

Draft Decision

Endeavour Energy

Electricity Distribution

Determination 2024 to 2029

(1 July 2024 to 30 June 2029)

Attachment 15

Pass through events

September 2023

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15 Pass through events

During the regulatory control period Endeavour Energy (Endeavour) can apply to pass through to its customers, in the form of higher or lower network charges, certain material changes in its efficient costs caused by pre-defined exogenous events. These events are called cost pass through events. Such events are limited to circumstances where the business can recover potential costs of defined yet unpredictable high-cost events that are outside the control of the business.

The National Electricity Rules (NER) prescribe the following pass through events for all distribution determinations:¹

- a regulatory change event
- a service standard event
- a tax change event
- a retailer solvency event.

In addition to these prescribed events, other pass through events may be 'nominated' by a service provider for a regulatory control period.² This attachment sets out our draft decision on the nominated pass through events to apply to Endeavour's distribution network for the 2024–29 regulatory control period.

15.1 Draft decision

Our draft decision is to:³

- accept three of Endeavour's nominated pass through events and event definitions as proposed (terrorism, insurance coverage, insurer credit risk) as they are consistent with our current definitions.
- accept the 'natural disaster' event, but with an amended definition for consistency with our recent determinations for other network service providers.⁴

Our reasons are set out in section 15.5 and our draft decision definitions in Table 15.2.

15.2 Endeavour's proposal

Endeavour's proposed nominated pass through events are set out in Table 15.1.

¹ NER, cl. 6.6.1(a1)(1)–(4). Each of these prescribed events is defined in Chapter 10 (Glossary) of the NER.

² NER, cl. 6.6.1(a1)(5).

³ This is one of the constituent decisions we must make under NER, cl 6.12.1(14).

⁴ E.g. AER, *Final Decision – AusNet Services distribution determination 2021–26 – Attachment 15 – Pass through events*, April 2021, pp. 16–19; AER, *Final Decision – CitiPower distribution determination 2021–26 – Attachment 15 – Pass through events*, April 2021, pp. 13–16.

Table 15.1 Endeavour's nominated pass through events

Proposed event	Endeavour's proposed definition
Insurance coverage event	<p>An insurance coverage event occurs if:</p> <ol style="list-style-type: none"> 1. Endeavour: <ol style="list-style-type: none"> a) makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy or set of insurance policies; or b) would have been able to make a claim or claims under a relevant insurance policy or set of insurance policies but for changed circumstances; and 2. Endeavour incurs costs: <ol style="list-style-type: none"> a) beyond a relevant policy limit for that policy or set of insurance policies; or b) that are unrecoverable under that policy or set of insurance policies due to changed circumstances; and 3. The costs referred to in paragraph 2 above materially increase the costs to Endeavour in providing direct control services. <p>For the purposes of this insurance coverage event:</p> <p>'changed circumstances' means movements in the relevant insurance liability market that are beyond the control of Endeavour, where those movements mean that it is no longer possible for Endeavour to take out an insurance policy or set of insurance policies at all or on reasonable commercial terms that include some or all of the costs referred to in paragraph 2 above within the scope of that insurance policy or set of insurance policies.</p> <p>'costs' means the costs that would have been recovered under the insurance policy or set of insurance policies had:</p> <ol style="list-style-type: none"> i. the limit not been exhausted; or ii. those costs not been unrecoverable due to changed circumstances. <p>A relevant insurance policy or set of insurance policies is an insurance policy or set of insurance policies held during the regulatory control period or a previous regulatory control period in which Endeavour was regulated; and</p> <p>Endeavour will be deemed to have made a claim on a relevant insurance policy or set of insurance policies if the claim is made by a related party of Endeavour in relation to any aspect of Endeavour's network or business; and</p> <p>Endeavour will be deemed to have been able to make a claim on a relevant insurance policy or set of insurance policies if, but for changed circumstances, the claim could have been made by a related party of Endeavour in relation to any aspect of Endeavour's network or business.</p> <p>Note for the avoidance of doubt, in assessing an insurance coverage event through application under rule 6.6.1(j), the AER will have regard to:</p> <ol style="list-style-type: none"> i. the relevant insurance policy or set of insurance policies for the event ii. the level of insurance that an efficient and prudent DNSP would obtain, or would have sought to obtain, in respect of the event

