or context is done for, or in connection with, political, religious, ideological, ethnic or similar purposes or reasons (including the intention to influence or intimidate any government and/or put the public, or any section of the public, in fear) and which increases the costs to Evoenergy in providing Direct Control Services.</p> <p>Note: In assessing a terrorism event pass through application, the AER will have regard to, among other things:</p> <ul style="list-style-type: none"> i. whether Evoenergy 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 an act of terrorism has occurred.
Natural disaster event	<p>Natural disaster event means any natural disaster including but not limited to fire, flood or earthquake that occurs during the 2019–24 regulatory control period that increases the costs to Evoenergy in providing Direct Control Services, provided the fire, flood or other event was not a consequence of the acts or omissions of the service provider.</p> <p>Note: In assessing a natural disaster event pass through application, the AER will have regard to, among other things:</p> <ul style="list-style-type: none"> i. whether Evoenergy has insurance against the event; and ii. the level of insurance that an efficient and prudent NSP would obtain in respect of the event.
Insurance cap event	<p>An insurance cap event occurs if:</p> <ul style="list-style-type: none"> a) Evoenergy makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy; b) Evoenergy incurs costs beyond the policy limit of the relevant insurance policy at the time of the event that gives rise to the relevant claim; and c) the costs beyond the relevant policy limit increase the costs to Evoenergy in providing Direct Control Services. <p>For this insurance cap event:</p> <ul style="list-style-type: none"> a) a relevant insurance policy is an insurance policy held during the 2019–24 regulatory control period or a previous regulatory control period in which Evoenergy was regulated; and

⁴ Evoenergy’s proposed nominated pass through events are either identical to or correspond closely with analogous nominated pass through events in the AER’s recent regulatory decisions, including the additional factors that the AER considers relevant for assessing the amount to be passed through for the purpose of a pass through application for the event in accordance with clause 6.6.1(j) of the Rules. As noted in AER 2017, Attachment 13 Pass through events, Draft decision ElectraNet transmission determination 2018 to 2023, pp. 13-11 to 13-13.

Proposed event	Nature and type of event
	<p>b) Evoenergy will be deemed to have made a claim on a relevant insurance policy if the claim is made by a related body corporate of Evoenergy in relation to any aspects of Evoenergy's Direct Control Services.</p> <p>Note: in making a determination on an insurance cap event, the AER will have regard to, among other things:</p> <ol style="list-style-type: none"> i. the insurance policy for the event; and ii. the level of insurance that an efficient and prudent NSP would obtain in respect of the event.
Insurer credit risk event	<p>An insurer's credit risk event occurs if:</p> <p>A nominated insurer of Evoenergy becomes insolvent, and as a result, in respect of an existing, or potential, claim for a risk that was insured by the insolvent insurer, Evoenergy:</p> <ol style="list-style-type: none"> a) 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 b) incurs additional costs associated with self-funding an insurance claim, which would otherwise have been covered by the insolvent insurer. <p>Note: In assessing an insurer's credit risk event pass through application, the AER will have regard to, among other things:</p> <ol style="list-style-type: none"> i. Evoenergy's attempts to mitigate and prevent the event from occurring by reviewing and considering the insurer's track record, size, credit rating and reputation; and ii. in the event that a claim would have been made after the insurance provider became insolvent, whether Evoenergy had reasonable opportunity to insure the risk with a different provider.

Each of Evoenergy's proposed nominated pass through events is consistent with the nominated pass through event considerations for the reasons discussed in section 13.3.

In its recent decisions, the AER has accepted that nominated pass through events that are identical or closely correspond with those proposed by Evoenergy are consistent with the nominated pass through event considerations.⁵ Specifically, the AER has concluded in respect of these events that:⁶

- they are not covered by a pass through event specified in the Rules;
- the nature and type of these events can be clearly identified at the time of the AER's decision, and where there is room for doubt, appropriate parameters can be applied through its assessment of a pass through application;
- while a prudent service provider could take steps to reduce the likelihood and cost impacts of these events, and could insure or self-insure against them, expenditure beyond a certain level aimed at completely eliminating the risk is likely to be

⁵ See, for example: AER 2017, Attachment 13 Pass through events, Draft decision ElectraNet transmission determination 2018 to 2023; AER 2016, Attachment 15 Pass through events, Final decision Jemena distribution determination 2016 to 2020.

