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Our Ref: 18174896  
Contact Officer: David Monk  
Contact Phone: [REDACTED]

23 April 2025

Trudy Fraser  
A/Executive General Manager Regulation  
Energy Queensland Limited  
PO Box 1090, Townsville QLD 4810

By email: [REDACTED]

Dear Trudy,

**Re: AER Determination – Ergon Energy Cyclone Kirrily Cost Pass Through Application**

I am writing to advise you of the Australian Energy Regulator's (AER) assessment of Ergon Energy's cost pass through (CPT) application, submitted on 28 October 2024, in relation to Cyclone Kirrily, which crossed the North Queensland coast on 25 January 2024.

In accordance with clause 6.6.1 of the National Electricity Rules (NER), the AER has determined that a positive change event has occurred, and that Ergon Energy may recover incremental revenue of \$15.3 million (nominal, smoothed) from network users over the first two years of the 2025–30 regulatory period. This will be recovered as follows: \$7.5 million (nominal) in 2025–26 and \$7.8 million (nominal) in 2026–27. This amount is \$1.7 million higher than Ergon Energy's initial proposal of \$13.6 million (nominal, smoothed), due to our adjustments to PTRM cost inputs for inflation, and due to the smoothing effect, which adjusts for the WACC and reflects the time value of money. To mitigate the impact on customers, we have determined that it is appropriate to smooth recovery of the approved pass through amount over two years, rather than Ergon Energy's initial proposal of recovery in 2025-26 alone.

Details of the AER's assessment against the relevant factors in the NER are set out in following attachments. If you have any queries in relation to this matter, please contact David Monk at [REDACTED]

Yours sincerely

[REDACTED]  
Arek Gulbenkoglul  
General Manager  
Network Expenditure

Sent by email on: 23.04.2025

## Attachment A: Reasons for determination

### 1. Occurrence of a natural disaster pass through event

Ergon Energy's 2020–25 revenue determination defines a natural disaster pass through event as follows:<sup>1 2</sup>

“Natural disaster event means any natural disaster including but not limited to cyclone, fire, flood or earthquake that occurs during the 2020–25 regulatory control period that increases the costs to Ergon Energy in providing direct control services, provided the fire, flood or other event was:

- 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
- not a consequence of any other act or omission of the service provider.”

We are satisfied that the occurrence of Cyclone Kirrily in North Queensland meets this definition and was not a consequence of any act or omission of Ergon Energy.

### 2. Positive change event

We are satisfied Cyclone Kirrily meets the definition of a “positive change event” in the NER as Ergon Energy has incurred materially<sup>3</sup> higher costs in providing direct control services as a result of the event, as demonstrated in **Table 1**.

**Table 1: AER – Materiality assessment (\$million, nominal)**

Costs	2020-21	2021-22	2022-23	2023- 24	2024-25	Total
Approved pass through opex	-	-	-	13.4	-	13.4
Approved pass through capex	-	-	-	0.2	-	0.2
Total costs	-	-	-	13.7	-	13.7
AER approved unsmoothed revenues	-	-	-	1,212.3	-	1,212.3
<b>Materiality (%)</b>	-	-	-	<b>1.1%</b>	-	<b>1.1%</b>

### 3. Timing of Ergon Energy's application

Ergon Energy's cost pass through application in relation to Cyclone Kirrily was due 90 business days after 25 January 2024, the date on which Cyclone Kirrily crossed the North Queensland coast.

On 13 March 2024, Ergon Energy requested an extension, citing difficulties in assessing and quantifying the cyclone's impact. The AER extended the submission deadline to 30 September 2024. Ergon Energy then sought an additional four week extension, highlighting the complexity of preparing three pass through applications within the timeframe. The concurrent focus on the Energex and Ergon Energy regulatory determinations for 2025-2030 further impacted the completion of these applications, as regulatory and finance experts were involved in both processes. The AER granted a further extension, setting the final deadline for 29 November 2024. Energex submitted its application ahead of that deadline, on 28 October 2024.

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<sup>1</sup> Cl. 6.6.1(a1)(5) of the NER.

<sup>2</sup> [Final decision - Ergon Energy distribution determination 2020-25 - Attachment 14 - Pass through events - June 2020](#)

<sup>3</sup> As defined in Chapter 10 of the NER (Glossary).

