AUSTRALIAN COMPETITION TRIBUNAL

Application by SPI Electricity Pty Limited [2012] ACompT 2

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| Citation: | Application by SPI Electricity Pty Limited [2012] ACompT 2 |
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| Review from: | Australian Energy Regulator |
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| Parties: | **SPI ELECTRICITY PTY LIMITED (ABN 91 064 235 776)** |
|  |  |
| File number: | ACT 7 of 2010 |
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| Tribunal: | **FOSTER J (DEPUTY PRESIDENT), MR G LATTA AM AND PROFESSOR D ROUND** |
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| Date of decision: | 6 January 2012 |
|  |  |
| Legislation: | *National Electricity Law,* s 71O(2) and s 71R  *National Electricity Rules*, cl 6.6.1 and Ch 10, Glossary |
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| Cases cited: | *Application by United Energy Distribution Pty Limited* [2012] ACompT 1 related |
|  |  |
| Dates of hearing: | 6 July 2011 |
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| Date of last submissions: | 6 July 2011 |
|  |  |
| Place: | Sydney |
|  |  |
| Category: | No catchwords |
|  |  |
| Number of paragraphs: | 60 |
|  |  |
| Counsel for SPI Electricity Pty Limited: | Mr D Farrands and Mr A Weinstock |
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| Solicitor for SPI Electricity Pty Limited: | SP AusNet |
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| Counsel for the Australian Energy Regulator: | Ms M Sloss SC, Mr S Lloyd SC, Mr P Gray, Mr D Star, Dr V Priskich, Mr T Clarke and Mr L Merrick |
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| Solicitor for the Australian Energy Regulator: | Corrs Chambers Westgarth |

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| IN THE AUSTRALIAN COMPETITION TRIBUNAL |  |
|  | NO: ACT 7 of 2010 |

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| RE: | application under section 71B of the national electricity law for a review of a distribution determination made by the australian energy regulator in relation to spi electricity pty limited pursuant to clause 6.11.1 of the national electricity rules |
| BY: | SPI ELECTRICITY PTY LIMITED (ABN 91 064 235 776) |

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| TRIBUNAL: | JUSTICE foster (deputy PRESIDENT),  MR G LATTA AM AND PROFESSOR D ROUND |
| DATE OF ORDER: | 6 JANUARY 2012 |
| WHERE MADE: | SYDNEY |

THE TRIBUNAL:

1. Orders that, until further order of the Tribunal, the Reasons for Decision accompanying these orders be kept confidential to the applicant and the Australian Energy Regulator and not be disclosed to any person other than officers, employees and duly authorised agents of the applicant and the Australian Energy Regulator and the legal representatives of each of them.
2. Pursuant to s 71P(2)(b) of the *National Electricity Law*, hereby remits the Final Distribution Determination dated October 2010 in respect of the 2011–2015 regulatory control period in relation to the applicant (SPI Electricity Pty Limited) to be made in accordance with the *National Electricty Law*, the *National Electricity Rules* and these Reasons for Decision.

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| IN THE AUSTRALIAN COMPETITION TRIBUNAL |  |
|  | nO: act 7 OF 2010 |

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| RE: | application under section 71B of the national electricity law for a review of a distribution determination made by the australian energy regulator in relation to spi electricity pty limited pursuant to clause 6.11.1 of the national electricity rules |
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| tribunal: | foster j (deputy president),  mr g latta am and professor d round |
| DATE: | 6 January 2012 |
| PLACE: |  |

**REASONS FOR DECISION**

1. At [533] of the principal Reasons for Decision (*Application by United Energy Distribution Pty Limited* [2012] ACompT 1), we said:

This issue [referring to the **insurance event issue**] concerns whether the reworked definition of *“insurance event”* in the final decision which included a rider to that definition confining the costs which might be the subject of a pass through payment as a result of the happening of such an event to costs incurred which exceed the level of insurance cover provided by policies the premiums for which were provided for in SP AusNet’s forecast opex for the 2011–2015 *regulatory control period* as approved by the AER was an incorrect exercise of discretion or unreasonable in all the circumstances or was arrived at as the result of errors of fact made by the AER. SP AusNet also contended that the decision to include the rider should be set aside because SP AusNet had been denied procedural fairness in the process leading to the final decision. The rider excluded from the scope of the additional nominated *pass through event* concerning insurance (**the insurance event**)events which occurred in a prior regulatory period (ie prior to 1 January 2011) and which were covered by insurance policies which were in place prior to 1 January 2011 but which had expired according to their terms by 1 January 2011, even though the financial impact and losses caused by those events are wholly or partly suffered in the 2011–2015 *regulatory control period*.