⁶ AER 2017, Attachment 13 Pass through events, Draft decision ElectraNet transmission determination 2018 to 2023, p. 13-11.

imprudent or inefficient. In such circumstances, a sharing of risk between the NSP and its customers is appropriate and more likely to be in the long-term interests of consumers with respect to price.

13.2. Assessment framework for nominated pass through events

13.2.1 Rule framework

A pass through event occurs if the requirements of one of the four pass through events defined in the Rules, or a nominated pass through event approved in a distribution determination, are satisfied.⁷

Pass through events can have either a positive or a negative impact on the costs incurred, or costs likely to be incurred, by a DNSP.⁸ If a pass through event occurs, the approved costs (savings) from the event are passed through to consumers and network charges increase (decrease).

Clause 6.5.10(a) of the Rules provides that a regulatory proposal may include a proposal as to the events that should be defined as pass through events having regard to the nominated pass through event considerations.

Clause 6.12.1(14) of the Rules, in turn, requires the AER to make a constituent decision on the nominated pass through events that are to apply for a regulatory control period. Clause 6.5.10(b) of the Rules requires the AER, in making this constituent decision, to take into account the nominated pass through event considerations.

13.2.2 Nominated pass through event considerations

The *nominated pass through event considerations* are as follows:⁹

- (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);
- (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:

⁷ Rules, clause 6.6.1(a1)(1)-(5).

⁸ Rules, clause 6.6.1(b).

⁹ Rules, Chapter 10 Glossary.

- (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.

For the purposes of paragraph (a) of the nominated pass through event considerations, the Rules specify the following categories of pass through events for DNSPs:

- a regulatory change event;
- a service standard event;
- a tax change event; and
- a retailer insolvency event.

The definitions of these four pass through events are shown in Table 13.2.

Table 13.2 Pass through events in the National Electricity Rules

Pass through events	Rules definitions
A regulatory change event	<p>A change in a regulatory obligation or requirement that:</p> <ul style="list-style-type: none"> (a) falls within no other category of pass through event; and (b) occurs during the course of a regulatory control period; and (c) substantially affects the manner in which the Transmission Network Service Provider provides prescribed transmission services or the Distribution Network Service Provider provides Direct Control Services (as the case requires); and (d) materially increases or materially decreases the costs of providing those services.
A service standard event	<p>A legislative or administrative act or decision that:</p> <ul style="list-style-type: none"> (a) has the effect of: <ul style="list-style-type: none"> (i) substantially varying, during the course of a regulatory control period, the manner in which a Transmission Network Service Provider is required to provide a prescribed transmission service, or a Distribution Network Service Provider is required to provide a direct control service; or (ii) imposing, removing or varying, during the course of a regulatory control period, minimum service standards applicable to prescribed transmission services or Direct Control Services; or (iii) altering, during the course of a regulatory control period, the nature or scope of the prescribed transmission services or Direct Control Services, provided by the service provider; and (b) materially increases or materially decreases the costs to the service provider of providing prescribed transmission services or Direct Control Services.

Pass through events	Rules definitions
A tax change event	<p>A tax change event occurs if:</p> <ul style="list-style-type: none"> (a) any of the following occurs during the course of a regulatory control period for a Transmission Network Service Provider or a Distribution Network Service Provider: <ul style="list-style-type: none"> (i) a change in a relevant tax, in the application or official interpretation of a relevant tax, in the rate of a relevant tax, or in the way a relevant tax is calculated; (ii) the removal of a relevant tax; (iii) the imposition of a relevant tax; and (b) in consequence, the costs to the service provider of providing prescribed transmission services or Direct Control Services are materially increased or decreased.
A retailer insolvency event	<p>The failure of a retailer during a regulatory control period, to pay a Distribution Network Service Provider an amount to which the service provider is entitled for the provision of Direct Control Services, if:</p> <ul style="list-style-type: none"> (a) an insolvency official has been appointed in respect of that retailer; and (b) the Distribution Network Service Provider is not entitled to payment of that amount in full under the terms of any credit support provided in respect of that retailer.

