DRAFT DECISION
Evoenergy
Access Arrangement

2021 to 2026

Attachment 10
Reference tariff variation mechanism

November 2020

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Note

This attachment forms part of the AER's draft decision on the access arrangement that will apply to Evoenergy for the 2021–26 access arrangement period. It should be read with all other parts of the draft decision.

The draft decision includes the following documents:

Overview

Attachment 1 – Services covered by the access arrangement

Attachment 2 – Capital base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

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10 Reference tariff variation mechanism

This attachment sets out our consideration of the reference tariff variation mechanism and cost pass through mechanism proposed by Evoenergy. The reference tariff variation mechanism:

- permits building block revenues to be recovered smoothly over the access arrangement period subject to any differences between forecast and actual demand
- accounts for actual inflation
- accommodates other reference tariff adjustments that may be required, such as for an approved cost pass through event
- sets administrative procedures for the approval of any proposed changes to reference tariffs – that is, updating tariffs each year.

In addition to the above, the cost pass through mechanism allows us to vary reference tariffs following the occurrence of a specified event which materially increases or decreases the cost of providing reference services. The inclusion of a pass through mechanism recognises a service provider can face risks beyond its control, which may have a material impact on costs.

Evoenergy proposed to make a number of amendments to the reference tariff variation mechanism in the 2021–26 access arrangement period including the cost pass throughs, licence fee factor, intra-year variation and inter-year variation. These are set out in Table 10.1.

Table 10.1 Evoenergy's proposed amendments

Clause	Summary of proposed change	Draft decision
Initial Reference Tariffs and Variations to Reference Tariffs		
Headings	Amended the headings to section 8 and clauses 8.1 and 8.2 to reflect that Initial Reference Tariffs are addressed in the section (and not just variations to those Reference Tariffs).	Accept
Annual reference tariff variation mechanism	Provided for the AER and Evoenergy to agree on an alternative CPI measure in the event the Australian Bureau of Statistics ceases to calculate and publish the CPI.	Not accept
Intra-year reference tariff variation mechanism	Added a new clause to allow for intra-year Reference Tariff variation with the approval of the AER. This would enable Evoenergy to respond to significant events with price impacts through the course of a Financial Year, consistent with the timing of when costs are incurred. Whereas in the 2016 access arrangement period, Evoenergy (then ActewAGL) implemented significant changes to the tariff structure, the applicable tariff structure is unchanged for the vast majority of customers in the 2016-21 access arrangement period (see "Schedule 3" below). Customers have adjusted to the new tariff structure and there is adequate stability to now allow such a mechanism. Evoenergy is proposing no significant tariff structure changes and therefore considers that customers should be able to respond to any intra-year price changes where these occur.	Not accept
Cost pass through events	• Amended the Natural Disaster Event to clarify that it includes any epidemic.	Not accept

Clause	Summary of proposed change	Draft decision
	• Amended the Regulatory Change Event definition to clarify that it may be triggered by the introduction of a new obligation, as well as a change to an existing obligation.	Accept
	• Deleted the requirement in the Regulatory Change Event and Service Standard Event definitions that costs be 'materially' increased or decreased. This requirement is duplicative and unnecessary given all cost pass through events must give rise to an "Administrative Cost Impact" before costs can be passed through (see clause 8.7, previously clause 7.7) and the definition of "Administrative Cost Impact" requires that the Event give rise to a change in cost in any relevant Financial Year that is equal to or greater than 1 per cent of the smoothed forecast revenue for that Financial Year (i.e. there is already a requirement that costs be material before they can be passed through).	Not accept
	• Amended the Service Standard Event definition to provide that the cessation of the current waiver of Evoenergy's obligations under clause 3.1 of the AER's Ring-fencing Guideline of October 2017 constitutes a Service Standard Event. The waiver expires on 1 July 2024. In the event a further waiver is not granted, as Evoenergy provides electricity distribution services, it could not continue to provide Pipeline Services and another legal entity would be required to do so. This would entail the service provider incurring higher costs in providing the Reference Service than if Evoenergy continued to provide the services in conjunction with providing electricity distribution services.	Not accept
	• Added a new definition of "Ring-fencing Guideline" used in the amended "Service Standard Event" definition.	Not accept
	• Added a new definition of "Service Provider" (which will at commencement be Evoenergy) and used this in place of "ActewAGL" as appropriate throughout the AA. This will ensure the AA remains workable in the event the current waiver of Evoenergy's obligations under clause 3.1 of the AER's Ring-fencing Guideline is not renewed and another legal entity is granted the right to provide Pipeline Services.	Not accept
	• Removed the Network User Failure Event. This event is no longer required because in February 2017, the Australian Energy Market Commission approved a rule change which enhanced the operation of the retailer insolvency cost pass through provisions in the NGR to enable distributors to collect unpaid network charges and any costs associated with a retailer default, regardless of the size of the retailer default.	Accept
Application process for seeking a cost pass through	• Corrected minor grammatical errors throughout (including to correct the references to 'Change in Costs').	Accept
	• Amended the obligation in clause 8.8 (previously clause 7.8) to notify the AER of a cost pass through event which has or is likely to have an Administrative Cost Impact so that it is triggered upon that Event occurring (and not before). This is consistent with the approach in other regulatory determinations by the AER.	Accept
	• Amended the obligation in clause 8.8 (previously clause 7.8) to notify the AER of a cost pass through event within 90 Business Days so that it is the later of the date on which Evoenergy becomes aware of the cost pass through event occurring and the date on which Evoenergy becomes aware that the Event will or is likely to have an Administrative Cost Impact. This is because the obligation should not be triggered before it is apparent that an Administrative Cost Impact associated with a cost pass through event is likely.	Not accept
	• Clarified in clauses 8.9 and 8.10 (previously clauses 7.9 and 7.10) that the cost information to be notified by Evoenergy to the AER is the Change in Cost for each relevant Financial Year.	Accept