1. These Reasons for Decision deal with Issue 12 referred to in the principal Reasons for Decision dated this day (6 January 2012) (**the insurance event issue**).
2. At [539] of the principal Reasons, we said:

The Tribunal is of the view that its reasons in respect of the insurance event issue should, for the time being at least, be kept confidential to the AER and SP AusNet. This is essentially for the same reasons that led the Tribunal to conduct the hearing of that issue in private. Accordingly, the Reasons for Decision in respect of the insurance event issue will be delivered in a confidential set of Reasons separate from these Reasons for Decision. As presently advised, the Tribunal does not consider that liberty should be granted to any person to apply for access to those confidential Reasons. That will remain the position unless and until the Tribunal directs otherwise.

# The Regulatory Process

1. In its initial regulatory proposal dated 30 November 2009, SP AusNet proposed that it should be able to pass through to its customers costs incurred during the 2011–2015 *regulatory control period*:

… that result from an event that leads to costs that exceed SP AusNet’s insurance limits for that event, that would, except for the existence of the insurance cap, have been covered by SP AusNet’s insurance policies that were in existence at the time of the event.

1. In its draft decision, the AER proposed an alternative formulation of the insurance event in the following terms:

An event that would be covered by an insurance policy but for the amount that materially exceeds the policy limit, and as a result the DNSP must bear the amount of that excess loss. For the purposes of this pass through event, the relevant policy limit is the greater of the actual limit from time to time and the limit under the DNSP’s insurance cover at the time of making this regulatory proposal. This event excludes all costs incurred beyond an insurance cap that are due to the DNSP’s negligence, fault, lack of care. This also excludes all liability arising from the DNSP’s unlawful conduct, and excludes all liability and damages arising from actions or conduct expected or intended by the DNSP.

For this purpose, an event is considered to materially increase or decrease costs where that event has an impact of 1% of the smoothed forecast revenue specified in the final decision in the years of the regulatory control period that costs are incurred.

1. In its revised regulatory proposal submitted in July 2010, SP AusNet proposed the same definition for a pass through insurance event as it had proposed in its initial regulatory proposal.
2. SP AusNet submitted that, although the definition of the insurance event specified by the AER in its draft decision was difficult to understand, the AER’s definition arguably entitled SP AusNet to claim a pass through for costs incurred in the 2011–2015 *regulatory control period* being amounts which exceeded the insurance cap relating to an event which occurred either in that period or in an earlier period which was covered by an insurance policy taken out prior to 1 January 2011. For this reason, so it submitted, SP AusNet did not need to address a proposal to disallow a pass through for such costs simply because no such proposal had been placed on the table by the AER.
3. In the final determination in respect of SP AusNet, the AER adopted a very different definition for the relevant pass through event. It defined an insurance pass through event in the following terms:

• an insurance event:

An insurance event occurs if:

(a) the DNSP makes a claim on an insurance policy that it holds; and

(b) the DNSP incurs costs beyond the policy limit for the relevant insurance policy; and

(c) the DNSP must bear the costs that are in excess of the policy limit; and

(d) the event materially increases the costs to the DNSP of providing direct control services.

For the purpose of this event, an event is considered to materially increase costs where the event has an impact of one per cent of the smoothed forecast revenue of the regulatory year in which the costs arc incurred.

For the purpose of this event, a relevant insurance policy refers to the policy coverage provided through a DNSP’s forecast operating expenditure allowance for an insured risk, as approved by the AER in its distribution determination and the reasons for the determination.

1. In the final decision, at par 16.6.10.5 (at p 794 of the final decision) the AER explained its conclusion in respect of this matter in the following way:

The AER has updated its definition of insurance event, in response to the concerns raised by JEN and SP AusNet in their revised regulatory proposals. The AER has allowed an opex step change for insurance for several DNSPs. Therefore, the definition of this event (as set out in the distribution determinations) relates to insurance policies for which the DNSP is providing opex as part of this final decision (that is, the ‘insurance cap’ that must be breached to trigger this event is the cap on the policies funded through the 2011–2015 opex allowances for each DNSP).

1. SP AusNet accepts that the AER would have been justified in ensuring that its definition of the insurance event pass through did not permit the pass through of costs which exceeded the insurance cap of policies taken out by a DNSP in circumstances where the DNSP did not take out the relevant insurance cover that was intended to be funded by the insurance premiums contained within its forecast opex and approved by the AER either by failing to insure at all or by failing to procure the approved level of cover. The AER would have been justified in defining the insurance pass through event in such a way as to ensure that costs were not being passed on to consumers via the pass through mechanism which should have been covered under the insurance policies the premiums for which had been allowed in the particular DNSP’s forecast opex. SP AusNet submitted that it was for this reason that the AER tied the pass through event to excess over the insurance cap in respect of policies the premiums for which would be paid during the 2011–2015 *regulatory control period* ie those which had been taken into account in arriving at the DNSP’s opex for that period. At pp 793–794 of the confidential part of the final decision, the AER said:

The AER has thus amended its definition of ‘insurance cap’ event to reflect the original wording contained in SP Ausnet’s and JEN’s initial regulatory proposals, subject to the following addition.