#### 4. Assessment of the pass through amounts

In assessing Ergon Energy's pass through application, the NER requires the AER to consider a number of factors<sup>4</sup> to determine whether the proposed level of costs is prudent and efficient. To assist our review, we sought additional information from Ergon Energy, which Ergon Energy provided. Our assessment found that:

- with the exception of the Guaranteed Service Level payments discussed below, the proposed pass through amount reflects only the incremental costs incurred as a consequence of the storm event, and not business-as-usual costs, or costs associated with increasing the scope of network services.
- Ergon Energy's decisions and actions in responding to the storm event were likely to be efficient, and the scope of works undertaken appears reasonable in the circumstances.
- Ergon Energy had not taken any action which had increased the magnitude of the pass through amount, or failed to take action that could reasonably have been taken to reduce the magnitude of the pass through amount.

#### ***Guaranteed Service Level (GSL) costs***

Ergon Energy's cost pass through application included incremental GSL costs identified as being incurred as a result of the event. The application stated that Ergon Energy was seeking recovery only for GSL payments made for late new connections during the natural disaster period. These delays occurred as resources were reallocated to address the emergency.

Upon cross-checking the proposed GSL payments with the annual report on GSL payments published on the Queensland Competition Authority's (QCA) website, we identified that the GSL payment amount included in the pass through application was higher than the total GSL payments made by Ergon Energy in the 2023–24 year.

Furthermore, under the NER, the AER must consider whether the costs of a pass-through event have already been factored into the annual revenue requirement for the regulatory control period in which the event occurred. Ergon Energy recovers GSL payments as part of its base opex, with the base year for opex forecasting being 2018-19. The QCA's GSL annual reports show that the total GSL payments for Ergon Energy in the base year were higher than the GSL costs incurred in 2023-24, including those related to the pass through event. Therefore, we are not satisfied that Ergon Energy has incurred incremental GSL costs due to the storm event. These costs should therefore be excluded from any approved pass through amount, as they are already accounted for in Ergon Energy's current revenue determination.

In response to an information request on the above issues, Ergon Energy explained that the GSL figures included in its application represented total costs incurred and had not been adjusted to account for the average monthly performance. Ergon Energy also agreed with the AER's view that the GSL costs were not incremental, and should be excluded from the pass through amount.

#### 5. Approved pass through amount

Our determination is to approve total incremental costs of \$13.7 million in capital and operating expenditure as shown in **Table 2**.

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<sup>4</sup> Cl. 6.6.1(j) of the NER.

**Table 2: Incremental expenditure for Cyclone KIRRILY (\$Dec 2023, million)**

Costs	Ergon Energy application	AER determination
Operating expenditure	13.5	13.4
Capital expenditure	0.2	0.2
<b>Total costs</b>	<b>13.7</b>	<b>13.7</b>

Note: Numbers may not add due to rounding.

The incremental revenue associated with these costs (the approved pass through amount) is detailed in **Table 3**.

**Table 3: AER approved incremental revenue resulting from Cyclone KIRRILY in January 2024 (\$million, nominal, smoothed)**

\$million (nominal)	2020-21	2021-22	2022-23	2023- 24	2024-25	Total
Return on capital	-	-	-	-	0.0	0.0
Return of capital (regulatory depreciation)	-	-	-	-	0.0	0.0
Operating expenditure	-	-	-	13.6	-	13.6
Revenue adjustments	-	-	-	-	-	-
Net tax allowance	-	-	-	-	-	-
Incremental annual revenue requirement (unsmoothed)	-	-	-	13.6	0.0	13.6
<b>Incremental annual expected revenue (smoothed)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>14.2</b>	<b>14.2</b>

Note: Numbers may not add due to rounding.

Our determination is to approve a positive pass through amount of \$15,313,898 (\$nominal, smoothed), to be recovered over two regulatory years, commencing from the first two regulatory years of the 2025–30 regulatory control period (i.e. 2025–26 and 2026–27) as follows:

- \$7,466,986 (\$ nominal) to be recovered in 2025–26
- \$7,846,913 (\$ nominal) to be recovered in 2026–27

These amounts reflect the incremental smoothed revenue in Table 3, adjusted for WACC to reflect the time value of money.

### **Calculation of pass through amount**

Ergon Energy’s cost pass through application included a post-tax revenue model (PTRM) and a cost build up model. Our analysis of Ergon Energy’s models identified a number of modelling issues.