Clause	Summary of proposed change	Draft decision
	• Clarified the drafting in clause 8.14(a) (previously clause 7.14(a)) to reflect that, in the event no determination is made, the AER is taken to have determined that the amount to be passed through is the sum of the Changes in Cost associated with the cost pass through event given to the AER by Evoenergy.	Accept
Inter-period treatment of cost pass through events and automatic adjustment factor costs	• Simplified drafting by using defined terms and made minor grammatical corrections. • Deleted reference to the automatic adjustment factor in clause 8.16 as cost pass through amounts are not included in the automatic adjustment factor (it is a separate factor in the Reference Tariff variation mechanism). • Added new clause 8.18 to clarify that automatic adjustment factor amounts that incurred in prior access arrangement periods that are not passed through in Reference Tariffs in those periods may be passed through in the subsequent access arrangement period.	Accept Accept Accept
Annual variation notice	Added subparagraph to reflect the inter-period treatment of cost pass through events already provided for in clause 8.16 (previously 7.16).	Accept
Intra-year variation notice	Added process for Evoenergy to submit intra-year Variation Notices that mirror the process for annual Variation Notices (the reasons for the intra-year mechanism are discussed in “Intra-year Reference Tariff Variation Mechanism” above).	Not accept
Reference Tariff Adjustment Factors		
Automatic adjustment factor (A)	Minor updates to refer to relevant Financial Year and provide for consistency in defined terms.	Accept
Factor amounts	• Amended the licence fee factor when t–2 is Financial Year 2020–21 so the automatic adjustment factor reflects the licence fee factor amounts for 2019–20 and 2020–21. This is required because the automatic adjustment factor amounts are not reflected in required revenues for the access arrangement period and, without the proposed change, there would be no true-up for the actual licence fee factor amount for 2019–20. • Amended the licence fee factor to clarify that, for costs other than the Utilities (Network Facilities) Tax, actual costs are those incurred in financial year t–2 (rather than costs relating to financial year t–2). This is consistent with the approach currently adopted by Evoenergy. It is preferable that actual costs be the costs incurred in year t–2 to avoid the possibility of Evoenergy being required to use forecast expenditure. This is consistent with how the operating expenditure allowance is calculated, which uses a base year of as-incurred operating expenditure as the starting point for forecasting operating expenditure. • Amended the licence fee factor to provide for the Utilities (Network Facilities) Tax to be adjusted based on the actual cost incurred by the Service Provider as a result of the Utilities (Networks Facilities) Tax for the 12 month period ending 31 March in Financial Year t–2. This is because the actual cost for the period 1 April to 30 June in year t–2 is not known at the time Evoenergy proposes its reference tariffs for year t. Under the 2016 AA, Evoenergy used a forecast for that three month period, with a true up in the following year. The proposed amendment will ultimately simplify the calculation of the automatic adjustment factor by avoiding the need for a true up. However, transitional provisions are required in calculating the licence fee factor when Financial Year t–2 is 2019–20, 2020–21 and 2021–22 to ensure there is a true up of all forecast amounts. The transitional provision for 2019-20 also accounts for the variance between the forecast and actual UNFT amounts for the period 1 April 2019 to 31 March 2020, as foreshadowed in Evoenergy’s 2020–21 tariff variation notice. • Amended the unaccounted for gas (UAG) factor amount calculation to allow for the change in the UAG target rate between 2019-20 and 2020-21 and the Financial Years in the 2016-21 access arrangement period.	Accept Accept Accept Accept

Clause	Summary of proposed change	Draft decision
	• Updated to refer to relevant Financial Years and ensure consistent use of defined terms.	Accept

10.1 Annual reference tariff variation mechanism

10.1.1 Draft decision

We accept most of Evoenergy's proposed reference tariff variation mechanism for the 2021–26 access arrangement period. We consider that some elements of Evoenergy's proposed reference tariff variation mechanism are not consistent with the National Gas Rules (NGR). In particular:

- we do not accept the proposed amendment to the consumer price index (CPI) measure
- we do not accept the proposal to vary reference tariffs during a financial year to apply at a date prior to the start of the next financial year
- we do not accept all of Evoenergy's proposed pass through events.

Our reasons for this decision are discussed below.

10.1.2 Evoenergy's proposal

Evoenergy proposed to make a number of amendments to the reference tariff variation mechanism in the 2021–26 access arrangement:

- Initial Reference Tariffs headings
- CPI formula
- intra-year reference tariff variation mechanism
- application process for cost pass through
- inter-period treatment of cost pass through events and automatic adjustment factor costs:
    - Annual variation notice
    - Intra-year variation notice
    - Automatic adjustment factor
- factor amounts:
    - Licence fee factor
    - UAG factor amount.

10.1.3 Assessment approach

Under the NGR, a reference tariff variation mechanism for an access arrangement:

- must be designed to equalise (in present value terms):
  - forecast revenue from reference services over the access arrangement period, and
  - the portion of total revenue allocated to reference services for the access arrangement period.
- may provide for variation of a reference tariff:
  - in accordance with a schedule of fixed tariffs, or
  - in accordance with a formula set out in the access arrangement, or
  - as a result of a cost pass through for a defined event, or
  - by the combination of two or more of these operations.

A formula for varying reference tariffs may (for example) provide for variable caps on the revenue to be derived from a particular combination of reference services; or tariff basket price control; or revenue yield control; or a combination of all or any of these factors. However, the reference tariff variation mechanism must give us adequate oversight and powers to approve reference tariff variations.

We must have regard to various factors in deciding whether an access arrangement's reference tariff variation mechanism is appropriate. These are:

- the need for efficient reference tariff structures
- the possible effects of the reference tariff variation mechanism on administrative costs
- the regulatory arrangements (if any) applicable to the relevant reference services before the commencement of the proposed reference tariff variation mechanism
- the desirability of consistency between regulatory arrangements for similar services
- any other relevant factor.