In its discussion on insurance, the AER permitted this step change (see Appendix L of this decision). However, the AER in that discussion noted that whilst it can permit increased insurance allowances, it cannot compel a DNSP to actually seek the increased coverage for which the premiums were sought. In this instance, the AER is concerned that customers could potentially pay twice—firstly, for increased premiums under the opex allowance, and secondly, through the pass through mechanism (the insurance event, whereby the DNSPs recover costs above its insurance cap). As part of the step changes appendix, the AER stated:

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The AER expects that, because an increase in coverage has been allowed for through opex for several DNSPs, the insurance cap pass through event should be amended so that only costs beyond caps on policies sought in this decision can be recovered, should an insurance event occur.

1. The AER achieved this apparent objective by including a definition of *“relevant insurance policy”* in subpar (b) of the insurance pass through event definition.
2. SP AusNet submitted that, when the AER addressed the issue described at [10] above, it used a mechanism which had the (perhaps) unintended effect of denying pass through relief to SP AusNet in the circumstances described at [533] of the principal Reasons (which is extracted at [1] above). It is this unintended effect which SP AusNet seeks to avoid.

# SP AusNet’s Contentions

1. SP AusNet submitted that the reworked definition of the insurance pass through event was brought about because the AER committed errors of fact or exercised its discretion incorrectly. It also argued that the decision to include the rider was unreasonable in the circumstances. As mentioned in the principal Reasons, SP AusNet also relies upon a procedural fairness ground.
2. The principal complaint made by SP AusNet is that the AER should not have excluded from the definition of the insurance pass through event claims under insurance policies entered into prior to 1 January 2011 which may or may not have expired according to their terms being policies which respond to events that occurred in a prior regulatory period with the consequential incurring of costs by the DNSP above the insurance cap in the current *regulatory control period*.
3. At par 157 to par 163 of its initial Written Submissions (those dated 28 February 2011), SP AusNet submitted that if:
4. …

(a) [SP AusNet] has taken out an insurance policy in a prior regulatory period;

(b) [SP AusNet] includes in its operating expenditure allowance for the prior period the insurance premiums for that policy;

(c) The relevant regulator (in particular the Essential Services Commission (the **ESC**)) has approved the inclusion of those premiums in [SP AusNet]’s operating expenditure within its revenue allowance for the prior period;

(d) An insurance event within the terms of the policy occurs in the prior regulatory period;

(e) [SP AusNet] incurred a liability in the current regulatory period (2011–15) in respect of that event which is in excess of the insurance cap under the prior policy; and

(f) [SP AusNet] seeks to pass the excess on as an insurance pass through event in the current regulatory period,

then it is unreasonable and/or an incorrect exercise of the AER’s discretion to deny the recoverability of that excess cost to [SP AusNet] as an insurance pass through event cost in the circumstances of the premiums having been paid in a previous regulatory period and the relevant policy having been taken out in that previous regulatory period. Indeed, [SP AusNet] submits that this is the case even if the relevant premiums were not included in [SP AusNet]’s operating expenditure allowance for the prior period.

158 xx xxxxxxxxxx xxxx xxxxxxx xxxx

(a) xx xxxxx xxxxxxxx xx xxx xxxx xxxx

(b) xxx xxxxx xxx xxxxxxx xx xx xxxxxxxxx xxxxxx xxx xxxxx xxx xxxxxxx xxx xxxx xxxx xx xxxx

(c) xxx xxxxxxxxx xxxxxx xxxxxxx xx xxxx

(d) xxx xxxxx xxxxxx xxx x xxxx xxxxx xxxxxxxxxxx xx xxxx xxx

(e) xxx xxx xxxxxxxx xxx xxx xx xxx xxxxxxxxx xxxxxx xxxxxxxxx xxx xxxxxxxxx xxxx

159 If the interpretation of the Insurance Decision is as per paragraph 150(a) or (b) above, the Uncovered Old Insurance Loss may not be able to be the subject of a pass through event claim. On this basis, the Uncovered Old Insurance Loss, however large, would not be passed through unless there was AER approval.