For the purposes of paragraph (e), the AER, in its recent decisions, has also taken into account:¹⁰

- the consistency of its approach to assessing nominated pass through events across its electricity determinations and gas access arrangements; and
- how a cost pass through application after an event occurs will be assessed, and the workability of the nominated pass through events in the context of the Rules' cost pass through mechanism.

In respect of the latter consideration, the AER has explained that, in assessing the amount to be passed through for the purpose of a pass through application in accordance with clause 6.6.1(j) of the Rules, there may be additional relevant factors that can be identified in advance for some events and that, where this is the case for nominated pass through events, the AER will include these in the approved definitions of those events as part of its determination.¹¹

13.2.3 National Electricity Law considerations

The AER must also take into account the revenue and pricing principles in making its constituent decision on nominated pass through events and make that decision in a manner that will or is likely to contribute to the achievement of the NEO.¹²

¹⁰ See, for example: AER 2016, Attachment 15 Pass through events, Final decision Jemena distribution determination 2016 to 2020, p. 15-11.

¹¹ See, for example: AER 2016, Attachment 15 Pass through events, Final decision Jemena distribution determination 2016 to 2020, p. 15-13.

¹² Section 16(1)(a) and (2)(a) of the National Electricity Law, Schedule to the *National Electricity (South Australia) Act 1996*.

13.3. Proposed nominated pass through events

This section explains why each of Evoenergy’s proposed nominated pass through events should apply in the 2019–24 regulatory period, including in particular how each of these proposed events is consistent with the *nominated pass through event considerations* in the Rules.

13.3.1 A terrorism event

Evoenergy proposes to include a terrorism event as a nominated pass through event for the 2019–24 regulatory control period.

The AER approved a terrorism event as a nominated pass through event in the 2015 final determination for ActewAGL Distribution.¹³ It has also approved a terrorism event as a nominated pass through event in more recent electricity determinations.¹⁴

While Evoenergy has in place systems to mitigate the risk of a terrorism event occurring, it cannot as a prudent and efficient service provider completely eliminate the risk of such an event occurring.

Table 13.3 sets out how Evoenergy has had regard to each of the nominated pass through event considerations in proposing a terrorism event. As recently as October 2017, the AER accepted that a terrorism event, defined in a manner that closely corresponds to that proposed by ElectraNet, is consistent with the nominated pass through event considerations.¹⁵

Table 13.3 Assessment of terrorism event against nominated pass through event considerations

Pass through event considerations	How Evoenergy has had regard
a) whether the event proposed is an event covered by a category of pass through event specified in the Rules	This event is not covered by any category of pass through event specified in clauses 6.6.1(a1)(1) to (4) of the Rules.
b) whether the nature or type of event can be clearly identified at the time the determination is made for the service provider	The nature and type of a terrorism event can be clearly identified at the time of the making of the determination. The pass through event only applies if an event occurs during the 2019–24 regulatory control period.
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	Evoenergy could not, acting prudently and efficiently, completely eliminate the risk of a terrorism event occurring or substantially mitigate the cost impact of such an event.

¹³ AER 2015, Attachment 15, Pass through events: ActewAGL Distribution final decision 2015–19, 30 April 2015, p. 15-9.

¹⁴ See, for example: AER 2017, Attachment 13 Pass through events, Draft decision ElectraNet transmission determination 2018 to 2023, pp. 13-7 to 13-8; AER 2016, Attachment 15 Pass through events, Final decision Jemena distribution determination 2016 to 2020, pp. 15-7 to 15-8.

¹⁵ AER 2017, Attachment 13 Pass through events, Draft decision ElectraNet transmission determination 2018 to 2023, pp. 13-11 to 13-13.