Having regard to these, we considered the implications of the proposed reference tariff variation mechanism for efficient tariff structures and administrative costs on natural gas consumers, potential users and Evoenergy. In doing so we took into account the nature and scope of pipeline reference services to which reference tariffs are applicable. Our assessment also included a comparison of:

- the proposed reference tariff variation mechanism arrangements with those in Evoenergy's current access arrangements
- other recent gas access arrangement decisions (and electricity determinations under the National Electricity Rules (NER))
- consistency in approach across the provision of similar services.

We assessed the potential impact of Evoenergy's proposal on incentives for pipeline operation in a manner consistent with the National Gas Objective (NGO) and with the revenue and pricing principles (RPP). We also judged the implications of Evoenergy's proposed reference tariff variation mechanism for effective risk management that would be in the long term interests of consumers of natural gas.

10.1.4 Reasons for draft decision

Evoenergy proposed to retain the current method for varying reference tariffs, with a small number of relatively minor amendments, in its 2021–26 access arrangement revision proposal. It submitted that the current method is consistent with the RPP of the National Gas Law (NGL) and supports the NGO by allowing tariffs to remain allocatively and dynamically efficient over the period.[1]

Evoenergy's proposal is largely consistent with the current access arrangement period and we have no concerns with most elements. Our draft decision is therefore to accept most elements without change. We discuss each issue below.

Headings

We accept the amendments proposed by Evoenergy to the heading in section 8 to reflect initial reference tariffs. This corresponds with the same amendment which we accepted with our 2020–25 final decision on the access arrangement proposal by Jemena Gas Networks (NSW) Ltd (JGN).[2]

CPI formula

Evoenergy proposed to amend the CPI paragraph in clause 8.4 of the access arrangement. Evoenergy's amendments relate to the tariff basket price control formula and how the CPI should be determined if the Australian Bureau of Statistics (ABS) ceases to publish the CPI. This clause previously stated that in this case, the CPI will mean the index which the Relevant Regulator considers is the best available alternative index. Evoenergy proposed that the CPI should instead mean an "inflation index or measure agreed between the AER and the Service Provider".[3]

We do not accept this proposed amendment. The current clause is consistent with our 2020–25 final decision on the JGN access arrangement proposal. Evoenergy has not provided evidence that would satisfy us that we should take a different approach in relation to its access arrangement.

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1 Evoenergy, *Attachment 10 – Reference services and tariffs, Access arrangement information, ACT and Queanbeyan-Palerang gas network 2021–26*, June 2020, p. 10-17.

2 AER - Final decision - JGN access arrangement 2020-25 - Approved Access Arrangement for JGN (NSW) Ltd 2020–25 - access arrangement 2020–25 compared to access arrangement 2015–20 – June 2020, Clause 3, p. 6.

3 Evoenergy, *Attachment 10 – Reference services and tariffs, Access arrangement information, ACT and Queanbeyan-Palerang gas network 2021–26*, June 2020, p. 10-18.

Intra-year reference tariff variation mechanism

We do not accept Evoenergy's proposal to vary reference tariffs during a regulatory year, including for the purpose of passing through an amount relating to a cost pass through event. We consider intra-year tariff variations create uncertainty for consumers on annual price movements. Giving further weight to not accepting this proposal, Evoenergy's consumers have indicated that they value price stability. We also note that limiting tariff variations to the beginning of a regulatory year has no impact on Evoenergy's ability to recover pass through costs which will be adjusted for the time value of money as necessary.

One of Evoenergy's pricing objectives for setting tariffs for the 2021–26 access arrangement and over the longer term is to provide stability in network tariffs – where possible, minimise any sudden changes in network tariffs. Intra-year tariff variations would undermine this objective.

We acknowledge that in the past we have accepted intra-year variations to reference tariffs in exceptional circumstances. We have done so only when we have considered it to be in the long term interests of consumers (such as removal of the carbon price from tariffs) where special legislative requirements dictated the necessity for a prompt tariff variation. However, they have been the rare exception to our general approach in relation to intra-year tariff variations.

It should also be noted that the AER's determinations set price caps – it is open to network service providers (NSPs) to charge less than the price caps we determine. Indeed many gas NSPs removed the national carbon price component from reference tariffs during a regulatory year by exercising this flexibility.

In the absence of a compelling rationale or supporting evidence from Evoenergy that intra-year tariff variations are necessary, we consider tariff stability should be the priority over the 2021–26 access arrangement period.

We received two submissions mentioning stakeholder concern about the inclusion of an intra-year reference tariff variation mechanism. These were from the ACT Council of Social Service (ACTCOSS)[4] and Energy Consumers Australia (ECA)[5]. They did not elaborate on the reasons for their concerns.

Inter-period treatment of cost pass through events and automatic adjustment factor costs

Evoenergy proposed some minor grammatical amendments and defined terms in this section which we accept.

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[4] ACTCOSS, *Submission: Evoenergy's gas network 2021–26 access arrangement proposal to the Australian Energy Regulator*, August 2020, p. 7.

[5] Energy Consumers Australia, *Evoenergy and Australian Gas Networks (SA) Gas access arrangement proposals 2021–26 submission*, August 2020, p. 29.

We accept Evoenergy’s proposed deletion of the reference to the automatic adjustment factor in clause 8.16. It is correct that the cost pass through amounts are not included in the automatic adjustment factor, rather, it is a separate factor in the reference tariff variation mechanism.

The proposed new clause 8.18 deals with automatic adjustment factor amounts that are incurred in prior access arrangement periods. It allows for the amounts that are not passed through in reference tariffs in those periods, to be passed through in the subsequent access arrangement period.

We consider this amendment to be reasonable. It is also consistent with the amendment made in clause 3.5(b) of the JGN 2020–25 access arrangement.