- Ergon Energy’s submitted 2020–25 PTRM contained only the incremental cost pass through expenditure. It did not contain the opening regulatory and tax asset bases or the forecast expenditure from the 2020–25 determination. We consider that the incremental cost pass through costs should be added to the latest 2020–25 PTRM updated for 2024–25 return on debt. We adopt this approach since it accounts for any changes in the tax building block in any years for which building block revenue is updated.
- In determining PTRM inputs, Ergon Energy deflated costs from \$Dec 2023 to \$Jun 2020 terms using a 6-month lagged actual December quarter CPI. We consider that it is appropriate to use the expected inflation rate rather than actual inflation.

- In calculating the amount of the incremental revenue to be recovered in the 2025–30 period, Ergon Energy applied expected inflation and WACC values consistent with its proposal PTRM in the 2025-30 distribution determination. We consider that it is appropriate to use:
  - the real vanilla WACC from the latest approved year which is the 2024–25 value of 2.31% from the 2020–25 PTRM updated for 2024–25 return on debt.
  - expected inflation of 2.72% p.a. reflecting the 5-year geometric average calculated with our glide-path approach from the PTRM, based on the latest forecast from the RBA.

In response to an information request on the above issues, Ergon Energy agreed to all our modelling corrections.

## **6. Timing of cost pass through recovery**

Ergon Energy proposed to recover the incremental revenue arising from its cost pass through application in 2025-26, the first year of the 2025–30 regulatory control period.

However, to assist in smoothing the bill impact of the pass through event on customers, the AER has determined that the approved pass through amount be recovered by Ergon Energy over the first two years of the 2025–30 regulatory control period (2025–26 and 2026–27). We are satisfied that this approach will allow Ergon Energy to recover its efficient costs in a timely manner, without materially increasing volatility in the revenue recovered from consumers.

## Attachment B: Requirements for determining a positive change event has occurred

Requirement of the NER	Our consideration
Is the pass through event a regulatory change event, service standard event, tax change event, or retailer insolvency event? <sup>5</sup>	No.
Does the pass through relate to any other event specified in Ergon Energy' 2020–25 distribution determination as a pass through event for that determination? <sup>6</sup>	Yes. We consider that Cyclone Kirrily in January 2025 is a natural disaster pass through event as specified in Ergon Energy's 2020–25 distribution determination. <sup>7</sup>
Was the pass through event a consequence of acts or omissions of Ergon Energy?	No. There is no evidence that Ergon Energy's acts or omissions caused the cyclone event or materially contributed to the costs of the event.
Did the pass through event entail Ergon Energy incurring materially higher costs in providing direct control services than it would have incurred but for the event? <sup>8</sup>	Yes. The additional costs incurred by Ergon Energy as a result of the cyclone event were material. The cost of responding to the cyclone event in 2023-24 was \$13.7 million or 1.1% of Ergon Energy's approved \$1,212.3 million revenue for that year.
What is the date on which the positive change event occurred? <sup>9</sup>	25 January 2024
Did Ergon Energy submit a written statement within 90 business days of the positive change event occurring? <sup>10</sup>	Yes. In response to Ergon Energy's request, the AER granted two extensions for submitting a cost pass through application, with the final deadline set for 29 November 2024. Ergon Energy submitted its application ahead of that deadline, on 28 October 2024.
Did Ergon Energy specify details of the positive change event, including the date on which the event occurred, in its written statement? <sup>11</sup>	Yes. Ergon Energy' application (written statement) included details of the positive change event, including the date on which the event occurred.
Did Ergon Energy specify in its written statement the eligible pass through amount, the proposed positive pass through amount, and the amounts proposed to be recovered from customers in each regulatory year? <sup>12</sup>	Yes. Ergon Energy proposed a positive pass through amount of \$13.6 million (\$nominal, smoothed) to be recovered from consumers in 2025-26, the first year of the next regulatory control period.
Did Ergon Energy specify in its written statement evidence of the actual and likely increase in costs that occurred solely as a consequence of the positive change event? <sup>13</sup>	Yes. Ergon Energy' pass through application sets out the costs incurred as a result of the cyclone event, as well as how it calculated its proposed pass through amount. <sup>14</sup>
Is the pass through amount, in whole or in part, in respect of expenditure for a restricted asset? <sup>15</sup>	No.

<sup>5</sup> NER, cl. 6.6.1(a1)(1) through 6.6.1(a1)(4); and chapter 10.

<sup>6</sup> NER, cl. 6.6.1(a1)(5).

<sup>7</sup> [Final decision - Ergon Energy distribution determination 2020-25 - Attachment 14 - Pass through events - June 2020](#)

<sup>8</sup> That is, does it meet the definition of a "positive change event" as defined in chapter 10 of the Rules.