Pass through event considerations	How Evoenergy has had regard
<p>d) whether the relevant service provider could insure against the event, having regard to:</p> <ol style="list-style-type: none"> 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: <ol style="list-style-type: none"> 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 	<p>Consistent with the AER's previous conclusion for Ausgrid,¹⁶ Evoenergy considers that the commercial market for insurance in Australia is insufficient to cover demand for a terrorism event. Insurance for the risk of a terrorism event is not available on a commercially reasonable basis despite the apparent risk to network and non-network assets.</p> <p>Evoenergy considers that the relative infrequency and potentially high costs of terrorism events create significant challenges for self-insurance for this type of risk. Further, there is limited data for calculating a credible self-insurance premium. Obtaining further commercial insurance would likely be inefficient and would not be in the long-term interests of consumers.</p>
<p>e) any other matter the AER considers relevant and which the AER has notified Network Service Providers (NSPs) is a nominated pass through event consideration.</p>	<p>Evoenergy's proposed definition of the terrorism event is either identical to or corresponds closely with analogous nominated pass through events in the AER's recent regulatory decisions. The AER has itself concluded that these recent decisions have brought a greater degree of consistency to pass throughs in its various electricity determinations and gas access arrangements.¹⁷</p> <p>In its proposed definition of a terrorism event, Evoenergy identifies additional factors that the AER may consider relevant for assessing the amount to be passed through for the purpose of a pass through application in accordance with clause 6.6.1(j) of the Rules.</p>

13.3.2 A natural disaster event

Evoenergy proposes to include a natural disaster event as a nominated pass through event for the 2019–24 regulatory control period.

Natural disaster events can result in substantial costs being incurred, which are beyond the control of Evoenergy. For example, the cost impact to the ACT of the 2003 Canberra Bushfire was around \$660 million (estimated loss value in 2015 dollars).¹⁸

¹⁶ AER 2014, Draft decision Ausgrid distribution determination 2015-16 to 2018-19, Attachment 15: Cost pass through, p. 15-12.

¹⁷ AER 2017, Attachment 13 Pass through events, Draft decision ElectraNet transmission determination 2018 to 2023, pp. 13-12 to 13-13.

¹⁸ Insured cost of the 2003 Canberra Bushfire as reported in the Insurance Council of Australia 2017, Catastrophe Database. The 2003 Canberra Bushfire was also the subject of a state of emergency measure. Source:

Evoenergy’s strategic planning is compliant with the Networks Emergency Management Plan of the Emergency Planning Code 2011, and in line with the *AS/NZS ISO 31000 Risk Management Standard*. The strategy and planning includes coordination with external stakeholders in the event of an emergency requiring a significant and coordinated response within the ACT.

The AER approved a natural disaster event as a nominated pass through event in the 2015 final determination for ActewAGL Distribution.¹⁹ It has also approved a natural disaster event as a nominated pass through event in more recent electricity determinations.²⁰

Table 13.4 sets out how Evoenergy has had regard to each of the nominated pass through event considerations in proposing a natural disaster event. As recently as October 2017, the AER accepted that a natural disaster event, defined in a manner that closely corresponds to that proposed by ElectraNet, is consistent with the nominated pass through event considerations.²¹

Table 13.4 Assessment of natural disaster event against nominated pass through event considerations

Pass through event considerations	How Evoenergy has had regard
a) whether the event proposed is an event covered by a category of pass through event specified in the Rules	This event is not covered by any category of pass through event specified in clause 6.6.1(a1)(1) to (4).
b) whether the nature or type of event can be clearly identified at the time the determination is made for the service provider	The nature and type of a natural disaster event can be clearly identified at the time of the making of the determination.
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	Evoenergy has a range of measures in place to mitigate the impact of a natural disaster event should such an event occur. For example, Evoenergy has the improved understanding of prevention and mitigation of bushfire risks that comes from using the ISO international standards for asset and risk management activities. Nonetheless, Evoenergy cannot eliminate the risk of a natural disaster event occurring nor can it, acting prudently and efficiently, completely eliminate or substantially mitigate the cost impact of such an event.

https://docs.google.com/spreadsheets/d/1vOVUklm2RR_XU1hR6dbGMT7QFj4I0BGI_JAq4-c9mcs/edit#gid=2147027033.

¹⁹ AER 2015, Attachment 15 Pass through events: ActewAGL Distribution final decision 2015–19, 30 April 2015, pp. 15-8 to 15-9.

²⁰ See, for example: AER 2017, Attachment 13 Pass through events, Draft decision ElectraNet transmission determination 2018 to 2023, p. 13-7; AER 2016, Attachment 15 Pass through events, Final decision Jemena distribution determination 2016 to 2020, p. 15-7.

²¹ AER 2017, Attachment 13 Pass through events, Draft decision ElectraNet transmission determination 2018 to 2023, pp. 13-11 to 13-13.