Proposed event	Endeavour's proposed definition
	<p>iii. any information provided by Endeavour to the AER about Endeavour's actions and processes; and</p> <p>iv. any guidance published by the AER on matters the AER will likely have regard to in assessing any insurance coverage event that occurs.</p>
Insurer credit risk event	<p>An insurer's credit risk event occurs if:</p> <ul style="list-style-type: none"> • A nominated insurer of Endeavour 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, Endeavour: <ul 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 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, amongst other things,</p> <ul style="list-style-type: none"> • Endeavour'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 • in the event that a claim would have been made after the insurance provider became insolvent, whether Endeavour had reasonable opportunity to insure the risk with a different provider.
Natural disaster event	<p>Natural disaster event means any individual or series of related natural disaster events including but not limited to cyclone, fire, flood or earthquake that occurs during the 2024–29 regulatory control period that changes the costs to Endeavour in providing direct control services, provided the cyclone, fire, flood, earthquake or other event was:</p> <p>(a) a consequence of an act or omission that was necessary for the service provider to comply with a regulatory obligation or requirement or with an applicable regulatory instrument; or</p> <p>(b) not a consequence of any other act or omission of the service provider.</p> <p>Note: In assessing a natural disaster event pass through application, the AER will have regard to, amongst other things:</p> <ol style="list-style-type: none"> (1) whether Endeavour has insurance against the event; (2) the level of insurance that an efficient and prudent NSP would obtain in respect of the event. (3) whether a relevant government authority has made a declaration that a natural disaster has occurred (4) the reasonable actual extent of the event, or series of related events, having regard to relevant factors including, but not limited to, enduring weather systems and earthquake aftershocks.

Proposed event	Endeavour's proposed definition
Terrorism event	<p>Terrorism event means 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:</p> <ul style="list-style-type: none"> • 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 • changes the costs to Endeavour in providing direct control services. <p>Note: In assessing a terrorism event pass through application, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> • whether Endeavour has insurance against the event; • the level of insurance that an efficient and prudent NSP would obtain in respect of the event; and • whether a declaration has been made by a relevant government authority that a terrorism event has occurred.

Source: Endeavour Energy, *0.11 Pass Through Event Proposal*, January 2023, pp. 12–22.

15.3 Assessment approach

The NER set out how we must assess nominated pass through events, and how we must assess an application from a service provider to pass through changes in costs where an event occurs.⁵

Our assessment approach is guided by the National Electricity Objective (NEO)⁶ and the Revenue and Pricing Principles (RPPs).⁷ The RPPs include that the service provider should have a reasonable opportunity to recover at least the efficient costs of providing services and comply with regulatory obligations.⁸ The NEO and the RPPs also reflect the importance of incentives to promote economic efficiency and balance the risks of under and over investment.

In the context of pass through events, we have particular regard to the impact on price, quality, reliability and security of supply that may arise as a result of any change in the efficient operation of, and ability and incentive of, a service provider to invest in it network. This is a similar approach to that taken by the Australian Energy Market Commission (AEMC) when considering pass through event rule changes.⁹

⁵ NER, cl. 6.5.10(b), 6.6.1.

⁶ The NEO is defined in s. 7 of the NEL.

⁷ The revenue and pricing principles are set out in s. 7A of the NEL.

⁸ NEL, s. 7A(2).

⁹ AEMC, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 6.

In determining whether we accept a nominated pass through event, we must take into account the 'nominated pass through event considerations' as defined,¹⁰ which are as follows:¹¹

- a) whether the event proposed is an event covered by a category of pass through event specified in clause 6.6.1(a1)(1) to (4) (in the case of a distribution determination) or clause 6A.7.3(a1)(1) to (4) (in the case of a transmission determination);
- b) whether the nature or type of event can be clearly identified at the time the determination is made for the service provider;
- c) whether a prudent service provider could reasonably prevent an event of that nature or type from occurring or substantially mitigate the cost impact of such an event;
- d) whether the relevant service provider could insure against the event, having regard to:
 - 1) the availability (including the extent of availability in terms of liability limits) of insurance against the event on reasonable commercial terms; or
 - 2) whether the event can be self-insured on the basis that:
 - i) it is possible to calculate the self-insurance premium; and
 - ii) the potential cost to the relevant service provider would not have a significant impact on the service provider's ability to provide network services; and
- e) any other matter the AER considers relevant and which the AER has notified network service providers is a nominated pass through event consideration.

The AEMC described the purpose of the nominated pass through event considerations as:

...to incorporate and reflect the essential components of a cost pass through regime in the NER. It was intended that in order for appropriate incentives to be maintained, any nominated pass through event should only be accepted when event avoidance, mitigation, commercial insurance and self-insurance are unavailable.¹²

...that a pass through event should only be accepted when it is the least inefficient option and event avoidance, mitigation, commercial insurance and self-insurance are found to be inappropriate. That is, it is included

¹⁰ NER, cl. 6.5.10(b).