160 [SP AusNet] has some insurance policies which were entered into, and have expired, prior to the current regulatory period and in respect of which insurance premiums were paid and included in prior operating expenditure which was included in SPI's revenue allowance (See A J C Parker’s affidavit, to be affirmed on 1 March 2011). These insurance policies still provide cover for events that have occurred prior to the current regulatory control period (See A J C Parker’s affidavit, to be affirmed on 1 March 2011).

161 None of those insurance policies or the associated premiums were approved by the AER in its Final Determination and Final Decision and, because they have expired, no premiums remained payable in relation to them for the current regulatory control period and so no allowance for those premiums was included in [SP AusNet]’s operating expenditure allowance for the current regulatory control period.

162 These policies should not be subject to the AER approval requirement.

163 In saying this, [SP AusNet] notes that this will not undermine the principle against ‘double recovery’ that the AER is seeking to implement (see paragraph 145, above). Premiums paid in relation to an insurance policy that has expired prior to the current regulatory control period are not funded from 2011–15 operating expenditure and they are paid in relation to an insurance cap which remains fixed into the future in respect of events that occur during the policy term. There is therefore no question of double recovery by the distributor.

1. SP AusNet went on to submit that the outcomes which it postulated at par 157–163 of its Written Submissions did not promote the NEO and could not be accommodated consistently with the RPP.
2. SP AusNet also complained that it had been denied procedural fairness because the matter of particular concern discussed at [14]–[15] above had not been revealed as an issue between it and the AER in any communication from the AER. In particular, it had not been telegraphed in the draft decision. SP AusNet submitted that the fact that the AER had under consideration a definition of the insurance pass through event which led to the result that policies entered into in prior regulatory periods could not be covered by the definition of the insurance pass through event nominated for the 2011–2015 *regulatory control period* was simply not disclosed at all by the AER.
3. In its Written Submissions, at par 178, SP AusNet offered three choices as the most appropriate way of resolving this issue in its favour. At pars 178–179 of those Submissions, SP AusNet submitted that:

178 [SP AusNet] seeks an order, under s 71P(2)(a), that the definition of *insurance event* in the Final Determination be varied such that the last paragraph:

(a) be deleted: or

(b) be amended to provide that a *relevant insurance policy* includes a policy which expired before the regulatory control period but which responds to claims made during the regulatory control period; or

(c) be amended to provide that a *relevant insurance policy* includes a policy if:

(i) the premium for the policy was paid before the regulatory control period: and

(ii) an opex allowance for the premium was approved by a regulator before the regulatory control period.

179 As to sub-paragraph 178(b), this issue could be resolved by providing, for example, that a *relevant insurance policy* is:

The policy coverage provided either:

(a) through a DNSP’s forecast operating expenditure allowance for an insurance risk, as approved by the AER in its distribution determination and the reasons for the determination; or

(b) by an insurance policy that has expired prior to the current regulatory control period but provides cover for claims made in respect of events that have occurred during the policy period.

# The AER’s Contentions

1. The AER submitted that there was no denial of procedural fairness to SP AusNet because it was SP AusNet which should have alerted the AER that SP AusNet needed to preserve its capacity to pass through costs incurred above an insurance cap in respect of a policy entered into prior to 1 January 2011, at least where those costs were incurred in the current *regulatory control period*. The AER submitted that, upon the correct interpretation of cl 6.6.1 of the NER, the occurrence of the pass through event and the suffering of the additional costs both need to occur during the same *regulatory control period*. In particular, the AER relied upon the definition of *eligible pass through amount* in Ch 10, Glossary insofar as that definition applies to DNSPs. Relevantly, that definition provides:

In respect of a *positive change event* for a [DNSP], the increase in costs in the provision of *direct control services* that the [DNSP] has incurred and is likely to incur until the end of the *regulatory control period* as a result of that *positive change event* (as opposed to the revenue impact of that event).

1. For a DNSP, the *positive pass through amount* is defined in Ch 10 as:

… an amount (not exceeding the *eligible pass through amount*) proposed by the [DNSP] under clause 6.6.1(c).