Annual variation notice

Evoenergy proposed a new clause 8.19(f) which includes a reference, under the requirements of an annual variation notice, to inter-period treatment of cost pass through events. We accept this proposed amendment. This is consistent with Inter-period treatment of cost pass through events requirements and clause 3.6(vi) in the JGN 2020–25 access arrangement.[6]

Intra-year variation notice

As outlined above, we do not accept Evoenergy’s proposal to vary reference tariffs during a regulatory year, including for the purpose of passing through an amount relating to a cost pass through event. Therefore, we do not accept this proposed amendment by Evoenergy to submit intra-year variation notices.

Automatic adjustment factor

We accept Evoenergy’s proposed updates that refer to relevant financial year and provide for consistency in defined terms.

Our draft decision formula is set out in Figure 10.1.

Figure 10.1 Automatic adjustment factor formula

$$A_t = \frac{(1 + A'_t)}{(1 + A'_{t-1})} - 1$$

where:

A_{t-1} is:

1.1 zero when t–1 refers to financial years 2021–22; and

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6 Access arrangement, JGN’s NSW gas distribution networks, 1 July 2020 – 30 June 2025, Marked up version, Clause 3.6(vi), p. 12.

1.2 value of $A_t^{'}$ determined for the financial year *t-1* for all other years

and

A_{t-1} is:

$$A'_t = \frac{(L_{t-2} + U_{t-2} + C_{t-2} + T_{t-2})[(1 + realWACC_t)^2 (1 + CPI_{t-1})]}{(1 - X_t)\sum_{i=1}^{n}\sum_{j=1}^{m} p_{t-1}^{ij} q_{t-2}^{ij}}$$

where:

t is the financial year for which tariffs are being set;

L_{t-2} is the licence fee factor amount, as defined in this Schedule 4, for financial year *t–2;*

When t–2 is financial year 2020–21, Lt–2 is:

$$L_{2019\text{-}20} * (1 + realWACC_{2020\text{-}21}) * (1 + CPI_{2020\text{-}21}) + L_{2020\text{-}21}$$

where:

$L_{2019\text{-}20}$:	is the licence fee factor amount for financial year 2019–20;
$L_{2020\text{-}21}$:	is the licence fee factor amount for financial year 2020–21;
$realWACC_{2020\text{-}21}$:	is the real WACC determined for financial year 2020–21; and
$CPI_{2020\text{-}21}$:	is the value of CPIt determined for the financial year 2020–21;

$realWACC_t$ is the real WACC for financial year t determined in accordance with the PTRM using the updated return on debt for financial year t determined in accordance with clauses 6.1 to 6.24;

$realWACC_{t-1}$ is the real WACC for financial year t-1;

U_{t-2} is the UAG factor amount, as defined in this Schedule 4, for financial year t–2

C_{t-2} is the carbon cost factor amount, as defined below in this Schedule 4, for financial year t–2

T_{t-2} is the change in relevant tax factor amount, as defined below in this Schedule 4, for financial year t–2

CPI_t has the same meaning as set out in clause 8.4;

CPI_{t-1} is the value of CPI_t determined for financial year t-1

X_t has the same meaning as set out in clause 8.4;

p_{t-1}^{ij} has the same meaning as set out in clause 8.4; and

q_{t-2}^{ij} has the same meaning as set out in clause 8.4.

Factor amounts

Licence fee factor

We accept Evoenergy's proposal to amend t–2 in the licence fee factor to financial year 2020–21 so the automatic adjustment factor reflects the licence fee factor amounts for 2019–20 and 2020–21. We are satisfied with Evoenergy's reasons for the amendment that the automatic adjustment factor amounts are not reflected in required revenues for the access arrangement period. Without the change, there would be no true-up for the actual licence fee factor amount for 2019–20.

We accept Evoenergy's proposal to amend the licence fee factor to an 'As incurred' timing basis. Evoenergy proposed that the costs no longer be those that relate to financial year t–2, rather they should be the actual costs that are incurred in financial year t–2.

We are satisfied Evoenergy has justified this amendment to the licence fee factor and recognise that this is consistent with how the operating expenditure allowance is calculated. That is, it uses a base year of as-incurred operating expenditure as the starting point for forecasting operating expenditure.

We also agree to amend the licence fee factor to provide for the Utilities (Network Facilities) Tax (UNFT) to be adjusted based on the actual cost incurred as proposed by Evoenergy. The UNFT cost is incurred for the 12-month period ending 31 March in financial year t–2. The actual cost for the period 1 April to 30 June in year t–2 is not known at the time Evoenergy proposes its reference tariffs for year t.

In the 2016–21 access arrangement period Evoenergy used a forecast for that three month period, with a true up in the following year. The true up will no longer be required where transitional provisions are used for years 2019–20, 2020–21 and 2021–22, which we also accept.

UAG factor amount

We currently require the UAG factor amount for financial year t–2 to be calculated as follows:

a. the benchmark cost incurred by Evoenergy for purchases of gas as UAG, calculated as the product of:

    a. gas receipts in gigajoules for financial year t–2;

    b. the UAG cost for financial year t–2 in $/gigajoule; and

    c. the UAG target rate of 1.96 per cent,

minus

b. the forecast of the total UAG costs included in the AER's relevant final decision for financial year t–2.

Evoenergy proposed several changes including deleting the reference to year t–2 and replacing it with “that financial year”, updating the UAG target rates to 1.96 per cent where the financial year is 2019–20 or 2020–21 and 2.49 per cent for all other financial years and updating the forecast of the total UAG costs to as follows:

Table 10.2 Evoenergy’s UAG forecast costs

	2021–22	2022–23	2023–24	2024–25	2025–26
Forecast UAG cost ($million, 2019–20)	1.41	1.94	1.75	1.73	1.68

We accept Evoenergy’s amendments to the UAG factor amount calculation and target and forecast amounts.

10.2 Weighted average price cap formula

The weighted average price cap reference tariff variation mechanism will remain unchanged.

