

# Draft Decision

**Evoenergy**

**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 Evoenergy 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:<sup>1</sup>

- 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.<sup>2</sup> This attachment sets out our draft decision on the nominated pass through events to apply to Evoenergy's distribution network for the 2024–29 regulatory control period.

### 15.1 Draft decision

Our draft decision is to:<sup>3</sup>

- accept Evoenergy's terrorism, insurance coverage, and insurer's credit risk events as proposed because they align with our current definitions for these events.
- accept the natural disaster event but amend the proposed definition to ensure consistency between Evoenergy and other network service providers.<sup>4</sup>

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

### 15.2 Evoenergy's proposal

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

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

<sup>2</sup> NER, cl. 6.6.1(a1)(5).

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

<sup>4</sup> E.g. AER, *Final Decision, AusNet 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 Evoenergy's nominated pass through events**

Pass through event	Evoenergy's proposed definition
Insurance coverage event	<p>An insurance coverage event occurs if:</p> <ol style="list-style-type: none"> <li>1. Evoenergy: <ol style="list-style-type: none"> <li>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</li> <li>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</li> </ol> </li> <li>2. Evoenergy incurs costs: <ol style="list-style-type: none"> <li>a) beyond a relevant policy limit for that policy or set of insurance policies; or</li> <li>b) that are unrecoverable under that policy or set of insurance policies due to changed circumstances; and</li> </ol> </li> <li>3. The costs referred to in paragraph 2 above materially increase the costs to Evoenergy in providing Direct Control Services.</li> </ol> <p>For the purposes of this insurance coverage event:</p> <p><i>changed circumstances</i> means movements in the relevant insurance liability market that are beyond the control of Evoenergy, where those movements mean that it is no longer possible for Evoenergy 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"> <li>i. the limit not been exhausted; or</li> <li>ii. those costs not been unrecoverable due to changed circumstances.</li> </ol> <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 Evoenergy was regulated; and</p> <p>Evoenergy 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 Evoenergy in relation to any aspect of Evoenergy's network or business; and</p> <p>Evoenergy 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 Evoenergy in relation to any aspect of Evoenergy's network or business.</p>

Pass through event	Evoenergy's proposed definition
	<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"> <li>i. the relevant insurance policy or set of insurance policies for the event;</li> <li>ii. the level of insurance that an efficient and prudent DNSP would obtain, or would have sought to obtain, in respect of the event;</li> <li>iii. any information provided by Evoenergy to the AER about Evoenergy's actions and processes; and any guidance published by the AER on matters the AER will likely have regard to in assessing any insurance coverage event that occurs.</li> </ul>
<p>Insurer's credit risk event</p>	<p>An insurer credit risk event occurs if an 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> <ul style="list-style-type: none"> <li>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</li> <li>b) incurs additional costs associated with funding an insurance claim, which would otherwise have been covered by the insolvent insurer.</li> </ul> <p>Note: In assessing an insurer credit risk event pass through application, the AER will have regard to, amongst other things:</p> <ol style="list-style-type: none"> <li>1. 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</li> <li>2. in the event that a claim would have been covered by the insolvent insurer's policy, whether Evoenergy had reasonable opportunity to insure the risk with a different provider.</li> </ol>
<p>Natural disaster event</p>	<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 Evoenergy in providing Direct Control Services, provided the cyclone, fire, flood or other event was:</p> <ul style="list-style-type: none"> <li>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</li> <li>b) not a consequence of the acts or omissions of the service provider.</li> </ul> <p>Note: In assessing a natural disaster event pass through application, the AER will have regard to, among other things:</p>

Pass through event	Evoenergy's proposed definition
	<ol style="list-style-type: none"> <li>1. whether Evoenergy has insurance against the event; and</li> <li>2. the level of insurance that an efficient and prudent NSP would obtain in respect of the event.</li> </ol>
Terrorism event	<p>A 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> <p>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 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> <ol style="list-style-type: none"> <li>i. whether Evoenergy has insurance against the event;</li> <li>ii. the level of insurance that an efficient and prudent NSP would obtain in respect of the event; and</li> <li>iii. whether a declaration has been made by a relevant government authority that a terrorism event has occurred.</li> </ol>

Source: Evoenergy, *Regulatory proposal*, January 2023, pp. 68-70.

## 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.<sup>5</sup>

Our assessment approach is guided by the National Electricity Objective (NEO)<sup>6</sup> and the Revenue and Pricing Principles (RPPs).<sup>7</sup> The RPPs include that the service provider should have a reasonable opportunity to recover at least the efficient costs of providing services and complying with regulatory obligations.<sup>8</sup> 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 its network.

<sup>5</sup> NER, cl. 6.5.10(b), 6.6.1.

<sup>6</sup> The NEO is defined in s. 7 of the NEL.

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

<sup>8</sup> NEL, s. 7A(2).

This is a similar approach to that taken by the Australian Energy Market Commission (AEMC) when considering pass through event rule changes.<sup>9</sup>

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

- 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.<sup>12</sup>

... 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 after

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

<sup>10</sup> NER, cl. 6.5.10(b).

<sup>11</sup> NER, Chapter 10, definition of nominated pass through event considerations.