Pass through event considerations	How Evoenergy has had regard
<p>d) whether the relevant service provider could insure against the event, having regard to:</p> <ol style="list-style-type: none"> 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: <ol style="list-style-type: none"> 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 	<p>Costs associated with natural disaster events can potentially undermine Evoenergy's financial viability and threaten the security of supply on the network. Evoenergy, as part of its insurance review processes, has not identified insurance for the impact of a natural disaster, which is available on reasonable commercial terms. Moreover, the relative infrequency and potentially high costs of a natural disaster event creates significant challenges for self-insurance for this type of risk. Self-insurance is not viable due to the unpredictable nature of natural disasters, despite the apparent risk to network and non-network assets. As a result, Evoenergy considers that the pass through mechanism represents the least inefficient means to manage the risks of a natural disaster and recover any material increases in costs following such an event.</p>
<p>e) any other matter the AER considers relevant and which the AER has notified Network Service Providers (NSPs) is a nominated pass through event consideration.</p>	<p>Evoenergy's proposed definition of the natural disaster event is either identical to or corresponds closely with analogous nominated pass through events in the AER's recent regulatory decisions. The AER has itself concluded that these recent decisions have brought a greater degree of consistency to pass throughs in its various electricity determinations and gas access arrangements.²²</p> <p>In its proposed definition of a natural disaster event, Evoenergy identifies additional factors that the AER may consider relevant for assessing the amount to be passed through for the purpose of a pass through application in accordance with clause 6.6.1(j) of the Rules.</p>

13.3.3 An insurance cap event

Evoenergy proposes to include an insurance cap event as a nominated pass through event for the 2019–24 regulatory control period.

Importantly, the rationale for proposing an insurance cap event is consistent with Evoenergy's risk management framework. The strategy of using insurance for managing risk recognises that the cost of insuring risk is commensurate with the frequency and duration of specific events occurring. An insurance cap event benefits consumers by enabling Evoenergy to reduce expenditure on insurance while managing risk on commercial terms.

²² AER 2017, Attachment 13 Pass through events, Draft decision ElectraNet transmission determination 2018 to 2023, pp. 13-12 to 13-13.

The AER approved an insurance cap event as a nominated pass through event in the 2015 final determination for ActewAGL Distribution.²³ It has also approved an insurance cap event as a nominated pass through event in more recent electricity determinations.²⁴

Table 13.5 sets out how Evoenergy has had regard to each of the nominated pass through event considerations in proposing an insurance cap event. As recently as October 2017, the AER accepted that an insurance cap event, defined in a manner that closely corresponds to that proposed by ElectraNet, is consistent with the nominated pass through event considerations.²⁵

Table 13.5 Assessment of insurance cap event against nominated pass through event considerations

Pass through event considerations	How Evoenergy has had regard
a) whether the event proposed is an event covered by a category of pass through event specified in the Rules	This event is not covered by any category of pass through event specified in clause 6.6.1(a1)(1) to (4).
b) whether the nature or type of event can be clearly identified at the time the determination is made for the service provider	The nature and type of an insurance cap event can be clearly identified at the time of the making of the determination.
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	<p>Evoenergy manages risk by obtaining a prudent level of insurance, and by holding targeted insurance products with its nominated insurers. Evoenergy mitigates risk through business continuity planning to reduce the excess costs of insurance policies, and covers contingencies for events through graduated cost thresholds.</p> <p>Evoenergy’s asset management, the high level of redundancy applied to the electricity network in the ACT, and the significant proportion of the distribution network underground also enables it to maintain low insurance premiums.</p> <p>Nonetheless, a prudent service provider would not incur the additional insurance premiums required to acquire cover for high cost impact events for which insurance is available but uneconomic.</p>
d) whether the relevant service provider could insure against the event, having regard to:	Due to the low probability and high magnitude of any event that exceeded the policy limit of insurance, it is not economically viable for Evoenergy to insure (commercial and self-insurance) against this event.

²³ AER 2015, Attachment 15 Pass through events: ActewAGL Distribution final decision 2015–19, 30 April 2015, pp. 15-7 to 15-8.

²⁴ See, for example: AER 2017, Attachment 13 Pass through events, Draft decision ElectraNet transmission determination 2018 to 2023, pp. 13-6 to 13-7; AER 2016, Attachment 15 Pass through events, Final decision Jemena distribution determination 2016 to 2020, pp. 15-6 to 15-7.