10.2.1 Draft decision

We accept Evoenergy's proposal which maintains the weighted average price cap reference tariff variation mechanism.

10.2.2 Evoenergy's proposal

Evoenergy proposed to maintain a tariff basket annual tariff variation mechanism. This is permitted under rule 97(2)(b) of the NGR in the form of a Weighted Average Price Cap (WAPC) formula for the 2021–26 period. It will be implemented using the CPI-X price control formula and annual tariff variation mechanism.[7]

10.2.3 Reasons – no change

We accept Evoenergy's proposal to maintain the weighted average price cap reference tariff variation mechanism. A weighted average price cap is a form of tariff basket price control which is compliant with the NGR. The weighted average price cap will include:

- an automatic adjustment factor to account for the differences between forecast and actual costs for specified uncontrollable events
- a pass through adjustment factor.

[7] Evoenergy, *Attachment 10 – Reference services and tariffs, Access arrangement information, ACT and Queanbeyan-Palerang gas network 2021–26*, June 2020, p. 10-17.

10.3 Cost pass through mechanism

The inclusion of a pass through mechanism recognises a service provider can be exposed to risks beyond its control, which may have a material impact on costs. A cost pass through enables a service provider to recover (or pass through) the costs of defined unpredictable, high cost events.

Evoenergy's proposed pass through events and the application process are set out in section 10.3.2.

10.3.1 Draft decision

Evoenergy has proposed some minor grammatical errors which we accept along with some amendments to the clauses relating to the Administrative Cost Impact and Change in Cost. We also accepted some proposed changes to the cost pass through event. However, we do not accept the proposed change to change the meaning of the time required to notify us of a cost pass through.

In respect to the cost pass through events, our draft decision is to:

- accept Evoenergy's proposed change to the Regulatory Change Event so that it may also be triggered by the introduction of a new obligation
- accept Evoenergy's proposed deletion of the Network User Failure Event
- not accept the proposed amendment to the Natural Disaster Event definition to include any epidemic
- not accept all the other proposed changes to the Regulatory Change Event and Service Standard Event, including new definitions for "Ring-fencing Guideline" and "Service Provider"
- make minor amendments to the definition of Insurance Credit Event, Natural Disaster Event and Terrorism Event as set out in Table 10.3, so that they are consistent with our recent decisions.[8]

10.3.2 Evoenergy's proposal

Evoenergy proposed the following cost pass through events for the 2021–26 period:

- Terrorism Event
- Natural Disaster Event
- Insurance Cap Event
- Insurer Credit Risk Event

[8] E.g. AER, *Draft Decision, SA Power Networks Distribution determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 12–14; AER, *Draft decision – Energex distribution determination 2020–25 – Attachment 14 Pass through events*, October 2019, pp. 10–12.

- Regulatory Change Event
- Service Standard Event.[9]

All of these cost pass through events are in Evoenergy's current access arrangement. Evoenergy's current access arrangement also contains a 'Network User Failure' event. Evoenergy has not reproposed this event, relating to retailer insolvency, as it considers this has now been addressed under rule 520 of the NGR.

Evoenergy proposed the following adjustments to the definitions for four cost pass events (including two new related definitions) from the existing definition in the current access arrangement:[10]

- amend the definition of Natural Disaster Event to include any epidemic.
- change the definition of Regulatory Change Event to clarify that this event may also be triggered by the introduction of a new obligation.
- delete the requirement that costs be 'materially' increased or decreased in the definitions for Regulatory Change Event and Service Standard Event on the basis that this requirement is duplicative and unnecessary given an "Administrative Cost Impact" clause.
- amend the definition of Service Standard Event to provide that the cessation of the current waiver of Evoenergy's obligations under clause 3.1 of the AER's Ring-fencing Guideline of October 2017 constitutes a Service Standard Event. This is proposed on the basis that if the waiver expires on 1 July 2024 and, if a further waiver is not granted, Evoenergy could not continue to provide Pipeline Services and using another legal entity to do that would incur higher costs.
- as a consequence of the proposed amended "Service Standard Event" definition add a new definition of "Ring-fencing Guideline" and a new definition of "Service Provider". These are proposed on the basis that they will ensure the access arrangement remains workable in the event the current waiver of Evoenergy's obligations under clause 3.1 of the AER's Ring-fencing Guideline is not renewed and another legal entity is granted the right to provide Pipeline Services.

In its proposal, Evoenergy stated that the changes to the Regulatory Change Event and removal of the Network User Failure event are consistent with JGN's definitions approved by us recently. It also stated that the change to the Service Standard Event

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9 Evoenergy, *Attachment 10 – Reference services and tariffs, Access arrangement information, ACT and Queanbeyan-Palerang gas network 2021–26*, June 2020, p. 10-21.

10 Evoenergy, *Attachment 10 – Reference services and tariffs, Access arrangement information, ACT and Queanbeyan-Palerang gas network 2021–26*, June 2020, pp. 10-20 to 10-21; Evoenergy, *Appendix 11.3 – Table of reasons for changes to Access Arrangement, Access arrangement information, ACT and Queanbeyan-Palerang gas network 2021–26*, June 2020, p. 7.

to recognise the ring fencing electricity distribution waiver for gas is required due to the unique circumstances of Evoenergy.[11]

Evoenergy's proposed adjustments to the application process for seeking a cost pass through as follows:[12]

- Corrected minor grammatical errors throughout (including to correct the references to 'Change in Costs').
- Amended the obligation in clause 8.8 to notify the AER of a cost pass through event which has or is likely to have an Administrative Cost Impact.
- Amended the obligation in clause 8.8 of the 90 business day notification to the AER rule.
- Clarified in clauses 8.9 and 8.10 that the cost information to be notified by Evoenergy to the AER is the Change in Cost for each relevant financial year.
- Clarified in clause 8.14(a) regarding where the AER has not made a determination.