¹¹ NER, Chapter 10, definition of 'nominated pass through event considerations'.

¹² AEMC, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 19.

after ascertaining the most efficient allocation of risks between a service provider and end customers.¹³

This protects the incentive regime under the NER by limiting erosion of a service provider's incentives to use market-based mechanisms to mitigate the cost impacts that would arise. This promotes the efficient investment in, and efficient operation and use of, network services for the long-term interests of consumers with respect to price.¹⁴

As a matter of good regulatory practice, we also take into account the desirability of consistency in our approach to assessing nominated pass through events across our electricity determinations and gas access arrangements.¹⁵

15.4 Interrelationships

The pass through mechanism is not the only way service providers can manage their risks under a distribution or transmission determination. It is interrelated with other parts of this decision, in particular with the forecast operating and capital expenditure (opex and capex) and rate of return included in our revenue determination. We must specify and take account of these interrelationships.¹⁶ This requires us to balance the incentives in the various parts of our decision.

For systemic risks, service providers are compensated through the allowed rate of return. Service providers also face business-specific, or residual, risks. Service providers are compensated for the prudent and efficient management of these risks through the forecast opex and capex we include in our revenue determination for strategies such as:

- prevention (avoiding the risk)
- mitigation (reducing the probability and impact 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. In order to maintain appropriate incentives under our determinations, we only accept nominated pass through events where we are satisfied that event avoidance, mitigation, commercial insurance and self-insurance under

¹³ AEMC, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 20.

¹⁴ AEMC, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 8.

¹⁵ AEMC, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 18.

¹⁶ NEL, s. 16(1)(c).

approved forecasts of prudent and efficient opex and capex are either unavailable or inappropriate.¹⁷

In general, in respect of unforeseen costs that are relatively minor, a service provider should manage them by using up its existing expenditure allowance, or reprioritising or substituting its projects, to avoid seeking cost recovery through the pass through mechanisms.¹⁸ This is reflected in the materiality threshold that applies to cost pass through applications.¹⁹

Cost pass through amounts approved in a regulatory control period are added to (or in the case of a negative pass through deducted from) forecast opex and capex for the purpose of calculating efficiency carryover amounts under the Efficiency Benefit Sharing Scheme and Capital Expenditure Sharing Scheme.²⁰

Any capex that has already been recovered in a regulatory control period by way of a cost pass through cannot be recovered again in the roll-forward of the regulatory asset base for the next regulatory control period.²¹

15.5 Reasons for draft decision

15.5.1 Insurance coverage, insurer's credit risk, natural disaster, and terrorism events

We consider Endeavour's proposed terrorism, natural disaster, insurer's credit risk and insurance coverage pass through events are consistent with the nominated pass through event considerations set out in the NER.²²

- the proposed events are not covered by an existing category of pass through event
- the nature of the events are clearly identifiable at this time
- a prudent service provider could not reasonably prevent an event of that nature or type from occurring or substantially mitigate its cost impact and could not insure (or self-insure) against the events on reasonable commercial terms.

With regard to the latter point, while Endeavour could take steps to reduce its risk exposure to these events, expenditure beyond a certain level aimed at completely eliminating the risk is likely to be imprudent or inefficient. In that context, sharing the

¹⁷ AEMC, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, pp. 19–20.

¹⁸ AEMC, *Economic Regulation of Network Service Providers, and Price and Revenue Regulation of Gas Services, Final Rule Determination*, 29 November 2012, p. 186.

¹⁹ NER, Chapter 10, definition of 'materially'.

²⁰ AER, *Efficiency Benefit Sharing Scheme for Electricity Network Service Providers*, November 2013, p. 7; AER, *Capital Expenditure Incentive Guideline for Electricity Network Service Providers*, November 2013, p. 6.

²¹ NER, cl. S6.2.1(e)(1)(ii).

²² NER, cl. 6.5.10(b); Chapter 10, definition of 'nominated pass through event considerations'.

risk between Endeavour and its customers is appropriate and more likely to be in the long-term interests of consumers with respect to price.

Endeavour's proposed terrorism, natural disaster, insurer's credit risk and insurance coverage pass through events are also consistent with our recent determinations for other network service providers.²³

For the above reasons, we accept the terrorism, insurer's credit risk, and insurance coverage events as proposed by Endeavour. We have made some amendments to Endeavour's definition of a natural disaster event as discussed below to ensure consistency with our recent determinations, as set out in Table 15.2. These changes are to provide greater drafting consistency between Endeavour and other network service providers.