²⁵ AER 2017, Attachment 13 Pass through events, Draft decision ElectraNet transmission determination 2018 to 2023, pp. 13-11 to 13-13.

Pass through event considerations	How Evoenergy has had regard
<p>1) the availability (including the extent of availability in terms of liability limits) of insurance against the event on reasonable commercial terms, or</p> <p>2) whether the event can be self-insured on the basis that:</p> <ul style="list-style-type: none"> 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 	<p>Evoenergy agrees with the AER's previous assessment that an insurance cap event would protect the business from high-cost impact events which would be uneconomical to insure against.²⁶ In so doing, it ensures consumers are not required to fund excessive insurance premiums but only to bear the risk that an insurance cap event will occur.</p>
<p>e) any other matter the AER considers relevant and which the AER has notified Network Service Providers (NSPs) is a nominated pass through event consideration.</p>	<p>Evoenergy's proposed definition of the insurance cap event is either identical to or corresponds closely with analogous nominated pass through events in the AER's recent regulatory decisions. The AER has itself concluded that these recent decisions have brought a greater degree of consistency to pass throughs in its various electricity determinations and gas access arrangements.²⁷</p> <p>In its proposed definition of an insurance cap event, Evoenergy identifies additional factors that the AER may consider relevant for assessing the amount to be passed through for the purpose of a pass through application in accordance with clause 6.6.1(j) of the Rules.</p>

13.3.4 An insurer credit risk event

Evoenergy proposes to include an insurer credit risk event as a nominated pass through event for the 2019–24 regulatory control period.

Insurance provides an appropriate avenue for managing risk by transferring the risk to another party under the terms of a commercial agreement. Evoenergy notes that general insurers are supervised by the Australian Prudential Regulation Authority (APRA).

Prudential Standards include the requirement for general insurers to:

- maintain adequate capital against the risks associated with its activities;²⁸
- maintain assets in Australia of a value that equals or exceeds the total amount of the general insurer's liabilities in Australia;²⁹ and

²⁶ AER 2015, Attachment 15, Pass through events: ActewAGL Distribution final decision 2015–19, 30 April 2015, p. 15-12.

²⁷ AER 2017, Attachment 13 Pass through events, Draft decision ElectraNet transmission determination 2018 to 2023, pp. 13-12 to 13-13.

²⁸ APRA 2013, Prudential Standard GPS 110 – Capital Adequacy, January.

²⁹ APRA 2013, Prudential Standard GPS 120 – Assets in Australia, January.

- maintain a risk management framework and strategy that is appropriate to the nature and scale of its operations.³⁰

The selection of insurance providers is based on robust assessment of financial viability and international reputation. Insurance premiums are purchased based on efficient costs. Incentives for risk management include, among other things, the potential for costs to be incurred that might otherwise be avoided or mitigated. Evoenergy considers that the pass through mechanism enables flexibility to recover costs in the unlikely event that an insurance provider to Evoenergy becomes insolvent and insurance payouts are inadequate or do not materialise.

The AER approved an insurer credit risk event as a nominated pass through event in the 2015 final determination for ActewAGL Distribution.³¹ It has also approved an insurer credit risk event as a nominated pass through event in more recent electricity determinations.³²

Table 13.6 sets out how Evoenergy has had regard to each of the nominated pass through event considerations in proposing an insurer credit risk event. As recently as October 2017, the AER accepted that an insurer credit risk event, defined in a manner that closely corresponds to that proposed by ElectraNet, is consistent with the nominated pass through event considerations.³³

Table 13.6 Assessment of insurer credit risk event against nominated pass through event considerations

Pass through event considerations	How Evoenergy has had regard
a) whether the event proposed is an event covered by a category of pass through event specified in the Rules	This event is not covered by any category of pass through event specified in clause 6.6.1(a1)(1) to (4).
b) whether the nature or type of event can be clearly identified at the time the determination is made for the service provider	The type of event, being the insolvency of an insurer, can be clearly identified at the time of the making of the determination.
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	Evoenergy mitigates the risk of any of its insurers becoming non-viable by regular monitoring and reporting by its insurance broker. Evoenergy scrutinises market developments, insurer reputation, credit rating and financial stabilities of potential insuring entities, such as applying a minimum acceptable insurer S&P rating of A or higher. In addition, Evoenergy sources insurances from key domestic and global insurers, such as the Lloyds syndicate, to reduce exposure to a single insurance market. Nevertheless,

³⁰ APRA 2013, Prudential Standard GPS 220 – Risk Management, January.