10.3.3 Assessment approach

The NGR state that a reference tariff variation mechanism may provide for the variation of a reference tariff:[13]

> "…as a result of a cost pass through for a defined event (such as a cost pass through for a particular tax)."

As a component of the reference tariff variation mechanism, a cost pass through mechanism must be assessed having regard to the matters in rule 97(3)[14] of the NGR and must give us adequate oversight and power to approve reference tariff variations.[15]

We must approach this assessment in a manner likely to contribute to the achievement of the NGO.[16]

In addition, we must take into account the RPP whenever we exercise discretion in approving or making those parts of an access arrangement relating to a reference tariff.[17] The RPP include a principle that the service provider should be provided with a reasonable opportunity to recover at least the efficient costs incurred in providing

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11 Evoenergy, *Attachment 10 – Reference services and tariffs, Access arrangement information, ACT and Queanbeyan-Palerang gas network 2021–26*, June 2020, p. 10-21.

12 Ibid., p. 10-21*;* Evoenergy, *Appendix 11.3 – Table of reasons for changes to Access Arrangement, Access arrangement information, ACT and Queanbeyan-Palerang gas network 2021–26*, June 2020, p. 7.

13 NGR, r. 97(1)(c).

14 In summary: efficient reference tariff structures; administrative costs; prior regulatory arrangements; consistency between regulatory arrangements; risk sharing arrangements and any other relevant factor.

15 NGR, r. 97(4).

16 NGL, s. 28(1)(a).

17 NGL, s. 28(2)(a).

reference services and complying with a regulatory obligation or requirement.[18] They also provide incentives to promote economic efficiency.[19] The RPP require us to have regard to the economic costs and risks of the potential for under- and over-investment by a service provider, to promote efficient investment.[20]

In the context of pass through events, we interpret the NGO as requiring us to have particular regard to the impact on price, quality, safety, 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.[21]

Our decision on the cost pass through mechanism includes a decision on what categories of event to accept.[22] In approaching this part of our task, we also take into account the following relevant factors:[23]

- whether the type of event is covered by another category of pass through event
- whether the nature or type of event can be clearly identified at the time the access arrangement is approved for the service provider
- 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
- 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
    2. whether the event can be self-insured on the basis that: it is possible to calculate the self-insurance premium; and the potential cost to the relevant service provider would not have a significant impact on the service provider's ability to provide network services.

These considerations also appear in the NER, where they guide our decision on whether to accept cost pass through events beyond those already included in the NER.[24] We consider they are consistent with the factors referred to in the NGR (rule 97(3)), and pertinent to our examination of the degree to which a proposed category of event is likely to contribute to the achievement of the NGO.[25]

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18 NGL, s. 24(2).

19 NGL, s. 24(3).

20 NGL, s. 24(6).

21 NGL, s. 23; See also AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination,* 2 August 2012, p. 6.

22 NGR, r. 97(1)(c).

23 NGR, r. 97(3)(e).

24 NER, cll. 6.5.10(b), 6A.6.9(b); NER Chapter 10: Glossary, definition of 'nominated pass through event considerations'.

25 NGR, r. 100(1).

The Australian Energy Market Commission (AEMC) described the purpose of these considerations as:

> "…to incorporate and reflect the essential components of a cost pass through regime. 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. That is, a cost pass through event is the least efficient option for managing the risk of unforeseen events.[26]
>
> …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 ascertaining the most efficient allocation of risks between a service provider and end customers."[27]

We consider that viewing pass throughs as a 'last resort' and accepting them only when event avoidance, mitigation and insurance are unavailable, is consistent with the RPP and will contribute to the achievement of the NGO. This approach maintains the incentives on service providers to use market based mechanisms to mitigate the cost impacts that would arise if the event is triggered.[28] In turn, this promotes the efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers with respect to price.[29]

We also look to promote consistency in our approach to pass through event definitions across our electricity determinations and gas access arrangement decisions.[30]

10.3.4 Interrelationships

Except as provided by a reference tariff variation mechanism, a reference tariff is not to vary during the course of an access arrangement period.[31] In assessing and approving a reference tariff variation mechanism, we consider the potential impact of the proposed mechanism on the service provider's incentives under the access arrangement to operate its network—and manage its risks—in a manner consistent with the NGO and RPP.[32]

The pass through component of the reference tariff variation mechanism is also interrelated with other parts of this decision, in particular with the forecast operating

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

27 Ibid., p. 20.

28 NGL, s. 24(3); AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination,* 2 August 2012, p. 8.

29 NGL, s. 23; AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination,* 2 August 2012, p. 8.

30 NGR r. 97(3)(d).

31 NGR, r. 97(5).

32 NGL, ss. 23-24.

expenditure (opex)[33] and capital expenditure (capex),[34] and rate of return[35] included in our forecast revenue requirement. These interrelationships require us to balance the incentives in the various parts of our decision.

Pass through events are one way, but not the only way, in which service providers can manage their risks under an access arrangement. 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 forecast revenue requirement 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 an access arrangement, we only accept 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.[36]

For smaller expenditure, a service provider should generally utilise its existing expenditure allowance or reprioritise its work program rather than seeking approval of a pass through.[37] This is reflected in the materiality threshold that applies to applications for cost pass through under the approved access arrangement.[38]

Opex cost pass through amounts accepted in an access arrangement period are added to forecast opex for the purpose of calculating efficiency carryover amounts under the efficiency carryover mechanism (ECM) in the accepted access arrangement.[39]

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33 Attachment 6 (Operating expenditure) to this draft decision.

34 Attachment 5 (Capital expenditure) to this draft decision.

35 Attachment 3 (Rate of return) to this draft decision.

36 This is consistent with the AEMC's conclusions in its review of the NER pass through arrangements. See: AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination,* 2 August 2012, pp. 19–20.