1. The *pass through event* in the draft decision was the occurrence of the insured risk. This is different from the making of a claim for a loss in excess of the limit of a DNSP’s insurance policy (as under the definition specified in the final decision). Having regard to this distinction, a pre-2011 event/post-end 2010 loss would not have been claimable as a pass through event under the definition in the draft decision. Alternatively, SP AusNet should have realised that such a view of the draft decision was at least open. In that event, it should have raised its concerns with the AER explicitly and directly.
2. xx xxxxxx xxx xxx xxxxxx xxx xxx xxxx xxx xxxxxxxxx xxxxxxxxx xx x xxxxxxxx xxxx xxxxx xxxxxxxx xxxxx xxxx xxxx xx xxxxxxxxxxx xx xxxxxx xx xxx xxxxxx xx xx xxxxxxx xxxxxxxxxx xxxxxxxxx xxxxxxxx xxxxx xxxx xx xxxxx xx xxx xxxx xxx xxxx xxxxx xxxxxxxxxxx xxxxx xxx xxxxxxxxxxx xxxxx xxx xxxxxxx xxxxxxxxxx xxxxxxx xxxxxx xxx xxxx xx xxx xxx xxxxxxxx xxx xxxx xxxx xxxxxx xxx xxxx xxxx xxxxxxx xx xxxx xxx xxxxx xxxx xxxxxxxx xx xxx xxxxxxxxxx xxx xxxxxxxxxxxxxx xxx xxxxxx xx xxxxx xxxx xx xxxxx xxxxx xxx xxx xx xxxxxx xxx xxx xxxx xx xxxx xxx xxxx xxxx xxx xxxxxxxxxx xxxxxxxx xx xx xxxxxxx x xxxxxxx xxxxx xxxxx xxxxxx x xxxxxxx xxxx xxxx xxx xxxx xx xxxx x xxxxxxx xxxx xx xxx xxxx xxxxx xxxxxxx xx xxxxxx xxx xx xxxxx xxx xxx xxxx xx xxx xxxxxxxxx xx xxxxxx xxxx xxx xxxxxxxxxx xx xxx xxxxxxxxx xxxx xxxxxxxx xxxxx xxxxxxx x xxxxxxx xxxxxx xxxxx xxxxxx x xxxxxxx xxxx xxxx xx xxx xxxxxxx xx xx xxxx xx xxxxx xxxxxx xxxxx xxx xxxxxxx xxxxxxxxxx xxxxxx xx xx xxxxxx xx xxxxxxx xxxxxx xxxxxx xxxxxx xxxxxxxx xxxx x xxxxxxx xxxx xx xxxxxx xx xx xxxxx xxxxx xxxxxxxx xxxx xx xxxx xxxx
3. Neither the definition of the insurance event proposed by SP AusNet nor the draft decision covered an event which occurred in the period before 2011 causing loss in the current *regulatory control period* (2011–2015). Alternatively, it was at least arguable that the definition did not apply to such circumstances.
4. In any event, there was no insurance pass through event under the last ESCV price determination. The capacity to reopen that determination was much more limited than SP AusNet has submitted. The reopener was not equivalent to the *pass through event* protocol.
5. The AER submitted that SP AusNet was precluded by the terms of s 71O(2) of the NEL from raising this matter now because it failed to do so during the course of the regulatory process.
6. There was no denial of procedural fairness to SP AusNet during the regulatory process.
7. A material issue that arose was whether it would be inconsistent with the requirements of the NEL if a DNSP was able to reduce its ongoing premium costs by reducing the level of its insurance coverage while retaining full ability to pass any excess over cap liabilities through to consumers.
8. The AER’s purpose for including the rider was to ensure that a DNSP would not be permitted to obtain a cost saving by reducing the limit of its policy coverage, while maintaining the benefit of a pass through for losses above its policy limits from time to time. It was SP AusNet which raised this issue with the AER. SP AusNet made a submission in support of the purpose for which the AER introduced the rider. Thus, SP AusNet cannot claim to have been deprived of an opportunity to make submissions in relation to that matter.
9. It was SP AusNet itself which introduced into the dialogue between it and the AER and thus into the regulatory process the idea that the issues described at [27]–[28] above should be specifically addressed by the AER in the definition of the insurance pass through event upon which it ultimately decided.

# Decision

1. Clause 6.6.1(a) to cl 6.6.1(e) of the NER are in the following terms:

**6.6.1 Cost pass through**

(a) If a *positive change event* occurs, a [DNSP]may seek the approval of the *AER* to pass through to *Distribution Network Users* a *positive pass through amount*.

(b) If a *negative change event* occurs, the *AER* may require the [DNSP] to pass through to *Distribution Network Users* a *negative pass through amount* as determined by the *AER* under paragraph (g).

**Positive pass through**

(c) To seek the approval of the *AER* to pass through a *positive pass through amount*, a [DNSP]must submit to the *AER*, within 90 *business days* of the relevant *positive change event* occurring, a written statement which specifies:

(1) the details of the *positive change event*; and

(2) the date on which the *positive change event* occurred; and

(3) the *eligible pass through amount* in respect of that *positive change event;* and

(4) the *positive pass through amount* the [DNSP] proposes in relation to the *positive change event*; and

(5) the amount of the *positive pass through amount* that the provider proposes should be passed through to *Distribution Network Users* in each *regulatory year* during the *regulatory control period*; and

(6) evidence:

(i) of the actual and likely increase in costs referred to in subparagraph (3); and

(ii) that such costs occur solely as a consequence of the *positive change event*; and

(7) such other information as may be required under any relevant *regulatory information instrument*.