<sup>9</sup> NER, cl. 6.6.1(c)(2).

<sup>10</sup> NER, cl. 6.6.1(c).

<sup>11</sup> NER, cl. 6.6.1(c)(1) and 6.6.1(c)(2).

<sup>12</sup> NER, cl. 6.6.1(c)(3), 6.6.1(c)(4), and 6.6.1(c)(5).

<sup>13</sup> NER, cl. 6.6.1(c)(6).

<sup>14</sup> [Ergon Energy - Attachment 5b - 2025-2030](#) Ergon Energy's [Cost Pass Through Post Tax Revenue Model](#)

<sup>15</sup> NER, cl. 6.6.1(c1) and (d2).

## Attachment C: Relevant factors under cl. 6.6.1(j)

Requirement of the NER	Our consideration
We must take into account the matters and proposals set out in Ergon Energy's written statement. <sup>16</sup>	This decision sets out how we have considered the matters and proposals in Ergon Energy's pass through application (written statement).
We must take into account the increase in costs in providing direct control services resulting from the pass through event. <sup>17</sup>	We are satisfied that the expenses incurred by Ergon Energy in providing direct control services in response to the cyclone event were incremental to existing costs, with the exception of the proposed Guaranteed Service Level payments.
We must take into account the efficiency of Ergon Energy's decisions and actions in relation to the risk of the event. <sup>18</sup>	We are satisfied the decisions and actions taken in responding to the cyclone event were efficient, and the scope of works undertaken is reasonable in the circumstances. There does not appear to be any action that Ergon Energy has failed to take to reduce the magnitude of the costs, or that it took or omitted to take which has increased the magnitude of these costs.
We must take into account the time cost of money. <sup>19</sup>	To account for the recovery of the pass through amount in 2025-26 and in 2026-27, we have used <ul style="list-style-type: none"> <li>the real rate of return of 2.31%, as determined in Ergon Energy's 2020–25 distribution determination, reflecting the most recent return on debt update in the approved PTRM.</li> <li>expected inflation of 2.72% p.a. reflecting the 5-year geometric average calculated with our glide-path approach from the PTRM, based on the latest forecast from the RBA from the February 2025 Statement on Monetary Policy.</li> </ul> <p>The higher revenue from smoothing reflects the adjustment for WACC to reflect the time value of money.</p>
We must take into account the need to ensure that the pass through amount reflects only costs incurred solely as a consequence of the cyclone event. <sup>20</sup>	We are satisfied the costs included in our approved pass through amount were solely incurred due to the event. Ergon Energy has taken an appropriate approach to identify cyclone related costs and exclude non-incremental costs from its application.
The AER will have regard to whether Ergon Energy has insurance against the event, and whether it is the level of insurance that an efficient and prudent network operator would obtain? <sup>21</sup>	Ergon Energy does not have insurance covering poles, wires and related network infrastructure due to prohibitively high costs for the limited coverage options commercially available. The premiums required to eliminate risks to poles and wires would result in higher customer charges inconsistent with efficient network operation.  We are satisfied it was prudent and efficient for Ergon Energy to not obtain insurance for its poles and wire assets. This approach is generally consistent with comparable peer networks including those impacted by other natural disasters.
We must take into account whether the costs of the event have already been factored into Ergon Energy's annual revenue requirement for the current regulatory control period or will be	Aside from the GSL costs, which have already been factored into the annual revenue requirement for the current regulatory control period, we do not consider that the costs Ergon Energy is proposing to recover have been included in its annual revenue requirement for either the current or the following regulatory control periods.

<sup>16</sup> NER, cl. 6.6.1(j)(1).

<sup>17</sup> NER, cl. 6.6.1(j)(2).

<sup>18</sup> NER, cl. 6.6.1(j)(3).

<sup>19</sup> NER, cl. 6.6.1(j)(4).

<sup>20</sup> NER, cl. 6.6.1(j)(5).

<sup>21</sup> [Final decision - Ergon Energy distribution determination 2020-25 - Attachment 14 - Pass through events - June 2020](#)

factored into annual revenue for the next regulatory control period. <sup>22</sup>	
We must take into account the extent to which Ergon Energy's costs have already been funded by previous pass through determinations. <sup>23</sup>	We do not consider that any of the proposed costs have been the subject of a previous pass through determination.

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<sup>22</sup> NER, cl. 6.6.1(j)(7).

<sup>23</sup> NER, cl. 6.6.1(j)(7A).