37 This is consistent with the AEMC's conclusions in its review of the NER pass through arrangements. See: AEMC 2012, *Economic Regulation of Network Service Providers, and Price and Revenue Regulation of Gas Services, Final Rule Determination*, 29 November 2012, p. 186.

38 AER, *Approved Access Arrangement for the JGN's NSW gas distribution networks – 1 July 2015 to 30 June 2020*, June 2015, cll. 3.4(b) and 3.4(c).

39 AER, *Approved Access Arrangement for the JGN's NSW gas distribution networks – 1 July 2015 to 30 June 2020*, June 2015, cl. 12.1(i); See Attachment 8 (Efficiency carryover mechanism) to this draft decision.

10.3.5 Reasons for draft decision

Evoenergy's proposed pass through events are consistent with those we approved in the 2016–21 period.

Overall, for the proposed cost pass through events we have accepted, we are satisfied that these events:

- are not covered by another category of pass through event
- can be clearly identified at the time when we are approving the access arrangement
- are of the nature or type that a prudent service provider could not reasonably prevent from occurring or substantially mitigate their cost impact
- are prohibitively costly to cover by full insurance or that there is no available insurance cover on reasonable commercial terms.

Our assessment of Evoenergy's proposed adjustments to the cost pass through definitions, compared to their current access arrangement, and other minor amendments is discussed below.

Natural disaster event

We do not accept the proposal to change the definition of the Natural Disaster Event to include any epidemic. In making our draft decision we have had regard to the pass through event considerations (see section 10.3.3). While a prudent service operator could not prevent an epidemic from occurring, there is still uncertainty around the cost impact of an epidemic and it is not clear whether those costs could be mitigated by a prudent service operator.

We have not been presented with any information by Evoenergy that the impact of an epidemic satisfies the pass through event considerations. We must have regard to the pass through event considerations. We are also required to determine this issue in a manner that we consider is most likely to contribute to the achievement of the NGO. As noted in section 10.3.3, in the context of cost pass through events, this means we give particular consideration to the impact of the proposal on price, quality, reliability and security of supply that may arise from changes in the efficient investment in, operation and use of gas services in the long term interests of consumers.

We have considered similar proposals by other network providers and have decided not to make a change to the definition of the natural disaster event to include epidemics and/or pandemics.[40] In summary, we have concerns that:

- the adoption of the proposal may have adverse effects that could impact future prices faced by consumers. For example, the proposed amendment is for

[40] For example, see AER, *Final Decision, SA Power Networks Distribution determination 2020–25, Attachment 14 - Pass through events*, June 2020, pp. 11–13.

increases in costs (e.g. opex or capex), however, there could also be cost savings as a result of an epidemic or pandemic (e.g. with delayed capex) that would not be captured by the pass through. Accepting a pass-through that is not well specified comes with the risk of unbalanced treatment of the effects of an epidemic.

- epidemics or pandemics (such as the current COVID-19 pandemic) have broader economic effects and would not be adequately addressed by a simple definitional amendment to the natural disaster event.
- restricting the pass through to events occurring during the 2021–26 access arrangement period may have other impacts for natural disasters that have already occurred.

Overall, we considered that we could not be satisfied that adoption of Evoenergy's proposal would promote the NGO.

Further, the appropriate response to events such as the COVID-19 pandemic should be consistent across all regulated businesses as it potentially affects all of the network businesses we regulate, and all of their customers. We consider that consistency in approach means that any impacts of the COVID-19 pandemic are likely to be more appropriately considered across the industry as a whole through a rule change. Going forward, if it becomes clear that that the impacts of COVID-19 are substantial, then a rule change would need to be considered to enable us to re-open existing revenue determinations.

Service standard event

We do not accept a number of changes proposed by Evoenergy to the definition of the Service Standard Event, including new definitions for "Ring-fencing Guideline" and "Service Provider", which were aimed at addressing a future circumstance if the current waiver of Evoenergy's ring-fencing obligations[41] should cease. While we recognise that such an event may lead to higher cost impacts, these impacts need to be assessed at that point in time whether they are related to a Service Standard Event and whether the costs are material. It is unclear if Evoenergy is proposing a new cost pass through event and if it is, then it should demonstrate that it can meet the key considerations set out in the NGR.[42] Cost pass through events should be limited to unpredictable, infrequent and high cost events that are beyond the control of the service provider[43] – we are not able to form this conclusion based on current information on the need for a Service Standard Event based on the cessation of the ring-fencing obligations waiver. For these reasons, these changes are not accepted.

41 AER, *Ring-fencing Guideline – Electricity distribution version 2*, October 2017, section 3.1, pp. 11–12.

42 NGR, r. 97(3)(e).

43 For example, see Australian Energy Market Commission, *Rule Determination – National Electricity Amendment (Cost pass through arrangements for Network Service Providers) Rule 2012*, 2 August 2012, p. Summary i.

Materiality reference in service standard event and regulatory change event

We also consider not appropriate to remove the material cost requirement in the Regulatory Change Event and Service Standard Event. We agree that there is a "materiality cost test" in the definition of "Administrative Cost Impact"[44]. However, for clarity, it is appropriate, on a standalone basis, for the definitions of the Regulatory Change Event and Service Standard Event to also include a cost materiality requirement. This aids consistency as some of the other network service providers do not have a similar "Administrative Cost Impact" clause in their access arrangements.[45]

Network User Failure event

We also accept the deletion of the Network User Failure Event as it has been addressed by the AEMC's approved rule change in February 2017. This rule change enhanced the operation of the retailer insolvency cost pass through provisions in the Rules to enable distributors to collect unpaid network charges and any costs associated with a retailer default, regardless of the size of the retailer default, thus removing the need for a cost pass through event. This is also consistent with our 2020–25 draft decision for JGN.[46]

Regulatory change event and other minor amendments

We accept the proposed change to the Regulatory Change Event definition that relates to the inclusion of a new obligation as it is consistent with our recent decision with respect to other network service providers.[47]

We have made some minor amendments to the definitions of Evoenergy's Insurer Credit Risk Event, Natural Disaster Event and Terrorism Event, as set out in Table 10.3, to provide greater drafting consistency between Evoenergy and other network service providers.[48]

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44 The definition of "Administrative Cost Impact" requires that the Event give rise to a change in cost in any relevant Financial Year to be equal to or greater than 1 per cent of the smoothed forecast revenue for that Financial Year.