(d) If the *AER* determines that a *positive change event* has occurred in respect of a statement under paragraph (c), the *AER* must determine:

(1) the *approved pass through amount*; and

(2) the amount of that *approved pass through amount* that should be passed through to *Distribution Network Users* in each *regulatory year* during the *regulatory control period*,

taking into account the matters referred to in paragraph (j).

(e) If the *AER* does not make the determinations referred to in paragraph (d) within 60 *business days* from the date it receives the [DNSP]*’s* statement and accompanying evidence under paragraph (c), then, on the expiry of that period, the *AER* is taken to have determined that:

(1) the *positive pass through amoun*t as proposed in the [DNSP]’s statement under paragraph (c) is the *approved pass through amount* in respect of that *positive change event*; and

(2) the amount of that *positive pass through amount* that the [DNSP] proposes in its statement under paragraph (c) should be passed through to *Distribution Network Users* in each *regulatory year* during the *regulatory control period*, is the amount that should be so passed through in each such *regulatory year*.

1. In the present review, we are not concerned with *negative change events*. Our sole interest is in *positive change events.*
2. Before making a determination under cl 6.6.1(d), the AER may consult with the relevant DNSP and others *“… on any matters arising out of the relevant* ***pass through event*** *the AER considers appropriate* (cl 6.6.1(i)).
3. Clause 6.6.1(j) provides:

**Relevant factors**

(j) In making a determination under paragraph (d) or (g) in respect of a [DNSP], the *AER* must take into account:

(1) the matters and proposals set out in any statement given to the *AER* by the [DNSP] under paragraph (c) or (f); and

(2) in the case of a *positive change event*, the increase in costs in the provision of *standard control services* that the [DNSP] has incurred and is likely to incur until the end of the *regulatory control period* as a result of the *positive change event*; and

(3) in the case of a *positive change event,* the efficiency of the [DNSP]’s decisions and actions in relation to the risk of the *positive change event*, including whether the [DNSP] has failed to take any action that could reasonably be taken to reduce the magnitude of the *eligible pass through amount* in respect of that *positive change event* and whether the [DNSP] has taken or omitted to take any action where such action or omission has increased the magnitude of the amount in respect of that *positive change event*; and

(4) the time cost of money based on the *weighted average cost of capital* for the [DNSP] for the relevant *regulatory control period*; and

(5) the need to ensure that the [DNSP] only recovers any actual or likely increment in costs under this paragraph (j) to the extent that such increment is solely as a consequence of a *pass through event*; and

(6) in the case of a *tax change event*, any change in the way another *tax* is calculated, or the removal or imposition of another *tax*, which, in the *AER’s* opinion, is complementary to the *tax change event* concerned; and

(7) whether the costs of the *pass through event* have already been factored into the calculation of the [DNSP]’s *annual revenue requirement;* and

(8) any other factors the *AER* considers relevant.

1. In Ch 10, Glossary, the following relevant definitions appear in respect of DNSPs:

***approved pass through amount***

…

In respect of a *positive change event* for a [DNSP]:

(a) the amount the *AER* determines should be passed through to *Distribution Network Users* under clause 6.6.1(d)(2); or

(b) the amount the *AER* is taken to have determined under clause 6.6.1(e)(3),

as the case may be.

***eligible pass through amount***

…

In respect of a *positive change event* for a [DNSP], the increase in costs in the provision of *direct control services* that the [DNSP] has incurred and is likely to incur until the end of the *regulatory control period* as a result of that *positive change event* (as opposed to the revenue impact of that event).

***pass through event***

Any of the following is a *pass through event*:

1. A regulatory change event;
2. A service standard event;
3. A tax change event;
4. A terrorism event;

…

An event nominated in a distribution determination as a *pass through event* is a *pass through event* for the determination (in addition to those listed above).

***positive change event***

…

For a [DNSP], a *pass through event* that materially increases the costs of providing *direct control services.*

***positive pass through amount***

…

For a [DNSP], an amount (not exceeding the *eligible pass through amount*) proposed by the [DNSP] under clause 6.6.1(c).