We have not received any stakeholder submissions on the proposed cost pass through events.

15.5.2 Natural disaster event

Endeavour proposed to amend our definition of natural disaster event by:

- explicitly adding a reference to 'series of related natural disaster events'
- including two new factors we are to take into account when considering a natural disaster cost pass through application.

We consider each of these points in the following sections.

15.5.2.1 Explicit reference to 'series of related natural disaster events'

Endeavour submitted that adding 'series of related natural disaster events' to the proposed definition would clarify that an 'event' can relate to an isolated event and / or a series of related events. Endeavour considered the proposed change would clarify its ability to make a cost pass through application following a natural disaster event which involves several individual events (e.g., the numerous and dispersed bushfires which underpinned its 2019–20 bushfire natural disaster event).²⁴ Endeavour stated that its proposed amendment is justified given the events over recent years and expectations that communities will be more frequently and materially impacted by climate change.²⁵

We consider that our current definition effectively captures the issues Endeavour's proposed amendments are seeking to address. Under our current definition for natural disaster event, network service providers already can make a cost pass through application following a natural disaster event which involves several individual but related events. For example, some of our recent determinations for natural disaster cost pass through applications relating to bushfires included the assessment of cases

²³ AER, Final Decision – AusNet Services distribution determination 2021–26 – Attachment 15 – Pass through events, April 2021, pp. 16–19; AER, Final Decision – CitiPower distribution determination 2021–26 – Attachment 15 – Pass through events, April 2021, pp. 14–16.

²⁴ Endeavour Energy, *0.11 Pass Through Event Proposal*, January 2023, pp. 12–22.

²⁵ Endeavour Energy, *0.11 Pass Through Event Proposal*, January 2023, pp. 12–22.

where the businesses (including Endeavour) proposed that multiple bushfires across their network over a specific period be considered as a single natural disaster event.

AusNet Services, Endeavour, Essential Energy, and Transgrid submitted natural disaster cost pass through applications for the 2019–20 bushfires where they each proposed a range of multiple bushfires be considered as a single natural disaster event.²⁶ We assessed these applications, agreeing with the businesses in some cases and disagreeing with others based on the relevant circumstances and information provided. This demonstrates that our current definition is sufficiently broad and captures the issues Endeavour's definition is seeking to address. Our determinations are publicly available.²⁷

For the above reasons we do not accept Endeavour's amendments. In this draft decision we maintain our current definition for the natural disaster event as set out in Table 15.2.

15.5.2.2 Inclusion of new factors

Our current definition for the natural disaster event includes some factors we are to take into account when assessing a cost pass through application for a natural disaster. However, Endeavour proposed to include two new factors in addition to those that are already reflected in our current definition:²⁸

- 'Whether a relevant government authority has made a declaration that a natural disaster has occurred'
- 'The reasonable actual extent of the event, or series of related events, having regard to relevant factors including, but not limited to, enduring weather systems and earthquake aftershocks'.

We do not consider the proposed amendments are necessary given that our current definition for natural disaster is sufficiently broad to allow us to have regard to such factors if relevant in the specific circumstances. For example, it is not necessary to include an exhaustive list of factors because the definition includes a reference to 'among other things' in respect of these factors. This is reflected by the fact that we discussed the proposed new factors in our recent determinations for natural disaster cost pass through despite our current definition not mentioning them explicitly.²⁹

²⁶ Essential Energy, *Cost Pass Through Application*, 28 September 2021, p. 5; Transgrid, *Cost pass through application – 2019–20 bushfire season*, 13 November 2020; AusNet Services, *2020 bushfire event cost pass through application*, 27 May 2020, pp. 9-14; Endeavour Energy, *2019-20 bushfire disaster event cost pass through application*, 31 August 2020, pp. 7-9.

²⁷ AER, *AER determination – AusNet 2019–20 bushfire cost pass through*, November 2020, p. 17; AER, *AER determination – Endeavour Energy bushfire pass through*, February 2021, p. 17; AER, *AER determination – Essential Energy 2019–20 bushfire cost pass through*, March 2022, pp. 8–11; AER, *AER determination – TransGrid 2019-20 bushfire cost pass through*, May 2021, pp. 4–22.

²⁸ Endeavour Energy, *0.11 Pass Through Event Proposal*, January 2023, pp. 12–22.

²⁹ AER, *AER Determination – Essential Energy 2019–20 bushfire cost pass through*, March 2022, pp. 8–11.