³¹ AER 2015, Attachment 15, Pass through events: ActewAGL Distribution final decision 2015–19, 30 April 2015, p. 15-8.

³² See, for example: AER 2017, Attachment 13 Pass through events, Draft decision ElectraNet transmission determination 2018 to 2023, p. 13-7; AER 2016, Attachment 15 Pass through events, Final decision Jemena distribution determination 2016 to 2020, p. 15-7.

³³ AER 2017, Attachment 13 Pass through events, Draft decision ElectraNet transmission determination 2018 to 2023, pp. 13-11 to 13-13.

Pass through event considerations	How Evoenergy has had regard
	despite adopting risk management measures, there is potential for Evoenergy to incur significant costs should an insurer credit risk event occur. This risk cannot be completely eliminated acting prudently and efficiently.
<p>d) whether the relevant service provider could insure against the event, having regard to:</p> <ol style="list-style-type: none"> 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: <ol style="list-style-type: none"> 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 	Evoenergy as part of its insurance review processes has not identified insurance available on reasonable commercial terms for insurer credit risk failure.
e) any other matter the AER considers relevant and which the AER has notified NSPs is a nominated pass through event consideration.	<p>Evoenergy's proposed definition of the insurer credit risk event is either identical to or corresponds closely with analogous nominated pass through events in the AER's recent regulatory decisions. The AER has itself concluded that these recent decisions have brought a greater degree of consistency to pass throughs in its various electricity determinations and gas access arrangements.³⁴</p> <p>In its proposed definition of an insurer credit risk event, Evoenergy identifies additional factors that the AER may consider relevant for assessing the amount to be passed through for the purpose of a pass through application in accordance with clause 6.6.1(j) of the Rules.</p>

³⁴ AER 2017, Attachment 13 Pass through events, Draft decision ElectraNet transmission determination 2018 to 2023, pp. 13-12 to 13-13.

Shortened forms

Term	Meaning
AER	Australian Energy Regulator
APRA	Australian Prudential Regulation Authority
DNSP	Distribution Network Service Provider
NEO	National Electricity Objective
NSPs	Network Service Providers
Rules	National Electricity Rules

References

- AEMC 2012, Rule Determination National Electricity Amendment (Cost pass through arrangements for Network Service Providers) Rule, November 2012
- AER 2014, Attachment 15: Cost pass through, ActewAGL Distribution draft decision, November 2014
- AER 2014, Draft decision Ausgrid distribution determination 2015-16 to 2018-19, November 2014
- AER 2015, Final Decision ActewAGL distribution determination, Attachment 15, Pass through events, April 2015
- AER 2015, Final decision Ausgrid distribution determination, Attachment 15, Pass through events, April 2015
- AER 2015, Final decision Energex distribution determination, Attachment 15, Pass through events, October 2015
- AER 2015, Final decision Ergon Energy distribution determination, Attachment 15, Pass through events, October 2015
- AER 2015, Final decision SA Power Networks distribution determination, Attachment 15, Pass through events, October 2015
- AER 2016, Final decision AusNet distribution determination, Attachment 15, Pass through events, May 2016
- AER 2016, Final decision CitiPower distribution determination, Attachment 15, Pass through events, May 2016
- AER 2016, Final decision Jemena distribution determination, Attachment 15, Pass through events, May 2016
- AER 2016, Final decision Powercor distribution determination, Attachment 15, Pass through events, May 2016
- AER 2016, Final decision United Energy distribution determination, Attachment 15, Pass through events, May 2016
- AER 2017, Draft Decision ElectraNet transmission determination 2018 to 2023, Attachment 13, Pass through events, October 2017
- APRA 2013, *Prudential Standard GPS 110 – Capital Adequacy*, January
- APRA 2013, *Prudential Standard GPS 120 – Assets in Australia*, January
- APRA 2013, *Prudential Standard GPS 220 – Risk Management*, January
- National Electricity (South Australia) Act 1996*
- National Electricity Law*
- National Electricity Rules*