



Submission to the AER on its Preliminary Determination Pass through events



Summary

This document sets out Ergon Energy's response to the Australian Energy Regulator (AER) on its Preliminary Determination – Pass through events.

Ergon Energy accepts the AER's Preliminary Determination in relation to the proposed new definitions for an 'insurance cap event' and an 'insurance event'. Our October Regulatory Proposal has been updated to reflect these definitions.

However Ergon Energy does not accept the AER's Preliminary Determination in relation to:

- the proposed new definition for a 'natural disaster event'
- non-acceptance of the retail separation and isolated network separation pass through events that we included in our October Regulatory Proposal.

In addition, we have proposed a new 'merger' pass through event. Ergon Energy has updated our Regulatory Proposal to include this event.

Outcomes

Ergon Energy has proposed revised pass through events that are in the best interests of consumers. We believe it is in our customers' interests to pay for these types of events only if and when they happen, rather than through upfront capital and operating expenditure allowances.

This is because:

- if the event does not occur or the effects are less costly than expected, customers would be paying higher network prices than needed
- if the impact is worse than anticipated, Ergon Energy's financial viability may be at risk, affecting our ability to provide safe, secure and reliable distribution services to our customers.

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1. Introduction

On 30 April 2015, the Australian Energy Regulator (AER) released its Preliminary Determination on Ergon Energy's Regulatory Proposal for the regulatory control period commencing on 1 July 2015 and ending on 30 June 2020.

This document details our response to the AER's Preliminary Determination in relation to pass through events. We have made revisions to our Regulatory Proposal and its supporting documents to reflect these positions, where necessary.

This document is structured in the following manner:

- Chapter 2 summarises the AER's Preliminary Determination in relation to the nominated cost pass through events.
- Chapter 3 provides our response to the positions adopted by the AER.
- Chapter 4 sets out areas of our October Regulatory Proposal which have been revised due to new or updated information, or changes in methodology.

2. AER's Preliminary Determination

Attachment 15 of the AER's Preliminary Determination details its positions on Ergon Energy's proposed nominated cost pass through events. Ergon Energy nominated five cost pass through events in our October Regulatory Proposal. The AER, in its Preliminary Determination, decided to:

- change the definition of our proposed natural disaster and insurance cap events
- rename our proposed insurance event to an insurer's credit risk event and change the definition
- not accept the retail separation and isolated network separation events because the events are likely to be captured by the prescribed regulatory change event.

The following sections summarise these positions and the AER's rationale.

2.1. Insurance cap event

Our October Regulatory Proposal included an insurance cap event that would allow Ergon Energy to recover any material costs incurred, which exceed our insurance claim limit. Although the AER accepted that an insurance cap event can be consistent with the nominated pass through considerations, it did not accept Ergon Energy's proposed definition. In particular, the AER noted that it did not consider that Ergon Energy's proposed definition of an 'insurance cap event' is sufficiently clear to satisfy the nominated pass through event considerations.

The AER amended Ergon Energy's proposed definition to reflect matters that the AER will have regard to in assessing a pass through event. Specifically, the AER noted that in assessing Ergon Energy's application to pass through costs, it will consider the efficiency of our decisions and actions, and whether Ergon Energy failed to take reasonable action to reduce the magnitude of claim or in any way contributed to an increase in the magnitude of the amount claimed.

In its proposed new definition, the AER has:

- included the term, 'relevant insurance policy', to use consistent terminology throughout the definition
- removed the reference to the 'forecast operating expenditure allowance approved in the AER's final decision' and replaced it instead with 'the level of insurance that an efficient and prudent Network Service Provider (NSP) would obtain in respect of the event'. This is because the AER considered that the National Electricity Rules (NER) would require them to consider the operating expenditure allowance and how Ergon Energy has sought to mitigate the risks of the event occurring.

2.2. Natural disaster event

Although the AER accepted that a natural disaster event can be consistent with the nominated pass through event considerations, if appropriately defined, it did not accept Ergon Energy's proposed definition for this kind of event. To this end, the AER amended Ergon Energy's proposed definition to reflect matters that it will have regard to in assessing an event of this nature. Specifically, the AER:

- noted that Ergon Energy's operating expenditure 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. The AER further noted 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, it will have regard to whether Ergon Energy has taken prudent and efficient steps to insure against the event

- removed the reference to the 'forecast operating expenditure 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'. This is because the AER considered that the NER would require them to consider the operating expenditure allowance and how Ergon Energy has sought to mitigate the risks of the event occurring
- noted that whether a relevant government authority has made a relevant declaration in respect of a natural disaster event is also a factor it would have regard to in considering whether to approve such a pass through event. As such, the AER included this element in their proposed new definition.

2.3. Insurance event

The AER accepted that an insurance event can be consistent with the nominated pass through event considerations, if appropriately defined. However, it did not accept Ergon Energy's proposed definition for this kind of event, on the basis that Ergon Energy's proposed definition does not provide sufficient clarity around when the AER will accept an event. Specifically, the AER did not accept the element of the definition that would allow an NSP to recover the costs associated with variations to the insurance premium or insurance becoming unavailable. The AER also considered that the event proposed by Ergon Energy was too broad in that it did not specify what may give rise to the event occurring.

To this end, the AER has amended Ergon Energy's proposed definition of this event to reflect the matters it will have regard to in assessing an event of this nature. The AER also removed the element which would allow pass throughs for changes to insurance premiums, and for consistency with other determinations made at this time, has referred to this event as the 'insurer's credit risk event'.