1. In order to engage cl 6.6.1(a), there must first of all be a *pass through event*.
2. The subject matter of the *pass through event* in the present case is not one of the events specified in subpars (a) to (d) of the definition of *pass through event* in Ch 10, Glossary. If it is to be brought within that definition, it must be nominated as an additional *pass through event* by the AER. The prospective nomination of the insurance *pass through event* was under consideration by the AER from the commencement of the regulatory process which culminated in the final decision.
3. On the assumption that an event occurs which falls within the definition of *pass through event*, the second matter which must be satisfied before cl 6.6.1(a) is engaged is that the *pass through event* must be a *positive change event*. This too is defined in Ch 10, Glossary.
4. If the postulated event is a *positive change event*, then the DNSP may seek the approval of the AER to pass through to consumers the *positive pass through amount*. That amount is the amount proposed by the DNSP to the AER under cl 6.6.1(c). It must not exceed the *eligible pass through amount*. This phrase is also defined in Ch 10, Glossary. It is the increase in costs incurred and likely to be incurred until the end of the *regulatory control period* as a result of that *positive change event*.
5. The AER must then consider whether it will approve the amount claimed by the DNSP. If the AER approves that amount, or if it is deemed to have been approved under cl 6.6.1(e), that amount becomes the *approved pass through amount* for the purposes of the NER.
6. It is to this protocol that the exercise undertaken by SP AusNet to secure the insurance pass through event as a nominated *pass through event* in the distribution determinations for the 2011–2015 *regulatory control period* was directed.
7. In framing a definition of a nominated *pass through event* for the purposes of the cl 6.6.1 protocol, the AER would need to keep firmly in mind the extent to which the various definitions to which we have referred may limit the permissible scope of nominated *pass through events*. It is this notion that underpins the AER’s submission in the present review to the effect that both the *pass through event* and the losses (costs) caused by it must occur in the same regulatory period.
8. In the final decision, the definition of the insurance *pass through event* in the case of SP AusNet provides that:
9. The relevant event for the purposes of the definition is the making of a claim by the DNSP on an insurance policy which it holds in circumstances where the DNSP suffers losses (“incurs costs”) which exceed the limit of the policy and where, for that reason, the DNSP must cover those losses itself, and the combination of those factors materially increases the costs incurred by the DNSP in providing its distribution services;
10. The materiality threshold is 1% of the smoothed forecast revenue of the regulatory year in which the costs are incurred; and
11. The claim must be made under a policy the premiums in respect of which are to be or have been funded through the DNSP’s forecast opex as approved by the AER in its distribution determination for the *regulatory control period.*
12. The first question which arises is: Was the AER bound by the NEL and/or the NER or otherwise to include within its definition of insurance *pass through event* a requirement that the event which causes the relevant insurance policy to respond, ie the making of the relevant claim under the policy and the incurring of costs in excess of the policy coverage all occur in the same *regulatory control period* by reason of the terms of cl 6.6.1 of the NER?
13. We see nothing in cl 6.6.1 which imposes on the AER a constraint of the kind described in [43] above. The relevant definitions do not impose such a constraint and there is nothing in cl 6.6.1 which imposes such a constraint. The reference in the definition of *eligible pass through amount* in Ch 10 to *“… costs … that it is likely to incur until the end of the* ***regulatory control period*** …” does not justify the conclusion for which the AER argued. The distinction made at the end of that definition between costs and revenue does not justify that conclusion either. The definition simply does not address the point at all.
14. It follows that it was open to the AER to impose such a constraint (as it has) but its decision to do so constituted an exercise of discretion and was not mandated by anything in the NEL or the NER.
15. The AER’s submission to the effect that the answer to the question posed at [43] above is *Yes* must be rejected.
16. We shall now consider the procedural fairness ground.
17. For SP AusNet’s part, it did not expressly consider whether the post-2011 loss pre-end 2010 event circumstance was covered by the definition of the insurance *pass through event* in the draft decision. Further, although that circumstance may have been covered by the definition propounded by SP AusNet in its initial regulatory proposal, it clearly did not expressly consider whether that circumstance was covered by that definition before it submitted that definition to the AER.
18. As far as the AER was concerned, the question of whether that circumstance was covered did not cross its mind. It simply never considered the point. As we have already noted at [10] and [28] above, the rider was introduced for very different reasons.