For the above reasons we do not accept Endeavour's proposed amendments. Instead, we have maintained our current definition as set out in Table 15.2.

Table 15.2 summarises the nominated pass through events we have accepted in this draft decision.

Table 15.2 AER pass through event definitions

Pass through event	Draft decision definition
Insurance coverage event	<p>An insurance coverage event occurs if:</p> <ol style="list-style-type: none"> 1. Endeavour: <ol style="list-style-type: none"> a) makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy or set of insurance policies; or b) would have been able to make a claim or claims under a relevant insurance policy or set of insurance policies but for changed circumstances; and 2. Endeavour incurs costs: <ol style="list-style-type: none"> a) beyond a relevant policy limit for that policy or set of insurance policies; or b) that are unrecoverable under that policy or set of insurance policies due to changed circumstances; and 3. The costs referred to in paragraph 2 above materially increase the costs to Endeavour in providing direct control services. <p>For the purposes of this insurance coverage event:</p> <ul style="list-style-type: none"> • 'changed circumstances' means movements in the relevant insurance liability market that are beyond the control of Endeavour, where those movements mean that it is no longer possible for Endeavour to take out an insurance policy or set of insurance policies at all or on reasonable commercial terms that include some or all of the costs referred to in paragraph 2 above within the scope of that insurance policy or set of insurance policies. • 'costs' means the costs that would have been recovered under the insurance policy or set of insurance policies had: <ul style="list-style-type: none"> – the limit not been exhausted; or – those costs not been unrecoverable due to changed circumstances. • a relevant insurance policy or set of insurance policies is an insurance policy or set of insurance policies held during the regulatory control period or a previous regulatory control period in which Endeavour was regulated; and • Endeavour will be deemed to have made a claim on a relevant insurance policy or set of insurance policies if the claim is made by a

Pass through event	Draft decision definition
	<p>related party of Endeavour in relation to any aspect of Endeavour's network or business; and</p> <ul style="list-style-type: none"> • Endeavour will be deemed to have been able to make a claim on a relevant insurance policy or set of insurance policies if, but for changed circumstances, the claim could have been made by a related party of Endeavour in relation to any aspect of Endeavour's network or business. <p>Note for the avoidance of doubt, in assessing an insurance coverage event through application under rule 6.6.1(j), the AER will have regard to:</p> <ul style="list-style-type: none"> i) the relevant insurance policy or set of insurance policies for the event; ii) the level of insurance that an efficient and prudent DNSP would obtain, or would have sought to obtain, in respect of the event; iii) any information provided by Endeavour to the AER about Endeavour's actions and processes; and iv) any guidance published by the AER on matters the AER will likely have regard to in assessing any insurance coverage event that occurs.
Insurer's credit risk event	<p>An insurer credit risk event occurs if an insurer of Endeavour becomes insolvent, and as a result, in respect of an existing or potential claim for a risk that was insured by the insolvent insurer, Endeavour:</p> <ul 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 funding an insurance claim, which would otherwise have been covered by the insolvent insurer. <p>Note: in assessing an insurer credit risk event pass through application, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> i) Endeavour 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 covered by the insolvent insurer's policy, whether Endeavour had reasonable opportunity to insure the risk with a different provider.
Natural disaster event	<p>Natural disaster event means any natural disaster including but not limited to cyclone, fire, flood or earthquake that occurs during the 2024–29 regulatory control period that changes the costs to Endeavour in providing direct control services, provided the cyclone, fire, flood, earthquake or other event was:</p> <ul style="list-style-type: none"> (a) a consequence of an act or omission that was necessary for the service provider to comply with a regulatory obligation or requirement or with an applicable regulatory instrument; or (b) not a consequence of any other act or omission of the service provider.

Pass through event	Draft decision definition
	<p>Note: In assessing a natural disaster event pass through application, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> i) whether Endeavour has insurance against the event; ii) the level of insurance that an efficient and prudent NSP would obtain in respect of the event.
Terrorism event	<p>Terrorism event means 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:</p> <ol style="list-style-type: none"> 1. 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 2. changes the costs to Endeavour in providing direct control services. <p>Note: In assessing a terrorism event pass through application, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> i) whether Endeavour 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.

Source: AER analysis

Shortened forms

Term	Definition
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
capex	Capital expenditure
CCP23	Consumer Challenge Panel, sub-panel 23
DNSP	Distribution network service provider
NEL	National electricity law
NEM	National electricity market
NEO	National electricity objective
NER	National electricity rules
NSP	Network service provider
opex	Operating expenditure
RPP	Revenue and pricing principles