2.4. Retail separation event

The AER did not accept Ergon Energy's proposal for a retail separation event as a pass through event. This is because the AER considers the event is likely to be covered by another category of pass through event. In particular, the AER considers that a retail separation event would come within the definition of a regulatory change event, in that it would constitute a regulatory obligation or requirement. Specifically, an obligation or requirement under the National Electricity Law (NEL), in particular section 2D(1)(b)(v). On this basis, the AER noted that if the divestment of Ergon Energy's retail assets materially changes Ergon Energy's costs, then Ergon Energy may be able to make a pass through application to the AER under one of the existing prescribed pass through events.

2.5. Isolated network separation event

The AER did not accept Ergon Energy's proposal for an isolated network separation event as a pass through event. This is because the AER considers the event is likely to be covered by another category of pass through event. In particular, the AER considers that an isolated network separation event would come within the definition of a regulatory change event, in that it would constitute a regulatory obligation or requirement. Specifically, an obligation or requirement under the NEL, in particular section 2D(1)(b)(v). On this basis, the AER considers that if an isolated network separation event materially changes Ergon Energy's costs, then Ergon Energy may be able to make a pass through application to the AER under one of the existing prescribed pass through events.

3. Ergon Energy's response

The following sections set out Ergon Energy's response to the AER's Preliminary Determination.

3.1 Insurance cap event

Ergon Energy's accepts the AER's proposed definition for an 'insurance cap event' set out in the Preliminary Determination. Ergon Energy has updated our Regulatory Proposal to reflect this definition.

3.2 Natural disaster event

Ergon Energy does not accept all of the AER's proposed changes to the definition of natural disaster event. Specifically, Ergon Energy does not accept the removal of 'cyclone' from the definition. Ergon Energy's proposed definition of a natural disaster event has been adapted from the AER's Final Determination for ElectraNet. The key difference is an explicit reference to cyclones, given the likelihood of this type of disaster occurring in our distribution area compared to other disasters.

3.3 Insurance event

Ergon Energy accepts the AER's proposed alternative definition for this kind of event, and the removal of the element of the definition which would allow a pass through for changes to insurance premiums. We also accept the AER's proposal to refer to this event as an 'insurer's credit risk event', for consistency with other determinations made at this time. Ergon Energy has updated our Regulatory Proposal to reflect this definition.

3.4 Retail separation event

Ergon Energy does not agree with the AER's position that a retail separation event is likely, at all times, to be covered by another category of pass through event. Specifically, Ergon Energy does not agree that a retail separation event would in every case come within the definition of a regulatory change event, as defined in the Glossary to the NEL. In particular, in accordance with section 2D(1)(b)(v) of the NEL:

(1) *A regulatory obligation or requirement is -*

...

(b) *an obligation or requirement under -*

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

Ergon Energy notes that it would be possible for the Queensland Government to put a retail separation event into place via the passing of an administrative decision, such that any obligation or requirement arising from that decision would not meet the NEL definition of a regulatory obligation or requirement. Consequently, in the absence of the proposed retail separation event, Ergon Energy would not in those circumstances have access to a mechanism for the recovery of the associated

costs where those cost are material. Of course, notwithstanding the approval by the AER of an event of this nature, Ergon Energy would seek to recover any material costs as a consequence of such an event being brought about through a regulatory obligation or requirement, as defined in the NEL, in accordance with that statutory pass through mechanism. Therefore, Ergon Energy has not updated our Regulatory Proposal to reflect the AER's Preliminary Determination.

3.5 Isolated network separation event

For the reasons discussed above in relation to a retail separation event, Ergon Energy does not agree with the AER's position that an isolated network retail separation event is likely, at all times, to be covered by another category of pass through event. Therefore, Ergon Energy has not updated our Regulatory Proposal to reflect the AER's Preliminary Determination.

4. Updates to our Regulatory Proposal

Ergon Energy has updated our October Regulatory Proposal and *04.01.03 – (Revised) Nominated cost pass through* events to reflect these issues, along with some minor adjustments to ensure consistency with the AER's Preliminary Determination.

Additionally, Ergon Energy has included a proposed new 'merger event' in our revised Regulatory Proposal and *04.01.03 – (Revised) Nominated cost pass through events* supporting document. This event is described below.

4.1 Merger event

The Queensland Government has indicated its intention to consider a merger of the State owned electricity transmission and distribution businesses. Although there has been no formal decision to proceed with the intended merger event, it is not unreasonable to expect that a decision of this nature will be made sometime in the future and will result in costs to Ergon Energy.

If a merger occurs, there will be a direct impact on our operational and fixed support costs, associated with changes to our call centre, finance, human resources, IT, property and management. We are therefore proposing a merger event to recover any material costs incurred if the merger proceeds. For the reasons discussed in relation to the retail separation event, Ergon Energy does not believe that a merger event is likely, at all times, to be covered by another category of pass through event. Therefore, it is appropriate to include this new event in our revised Regulatory Proposal.

Supporting documents

The following documents support our response to the AER on the AER's Preliminary Determination – pass through events:

Name	Ref
<i>(Revised) Nominated cost pass through events</i>	04.01.03

Definitions, acronyms, and abbreviations

This section contains definitions for all acronyms, technical terms, and abbreviations used in the document.

AER	Australian Energy Regulator
Ergon Energy	Ergon Energy Corporation Limited
NEL	National Electricity Law
NER	National Electricity Rules
NSP	Network Service Provider