19. It is common ground that the definition of the insurance *pass through event* in the final decision was changed substantially from the definition which was in the AER’s draft decision and that the main reason for the change was to ensure that a DNSP did not secure approval in its forecast opex for $X for insurance premiums upon the basis that the $X for those premiums would actually be spent in order to secure the coverage contemplated by the approved opex and then not spend the premiums amount or not fully spend it thereby reducing or eliminating the cover contemplated by the forecast opex. The change was also made to remove the exclusion for negligence by the DNSP.
20. Although the reason for the principal change was raised by SP AusNet and JEN in their revised regulatory proposals, the additional effect of the change was not raised by the DNSPs. The change addressed most of the concerns raised by the DNSPs but, in so doing, wrought a consequence of which SP AusNet was given no notice and which was probably unintended at the time. As we have already noted, the AER believed it was addressing the concerns described at [50] above.
21. The AER has since sought to justify the change and the consequences of it by reference to arguments and contentions which were not part of its thinking at the time. Those arguments are of no assistance in dealing with SP AusNet’s procedural fairness complaint.
22. Given the substantial changes made by the AER to the definition of the insurance *pass through event* after it had published its draft decision, given that those changes were not, as drafted, propounded by the DNSPs in their revised regulatory proposals and given the unintended consequences wrought by those changes, the AER should have notified SP AusNet and the other DNSPs of the precise wording of the definition of insurance *pass through event* which it intended to include in its final decision and in the distribution determination and before it included that definition in those instruments the AER should have afforded to SP AusNet and the other DNSPs a reasonable opportunity to comment on that proposed definition and on the consequences of the inclusion of that definition in the distribution determinations. This was not done. By failing to take the steps which we have identified, the AER denied procedural fairness to SP AusNet. After all, the sole subject matter of the decision which the AER had under consideration was the **definition** of the insurance *pass through event*.
23. The precise wording of that definition was critical to SP AusNet and it clearly had a vital interest in knowing what that wording would be.
24. Had the AER adopted the wording proposed by SP AusNet or substantially adhered to its own wording in the definition contained in the draft decision making only such changes as reasonably flowed from the suggestions made by SP AusNet in its revised regulatory proposal, the position would have been different. But, in the propose/response environment in which these parties were operating, substantial changes to the relevant definition of the kind which were effected here should have been notified to SP AusNet.
25. xx xx xx xxxxxx xx xxx xxxxxxxxxxxxx xx xxxx xxxx xxx xxx xxx xx xxx xx xx xxxx xxxx xx xxx xxxxxxxxx xx xx xxxxxx xx xxx xxx xxxxx xx xxx xxxxx xx xx xxxxxx xxx xx xxxxx xxx xxx xx xxx xxxxx xxxxxxxx xx xxx xxxxxxxxxx xx xxxxxxxx xxxx xxxxxxx xxxxx xxx xxxxxxxxx xx xxxxx xxxx xx xxxxxx xxx xxx xxxx xxx xxxx xx xxx xxxxxxxxxx xxxxxxxx xxxxx xx xx xxx xxxxxxxxxx xxxxxxxx xxx xxx xxxxx xxxxxxx xxxx xxxxxxxx xx xx xxxxx xx xxx xxxxx xxxxxxxx xxxxx xxxx xxx xxx xx xxxx xxxxx x xxxxxxxxxx xxxxxxxxxx xx xxxxxxxx xxx xxxxxxx xx xxxx xx xxxxx xxxx xxxx xxx xxxxxxx xxx xxxxx xxxxx xx xxx xx
26. We propose to set aside the AER’s decision whereby it imposed a definition of insurance event in the distribution determination made by it in respect of SP AusNet and to remit that matter to the AER with a direction to reconsider that definition in accordance with these Reasons. The AER should provide to SP AusNet the wording of any definition of insurance event which the AER proposes to include in the *distribution determination* of SP AusNet and afford to SP AusNet a reasonable opportunity to consider and comment upon that definition. It will then obviously be able to put to the AER all of the arguments which it has put to us as to why its views should be accepted. Because our decision on this issue is being made on the procedural fairness ground, the parties should understand that the decision says nothing about the merits of the definition which the AER included in the final decision. In particular, we are not to be taken as either endorsing or rejecting a discretionary decision to disallow pass through for events which occurred prior to 1 January 2011 with financial consequences post 1 January 2011 and before 31 December 2015. We do say, however, that nothing in the NEL or the NER requires that the occurrence of the event and the suffering of the loss both occur within the same *regulatory control period*. The AER ought not make future decisions in relation to these matters upon the basis that the NEL and the NER oblige the AER to give effect to such a proposition.
27. In light of the decision which we have reached concerning procedural fairness, it is not necessary to consider the AER’s s 71O(2) and s 71R points or the other matters covered in the parties’ submissions.
28. The consequence of our upholding SP AusNet’s contentions is that the AER’s decision was unreasonable in all the circumstances.
29. There will be orders accordingly.

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| I certify that the preceding sixty (60) numbered paragraphs are a true copy of the Reasons for Judgment herein of the Honourable Justice Foster (Deputy President), Mr G Latta AM and Professor D Round. |

Associate:

Dated: 6 January 2012