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



ascertaining the most efficient allocation of risks between a service provider and end customers.<sup>13</sup>

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.<sup>14</sup>

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.<sup>15</sup>

## 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.<sup>16</sup> 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 approved forecasts of prudent and efficient opex and capex are either unavailable or inappropriate.<sup>17</sup>

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

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

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

<sup>16</sup> NEL, s. 16(1)(c).

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

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.<sup>18</sup> This is reflected in the materiality threshold that applies to cost pass through applications.<sup>19</sup>

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.<sup>20</sup>

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.<sup>21</sup>

## 15.5 Reasons for draft decision

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

We consider that Evoenergy's proposed terrorism, natural disaster, insurer's credit risk and insurance coverage pass through events meet the nominated pass through event considerations set out in the NER:<sup>22</sup>

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

The cost pass through events proposed by Evoenergy are the same as those included in its 2019–24 determination, and also consistent with our recent determinations for other network providers.<sup>23</sup>

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<sup>18</sup> AEMC 2012, *Economic Regulation of Network Service Providers, and Price and Revenue Regulation of Gas Services, Final Position Paper*, 29 November 2012, p. 186.

<sup>19</sup> NER, *Chapter 10: Glossary, definition of 'materially'*.

<sup>20</sup> 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.

<sup>21</sup> NER, cl. S6.2.1(e)(1)(ii).

<sup>22</sup> NER, cl. 6.5.10(b); Chapter 10: Glossary, definition of 'nominated pass through event considerations'.

<sup>23</sup> Evoenergy, *Regulatory proposal*, January 2023, pp. 68-72.

We have made minor amendments to the proposed definition of the insurance coverage event and natural disaster event to ensure consistency with our recent determinations. For example, we added 'earthquake' to the list of events in the first paragraph of the natural disaster event definition. We also replaced 'the acts or omissions' with 'any other act or omission' in sub-point (b) (see Table 15.1 compared with Table 15.2). These changes are to provide drafting consistency between Evoenergy and other network service providers.

We did not receive any stakeholder submissions on the proposed cost pass through events.

Table 15.2 sets out our draft decision on the nominated pass through events and event definitions for Evoenergy's 2024–29 regulatory determination.

**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"> <li>1. Evoenergy:                             <ol style="list-style-type: none"> <li>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</li> <li>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</li> </ol> </li> <li>2. Evoenergy incurs costs:                             <ol style="list-style-type: none"> <li>a) beyond a relevant policy limit for that policy or set of insurance policies; or</li> <li>b) that are unrecoverable under that policy or set of insurance policies due to changed circumstances; and</li> </ol> </li> <li>3. The costs referred to in paragraph 2 above materially increase the costs to Evoenergy in providing direct control services.</li> </ol> <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 Evoenergy, where those movements mean that it is no longer possible for Evoenergy 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"> <li>i. the limit not been exhausted; or</li> <li>ii. those costs not been unrecoverable due to changed circumstances.</li> </ol> <p>A relevant insurance policy or set of insurance policies is an insurance policy or set of insurance policies held during the</p>

Pass through event	Draft decision definition
	<p>regulatory control period or a previous regulatory control period in which Evoenergy was regulated; and</p> <p>Evoenergy 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 Evoenergy in relation to any aspect of Evoenergy’s network or business; and</p> <p>Evoenergy 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 Evoenergy in relation to any aspect of Evoenergy’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> <ul style="list-style-type: none"> <li>i. the relevant insurance policy or set of insurance policies for the event</li> <li>ii. the level of insurance that an efficient and prudent DNSP would obtain, or would have sought to obtain, in respect of the event; and</li> <li>iii. any information provided by Evoenergy to the AER about Evoenergy’s actions and processes</li> <li>iv. any guidance published by the AER on matters the AER will likely have regard to in assessing any insurance coverage event that occurs.</li> </ul>
<p>Insurer's credit risk event</p>	<p>An insurer credit risk event occurs if an 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> <ul style="list-style-type: none"> <li>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</li> <li>b) incurs additional costs associated with funding an insurance claim, which would otherwise have been covered by the insolvent insurer.</li> </ul> <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"> <li>i. Evoenergy attempts to mitigate and prevent the event from occurring by reviewing and considering the insurer's track record, size, credit rating and reputation; and</li> <li>ii. in the event that a claim would have been covered by the insolvent insurer's policy, whether Evoenergy had</li> </ul>

Pass through event	Draft decision definition
	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 increases the costs to Evoenergy in providing direct control services, provided the cyclone, fire, flood, earthquake or other event was:</p> <ul style="list-style-type: none"> <li>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</li> <li>b) not a consequence of any other act or omission of the service provider.</li> </ul> <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"> <li>i. whether Evoenergy has insurance against the event;</li> <li>ii. the level of insurance that an efficient and prudent NSP would obtain in respect of the event.</li> </ul>
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"> <li>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</li> <li>2. changes the costs to Evoenergy in providing direct control services.</li> </ul> <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"> <li>i. whether Evoenergy has insurance against the event;</li> <li>ii. the level of insurance that an efficient and prudent NSP would obtain in respect of the event; and</li> <li>iii. whether a declaration has been made by a relevant government authority that a terrorism event has occurred.</li> </ul>

Source: AER analysis

## Shortened forms

Term	Definition
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
capex	capital expenditure
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

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