45 NGR, r. 97(3)(d).

46 AER, *Draft Decision, Jemena Gas Networks 2020–25, Attachment 10 – Reference tariff variation mechanism*, November 2019, p. 14.

47 AER, *Draft Decision, Jemena Gas Networks 2020–25, Attachment 10 – Reference tariff variation mechanism*, November 2019, pp. 13–14.

48 E.g. AER, *Draft Decision, SA Power Networks Distribution determination 2020–25, Attachment 14 – Pass through events*, June 2020, pp. 12–14; AER, *Draft decision, Energex distribution determination 2020–25, Attachment 14 – Pass through events*, October 2019, pp. 10–12.

Table 10.3 Accepted cost pass through definitions consistent with our recent decisions

<table>
<tr><th>Pass through event</th><th>Accepted Definition</th></tr>
<tr><td>Insurer credit risk</td><td>An insurer credit risk event means an event where 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:
o 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
o incurs additional costs associated with funding an insurance claim, which would otherwise have been covered by the insolvent insurer.
Note: In making a determination on an insurer credit risk event pursuant to clause 8.11 of this Access Arrangement, the AER will have regard to, amongst other things:
• Evoenergy's attempts to mitigate and prevent the event from occurring by reviewing and considering the insurers track record, size, credit rating and reputation, and
• in the event that a claim would have been made after the insurer became insolvent, whether Evoenergy had reasonable opportunity to insure the risk with a different insurer.</td></tr>
<tr><td>Natural disaster</td><td>Natural disaster event means any natural disaster including but not limited to cyclone, fire, flood or earthquake that occurs during the 2021–26 access arrangement period that increases the costs to Evoenergy in providing the Reference Service, 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.
Note: In making a determination on a natural disaster event pursuant to clause 8.11 of this Access Arrangement, the AER will have regard to, amongst other things:
• whether Evoenergy has insurance against the event, and
• the level of insurance that an efficient and prudent service provider would obtain in respect of the event.</td></tr>
<tr><td>Terrorism</td><td>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:
• 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
• increases the costs to Evoenergy in providing the Reference Service.
Note: In making a determination on a terrorism event pursuant to clause 8.11 of this Access Arrangement, the AER will have regard to, amongst other things:
• whether Evoenergy has insurance against the event;</td></tr>
</table>

Pass through event	Accepted Definition
	• the level of insurance that an efficient and prudent service provider 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: AER analysis.

Application process for seeking a cost pass through

Evoenergy has proposed amendment to some minor grammatical errors, which we accept, and some amendments to the clauses relating to the Administrative Cost Impact and Change in Cost.

Administrative Cost Impact

We accept Evoenergy's proposed amendment to the obligation in clause 8.8 (previously clause 7.8) requiring Evoenergy to notify the AER of a cost pass through event if it occurs, not if it is likely of occur. It is noted that this does not exclude Evoenergy from notifying us if they believe that a cost pass through event will occur.

However, we do not accept Evoenergy's proposed amendment to the obligation in clause 8.8 (previously clause 7.8) that extends the notification date to when it becomes aware that the Event will or is likely to have an Administrative Cost Impact. We prefer it to remain on the date on which Evoenergy becomes aware of the occurrence of the cost pass through event. Otherwise the date becomes too subjective.

It must be noted that the requirement is not an application to vary the reference tariffs. It is only a requirement to notify us of the cost pass through events. The details and amounts can be provided at a later date so we do not see a reason to change this clause and we not accept this amendment.

Change in Cost

We accept Evoenergy's proposed amendments to clauses 8.9 and 8.10 to link the Changes in Cost to each relevant financial year. There is currently no reference to the time period which the Changes in Cost relate. This amendment clarifies that the values should be identified for each relevant financial year period which is what we will require.

We also agree to Evoenergy's proposed amendment that rewords clause 8.14(a) to refer specifically to the pass through amount being the sum of the Changes in Cost associated with the cost pass through event. This amendment doesn't change the meaning, it only refers to the correct terms as set out in the access arrangement.

10.4 Revisions

We require the following revisions to make the access arrangement proposal acceptable:

Table 10.4 Evoenergy's reference tariff variation mechanism revisions

Revision	Amendment
CPI paragraph in clause 8.4	Retain current clause.
Annual reference tariff variation mechanism – CPI amendment	Retain current clause.
Intra-year reference tariff variation mechanism & variation notice	Retain current clause.
Application process for seeking a cost pass through – 90 days	Retain current clause.
Cost pass through events – Natural disaster, Regulatory Change Event and Service Standard Event (materiality), Service Standard Event (Ring-fencing) and Ring-fencing.	Retain current clause.

Shortened forms

Shortened form	Extended form
ABS	Australian Bureau of Statistics
ACTCOSS	ACT Council of Social Service
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
Capex	Capital expenditure
CCP/CCP24	Consumer Challenge Panel, sub panel 24
CPI	Consumer price index
ECA	Energy Consumers Australia
ECM	Efficiency carryover mechanism
JGN	Jemena Gas Networks (NSW) Ltd
NER	National Electricity Rules
NGL	National Gas Law
NGO	National Gas Objective
NGR	National Gas Rules
NSP	Network service provider
Opex	Operating expenditure
RPP	Revenue and pricing principles
UAG	Unaccounted for gas
UNFT	Utilities (Network Facilities) Tax
WAPC	Weighted Average Price Cap